

FIRST MID ILLINOIS BANCSHARES INC  
Form 10-K  
March 07, 2012

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2011

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-13368

FIRST MID-ILLINOIS BANCSHARES, INC.

(Exact name of Registrant as specified in its charter)

Delaware

37-1103704

(State or other jurisdiction of incorporation or  
organization)

(I.R.S. Employer Identification No.)

1421 Charleston Avenue, Mattoon, Illinois

61938

(Address of Principal Executive Offices)

(Zip Code)

(217) 234-7454

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

NONE

Securities registered pursuant to Section 12(g) of the Act:

Common stock, par value \$4.00 per share,

and related Common Stock Purchase Rights

(Title of class)

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  Yes  No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).  Yes  No

The aggregate market value of the outstanding common stock, other than shares held by persons who may be deemed affiliates of the Registrant, as of the last business day of the Registrant's most recently completed second fiscal quarter was approximately \$66,949,466. Determination of stock ownership by non-affiliates was made solely for the purpose of responding to this requirement and the Registrant is not bound by this determination for any other purpose.

As of March 6, 2012, 6,018,625 shares of the Registrant's common stock, \$4.00 par value, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Document Into Form 10-K Part:  
Portions of the Proxy Statement for 2012 Annual Meeting of Shareholders to be held on April 25, 2012

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PART I

ITEM 1.BUSINESS

Company and Subsidiaries

First Mid-Illinois Bancshares, Inc. (the “Company”) is a financial holding company. The Company is engaged in the business of banking through its wholly owned subsidiary, First Mid-Illinois Bank & Trust, N.A. (“First Mid Bank”). The Company provides data processing services to affiliates through another wholly owned subsidiary, Mid-Illinois Data Services, Inc. (“MIDS”). The Company offers insurance products and services to customers through its wholly owned subsidiary, The Checkley Agency, Inc. doing business as First Mid Insurance Group (“First Mid Insurance”). The Company also wholly owns two statutory business trusts, First Mid-Illinois Statutory Trust I (“Trust I”), and First Mid-Illinois Statutory Trust II (“Trust II”), both unconsolidated subsidiaries of the Company.

The Company, a Delaware corporation, was incorporated on September 8, 1981, and pursuant to the approval of the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”) became the holding company owning all of the outstanding stock of First National Bank, Mattoon (“First National”) on June 1, 1982. First National changed its name to First Mid-Illinois Bank & Trust, N.A. in 1992. The Company acquired all of the outstanding stock of a number of community banks or thrift institutions on the following dates, and subsequently combined their operations with those of the Company:

- Mattoon Bank, Mattoon on April 2, 1984
- State Bank of Sullivan on April 1, 1985
- Cumberland County National Bank in Neoga on December 31, 1985
- First National Bank and Trust Company of Douglas County on December 31, 1986
  - Charleston Community Bank on December 30, 1987
- Heartland Federal Savings and Loan Association on July 1, 1992
  - Downstate Bancshares, Inc. on October 4, 1994
  - American Bank of Illinois on April 20, 2001
  - Peoples State Bank of Mansfield on May 1, 2006

In 1997, First Mid Bank acquired the Charleston, Illinois branch location and the customer base of First of America Bank and in 1999 acquired the Monticello, Taylorville and DeLand branch offices and deposit base of Bank One Illinois, N.A.

First Mid Bank also opened a de novo branch in Decatur, Illinois and a banking center in the Student Union of Eastern Illinois University in Charleston, Illinois (2000); de novo branches in Champaign, Illinois and Maryville, Illinois (2002), and a de novo branch in Highland, Illinois (2005).

In 2002, the Company acquired all of the outstanding stock of Checkley, an insurance agency located in Mattoon.

In 2009, the Company opened de novo branches in Decatur and Champaign.

On September 10, 2010, the Company acquired 10 Illinois branches (the “Branches”) from First Bank, a Missouri state chartered bank, located in Bartonville, Bloomington, Galesburg, Knoxville, Peoria and Quincy, Illinois.

Employees

The Company, MIDS, First Mid Insurance and First Mid Bank, collectively, employed 402 people on a full-time equivalent basis as of December 31, 2011. The Company places a high priority on staff development, which involves

extensive training, including customer service training. New employees are selected on the basis of both technical skills and customer service capabilities. None of the employees are covered by a collective bargaining agreement with the Company. The Company offers a variety of employee benefits.

#### Business Lines

The Company has chosen to operate in three primary lines of business—community banking and wealth management through First Mid Bank and insurance brokerage through First Mid Insurance. Of these, the community banking line contributes approximately 90% of the Company's total revenues and profits. Within the community banking line, the Company serves commercial, retail and agricultural customers with a broad array of deposit and loan related products. The wealth management line provides estate planning, investment and farm management services for individuals and employee benefit services for business enterprises. The insurance brokerage line provides commercial lines insurance to businesses as well as homeowner, automobile and other types of personal lines insurance to individuals.

All three lines emphasize a “hands on” approach to service so that products and services can be tailored to fit the specific needs of existing and potential customers. Management believes that by emphasizing this personalized approach, the Company can, to a degree, diminish the trend towards homogeneous financial services, thereby differentiating the Company from competitors and allowing for slightly higher operating margins in each of the three lines.

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## Business Strategies

**Strategy for Operations and Risk Management.** Operationally, the Company centralizes most administrative and clerical tasks within its home office location in Mattoon, Illinois. This allows branches to maintain customer focus, helps assure compliance with banking regulations, keeps fixed administrative costs at as low a level as is practicable, and better manages the various forms of risk inherent in this business. This approach also makes use of technology in day-to-day banking activities thereby reducing the potential for human error. While the Company does not employ every new technology that is introduced, it attempts to be competitive with other banking organizations with respect to operational technology.

The Company has a comprehensive set of operational policies and procedures that have been developed over time to address risk. These policies are intended to be as close as possible to “best practices” of the financial services industry and are subjected to continual review by management and the Board of Directors. The Company’s internal audit function incorporates procedures to determine compliance with these policies.

In the business of banking, credit risk is an important risk as losses from uncollectible loans can significantly diminish capital, earnings and shareholder value. In order to address this risk, the lending function of First Mid Bank receives significant attention from executive management and the Board of Directors. An important element of credit risk management is the quality, experience and training of the loan officers of First Mid Bank. The Company has invested, and will continue to invest, significant resources to ensure the quality, experience and training of First Mid Bank’s loan officers in order to keep credit losses at a minimum. In addition to the human element of credit risk management, the Company’s loan policies address the additional aspects of credit risk. Most lending personnel have signature authority that allows them to lend up to a certain amount based on their own judgment as to the creditworthiness of a borrower. The amount of the signature authority is based on the lending officers’ experience and training. The Senior Loan Committee, consisting of the most experienced lenders within the organization and three non-employee members of the board of directors, must approve all underwriting decisions in excess of \$2 million and up to 75% of the legal lending limit which was \$13.9 million at December 31, 2011. The Board of Directors must approve all underwriting decisions in excess of 75% of the legal lending limit.

While the underlying nature of lending will result in some amount of loan losses, First Mid Bank’s loan loss experience has been good with average net charge offs amounting to \$2.2 million (.30% of average loans) over the past five years. Nonperforming loans were \$7.4 million (.86% of total loans) at December 31, 2011. These percentages have historically compared well with peer financial institutions and continue to do so today.

Interest rate and liquidity risk are two other forms of risk embedded in the business of financial intermediation. The Company’s Asset Liability Management Committee, consisting of experienced individuals who monitor all aspects of interest rates and maturities of interest earning assets and interest paying liabilities, manages these risks. The underlying objectives of interest rate and liquidity risk management are to shelter the Company’s net interest margin from changes in interest rates while maintaining adequate liquidity reserves to meet unanticipated funding demands. The Company uses financial modeling technology as a tool, employing a variety of “what if” scenarios to properly plan its activities. Despite the tools and methods used to monitor this risk, a sustained unfavorable interest rate environment will lead to some amount of compression in the net interest margin. During 2011, the Company’s net interest margin decreased to 3.45% from 3.51% in 2010. This was primarily the result of the impact of an increase in liquidity from the acquisition of the Branches completed in the third quarter of 2010.

**Strategy for Growth.** The Company believes that growth of its revenue stream and of its customer base is vital to the goal of increasing the value of its shareholders’ investment. Management attempts to grow in two primary ways:

- by organic growth through adding new customers and selling more products and services to existing customers; and

- by acquisitions.

Virtually all of the Company's customer-contact personnel, in each of its business lines, are engaged in organic growth efforts to one degree or another. These personnel are trained to engage in needs-based selling whereby they make an attempt to match its products and services with the particular financial needs of individual customers and prospective customers. Most senior officers of the organization are required to attend monthly sales meetings where they report on their business development efforts and results. Executive management uses these meetings as an educational and risk management opportunity as well. Cross-selling opportunities are encouraged between the business lines.

Within the community banking line, the Company has focused on growing business operating and real estate loans. Total commercial real estate loans have increased from \$203 million at December 31, 2007 to \$321 million at December 31, 2011 primarily due to loans acquired in the acquisition of the Branches completed during the third quarter of 2010. Approximately 64% of the Company's total revenues were derived from lending activities in the fiscal year ended December 31, 2011. The Company has also focused on growing the commercial and retail deposit base through growth in checking, money markets and customer repurchase agreement balances. The wealth management line has focused its growth efforts on estate planning, investment and farm management services for individuals and employee benefit services for businesses. The insurance brokerage line has focused on increasing property and casualty insurance for businesses and personal lines insurance to individuals.

Growth through acquisitions has been an integral part of the Company's strategy for an extended period of time. When reviewing acquisition possibilities, the Company focuses on those organizations where there is a cultural fit with its existing operations and where there is a strong likelihood of adding to shareholder value. Most past acquisitions have been cash-based transactions. While the Company expects to continue this trend in the future, it would consider a stock-based acquisition if the strategic and financial metrics were compelling. The Company viewed the acquisition of the Branches in the third quarter of 2010 as an unusual opportunity to acquire selected assets, add to its deposit base and expand its geographical reach.

This overall growth strategy has been to grow the customer base without significantly increasing the shareholder base. This requires a certain amount of financial leverage and the Company monitors its capital base carefully to satisfy all regulatory requirements while maintaining flexibility. The Company has maintained a Dividend Reinvestment Plan as well as various forms of equity compensation for directors and key managers. It has also maintained an ongoing share buy back program both as a service to shareholders and a means of maintaining optimal levels of capital.

In 2009, the Company issued and sold Series B 9% Non-Cumulative Perpetual Convertible Preferred Stock (the "Series B Preferred Stock") issued to certain investors, and in 2011, the Company issued and sold Series C 8% Non-Cumulative Perpetual Preferred Stock (the "Series C Preferred Stock") to certain investors. The Company also uses various forms of long-term debt to augment its capital when appropriate.

## Markets and Competition

The Company has active competition in all areas in which First Mid Bank presently does business. First Mid Bank competes for commercial and individual deposits, loans, and trust business with many east central Illinois banks, savings and loan associations, and credit unions. The principal methods of competition in the banking and financial services industry are quality of services to customers, ease of access to facilities, and pricing of services, including interest rates paid on deposits, interest rates charged on loans, and fees charged for fiduciary and other banking services.

First Mid Bank operates facilities in the Illinois counties of Adams, Bond, Champaign, Christian, Coles, Cumberland, Dewitt, Douglas, Effingham, Fulton, Knox, Macon, Madison, McClean, Moultrie, Peoria and Piatt. Each facility primarily serves the community in which it is located. First Mid Bank serves twenty-five different communities with thirty-eight separate locations in the towns of Altamont, Arcola, Bartonville, Bloomington, Champaign, Charleston, Decatur, Effingham, Galesburg, Highland, Knoxville, Mansfield, Mahomet, Maryville, Mattoon, Monticello, Neoga, Peoria, Pocahontas, Quincy, Sullivan, Taylorville, Tuscola, Urbana, and Weldon Illinois. Within the areas of service, there are numerous competing financial institutions and financial services companies.

## Website

The Company maintains a website at [www.firstmid.com](http://www.firstmid.com). All periodic and current reports of the Company and amendments to these reports filed with the Securities and Exchange Commission (“SEC”) can be accessed, free of charge, through this website as soon as reasonably practicable after these materials are filed with the SEC.

## SUPERVISION AND REGULATION

### General

Financial institutions, financial services companies, and their holding companies are extensively regulated under federal and state law. As a result, the growth and earnings performance of the Company can be affected not only by management decisions and general economic conditions, but also by the requirements of applicable state and federal statutes and regulations and the policies of various governmental regulatory authorities including, but not limited to, the Office of the Comptroller of the Currency (the “OCC”), the Federal Reserve Board, the Federal Deposit Insurance Corporation (the “FDIC”), the Internal Revenue Service and state taxing authorities. Any change in applicable laws, regulations or regulatory policies may have material effects on the business, operations and prospects of the Company and First Mid Bank. The Company is unable to predict the nature or extent of the effects that fiscal or monetary policies, economic controls or new federal or state legislation may have on its business and earnings in the future.

Federal and state laws and regulations generally applicable to financial institutions and financial services companies, such as the Company and its subsidiaries, regulate, among other things, the scope of business, investments, reserves against deposits, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, mergers, consolidations and dividends. The system of supervision and regulation applicable to the Company and its subsidiaries establishes a comprehensive framework for their respective operations and is intended primarily for the protection of the FDIC’s deposit insurance fund and the depositors, rather than the stockholders, of financial institutions.

The following references to material statutes and regulations affecting the Company and its subsidiaries are brief summaries thereof and do not purport to be complete, and are qualified in their entirety by reference to such statutes and regulations. Any change in applicable law or regulations may have a material effect on the business of the Company and its subsidiaries.



## Financial Modernization Legislation

The 1999 Gramm-Leach-Bliley Act (the “GLB Act”) significantly changed financial services regulation by expanding permissible non-banking activities of bank holding companies and removing certain barriers to affiliations among banks, insurance companies, securities firms and other financial services entities. These activities and affiliations can be structured through a holding company structure or, in the case of many of the activities, through a financial subsidiary of a bank. The GLB Act also established a system of federal and state regulation based on functional regulation, meaning that primary regulatory oversight for a particular activity generally resides with the federal or state regulator having the greatest expertise in the area. Banking is supervised by banking regulators, insurance by state insurance regulators and securities activities by the SEC and state securities regulators. The GLB Act also requires the disclosure of agreements reached with community groups that relate to the Community Reinvestment Act, and contains various other provisions designed to improve the delivery of financial services to consumers while maintaining an appropriate level of safety in the financial services industry.

The GLB Act repealed the anti-affiliation provisions of the Glass-Steagall Act and revises the Bank Holding Company Act of 1956 (the “BHCA”) to permit qualifying holding companies, called “financial holding companies,” to engage in, or to affiliate with companies engaged in, a full range of financial activities, including banking, insurance activities (including insurance portfolio investing), securities activities, merchant banking and additional activities that are “financial in nature,” incidental to financial activities or, in certain circumstances, complementary to financial activities. A bank holding company’s subsidiary banks must be “well-capitalized” and “well-managed” and have at least a “satisfactory” Community Reinvestment Act rating for the bank holding company to elect and maintain its status as a financial holding company.

A significant component of the GLB Act’s focus on functional regulation relates to the application of federal securities laws and SEC oversight of some bank securities activities previously exempt from broker-dealer registration. Among other things, the GLB Act amended the definitions of “broker” and “dealer” under the Securities Exchange Act of 1934, as amended, to remove the blanket exemption for banks. Under the GLB Act, banks may conduct securities activities without broker-dealer registration only if the activities fall within a set of activity-based exemptions designed to allow banks to conduct only those activities traditionally considered to be primarily banking or trust activities.

Securities activities outside these exemptions, as a practical matter, need to be conducted by registered broker-dealer affiliate. The GLB Act also amended the Investment Advisers Act of 1940 to require the registration of banks that act as investment advisers for mutual funds. The Company believes that it has taken the necessary actions to comply with these requirements of the GLB Act and the regulations adopted under them.

### Anti-Terrorism Legislation

The USA PATRIOT Act of 2001 included the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 (the "IMLAFA"). The IMLAFA contains anti-money laundering measures affecting insured depository institutions, broker-dealers, and certain other financial institutions. The IMLAFA requires U.S. financial institutions to adopt policies and procedures to combat money laundering and grants the Secretary of the Treasury broad authority to establish regulations and to impose requirements and restrictions on financial institutions' operations. The Company has established policies and procedures for compliance with the IMLAFA and the related regulations. The Company has designated an officer solely responsible for ensuring compliance with existing regulations and monitoring changes to the regulations as they occur.

### Emergency Economic Stabilization Act of 2008

In response to unprecedented financial market turmoil, the Emergency Economic Stabilization Act of 2008 ("EESA") was enacted on October 3, 2008. EESA authorizes the U.S. Treasury Department ("Treasury") to provide up to \$700 billion in funding for the financial services industry. The Treasury's authority under the Troubled Asset Relief Program ("TARP") expired October 3, 2010. The Company decided to not participate in the TARP Capital Purchase Program.

On October 14, 2008, the FDIC announced the Temporary Liquidity Guarantee Program ("TLGP"). The FDIC stated that the purpose of these actions is to strengthen confidence and encourage liquidity in the banking system by guaranteeing newly issued senior unsecured debt of 31 days or greater, of banks, thrifts, and certain holding companies, and by providing full FDIC insurance coverage for all non-interest bearing transaction accounts, regardless of dollar amount. Inclusion in the program was voluntary. Institutions participating in the senior unsecured debt portion of the program are assessed fees on a sliding scale, depending on length of maturity for debt actually issued.

First Mid Bank elected to participate in both parts of the TLGP, the Transaction Account Guarantee ("TAG") Program and the Debt Guarantee Program. The FDIC's TAG Program, provided, without charge to depositors, a full guarantee on all non-interest bearing transaction accounts held by any depositor, regardless of dollar amount, through December 31, 2010. Participation in the TAG Program cost the Company 15 basis points annually on the amount of the deposits during 2010 and cost 10 basis points annually during 2009. The Company and First Mid Bank did not issue any debt under the FDIC's Debt Guarantee Program, which expired in October 2009.

### Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") was signed into law on July 21, 2010. Generally, the Act is effective the day after it was signed into law, but different effective dates apply to specific sections of the law. Uncertainty remains as to the ultimate impact of the Act, which could have a material adverse impact either on the financial services industry as a whole, or on the Company's business, results of operations and financial condition. The Act, among other things:

- Resulted in the Federal Reserve issuing rules limiting debit-card interchange fees.
- After a three-year phase-in period which begins January 1, 2013, existing trust preferred securities for holding companies with consolidated assets greater than \$15 billion and all new issuances of trust preferred securities are removed as a permitted component of a holding company's Tier 1 capital. Trust preferred securities outstanding as of May 19, 2010 that were issued by bank holding companies with total consolidated assets of less than \$15 billion, such as First Mid, will continue to count as Tier 1 capital.

- Provides for an increase in the FDIC assessment for depository institutions with assets of \$10 billion or more, increases in the minimum reserve ratio for the deposit insurance fund from 1.15% to 1.35% (however, the FDIC is to offset the effect of this increase for holding companies with total consolidated assets of less than \$10 billion, such as First Mid) and changes in the basis for determining FDIC premiums from deposits to assets.
  - Creates a new Consumer Financial Protection Bureau that will have rulemaking authority for a wide range of consumer protection laws that would apply to all banks and certain non-bank financial institutions and would have broad powers to supervise and enforce consumer protection laws.
  - Provides for new disclosure and other requirements relating to executive compensation and corporate governance.
  - Changes standards for Federal preemption of state laws related to federally chartered institutions and their subsidiaries.
  - Provides mortgage reform provisions including (i) a customer's ability to repay, (ii) restricting variable-rate lending by requiring the ability to repay to be determined for variable-rate loans by requiring lenders to evaluate using the maximum rate that will apply during the first five years of a variable-rate loan term, and (iii) making more loans subject to provisions for higher cost loans and new disclosures.
  - Creates a financial stability oversight council that will recommend to the Federal Reserve increasingly strict rules for capital, leverage, liquidity, risk management and other requirements as companies grow in size and complexity.
  - Permanently increases the deposit insurance coverage to \$250 thousand and allows depository institutions to pay interest on checking accounts.
  - Requires publicly-traded bank holding companies with assets of \$10 billion or more to establish a risk committee responsible for enterprise-wide risk management practices.
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## The Company

**General.** As a registered bank holding company under the BHCA that has elected to become a financial holding company under the GLB Act, the Company is subject to regulation by the Federal Reserve Board. In accordance with Federal Reserve Board policy, the Company is expected to act as a source of financial strength to First Mid Bank and to commit resources to support First Mid Bank in circumstances where the Company might not do so absent such policy. The Company is subject to inspection, examination, and supervision by the Federal Reserve Board.

**Activities.** As a financial holding company, the Company may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental or complementary to activities that are financial in nature. A bank holding company that is not also a financial holding company is limited to engaging in banking and such other activities as determined by the Federal Reserve Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

No Federal Reserve Board approval is required for the Company to acquire a company (other than a bank holding company, bank, or savings association) engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board. However, the Company generally must give the Federal Reserve Board after-the-fact notice of these activities. Prior Federal Reserve Board approval is required before the Company may acquire beneficial ownership or control of more than 5% of the voting shares or substantially all of the assets of a bank holding company, bank, or savings association.

If any subsidiary bank of the Company ceases to be “well-capitalized” or “well-managed” under applicable regulatory standards, the Federal Reserve Board may, among other actions, order the Company to divest its depository institution. Alternatively, the Company may elect to conform its activities to those permissible for a bank holding company that is not also a financial holding company.

If any subsidiary bank of the Company receives a rating under the Community Reinvestment Act of less than “satisfactory”, the Company will be prohibited, until the rating is raised to “satisfactory” or better, from engaging in new activities or acquiring companies other than bank holding companies, banks, or savings associations.

**Capital Requirements.** Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve Board capital adequacy guidelines. The Federal Reserve Board’s capital guidelines establish the following minimum regulatory capital requirements for bank holding companies: a risk-based requirement expressed as a percentage of total risk-weighted assets, and a leverage requirement expressed as a percentage of total assets. The risk-based requirement consists of a minimum ratio of total capital to total risk-weighted assets of 8%, at least one-half of which must be Tier 1 capital. The leverage requirement consists of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly rated companies, with minimum requirements of at least 4% for all others. For purposes of these capital standards, Tier 1 capital consists primarily of permanent stockholders’ equity, which includes the Series B 9% Preferred Stock issued by the Company in 2009 and the Series C Preferred Stock subsequently issued by the Company in 2011, less intangible assets (other than certain mortgage servicing rights and purchased credit card relationships), and total capital means Tier 1 capital plus certain other debt and equity instruments which do not qualify as Tier 1 capital, limited amounts of unrealized gains on equity securities and a portion of the Company’s allowance for loan and lease losses.

The risk-based and leverage standards described above are minimum requirements, and higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual banking organizations. For example, the Federal Reserve Board’s capital guidelines contemplate that additional capital may be required to take adequate account of, among other things, interest rate risk, or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (i.e., Tier 1 capital

less all intangible assets), well above the minimum levels.

In December 2007, the U.S. bank regulatory agencies adopted final rules that require large, internationally active financial services organizations to use the most sophisticated and complex methodology for calculating capital requirements reflected in the New Basel Capital Accord, developed by the Basel Committee on Banking Supervision. These rules became operational in April 2008, but are mandatory only for “core banks,” i.e., banks with consolidated total assets of \$250 billion or more.

In September 2010, the Basel Committee on Banking Supervision proposed higher global minimum capital standards, including a minimum Tier 1 common capital ratio and additional capital and liquidity requirements, with rules expected to be implemented between 2013 and 2019. Adoption in the U.S. is expected to occur over a similar timeframe, but the final form of the U.S. rules is uncertain. While uncertainty exists in both the final form of the guidance and whether or not the Company will be required to adopt the guidelines, the Company is closely monitoring the development of the guidance.

As of December 31, 2011, the Company had regulatory capital, calculated on a consolidated basis, in excess of the Federal Reserve Board’s minimum requirements, and its capital ratios exceeded those required for categorization as well-capitalized under the capital adequacy guidelines established by bank regulatory agencies with a total risk-based capital ratio of 14.48%, a Tier 1 risk-based ratio of 13.37% and a leverage ratio of 8.99%.

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**Control Acquisitions.** The Change in Bank Control Act prohibits a person or group of person from acquiring “control” of a bank holding company unless the Federal Reserve Board has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve Board, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended, such as the Company, would, under the circumstances set forth in the presumption, constitute acquisition of control of the Company.

In addition, any company is required to obtain the approval of the Federal Reserve Board under the BHCA before acquiring 25% (5% in the case of an acquirer that is a bank holding company) or more of the outstanding common of the Company, or otherwise obtaining control of a “controlling influence” over the Company or First Mid Bank.

**Interstate Banking and Branching.** The Dodd-Frank Act expands the authority of banks to engage in interstate branching. The Dodd-Frank Act allows a state or national bank to open a de novo branch in another state if the law of the state where the branch is to be located would permit a state bank chartered by that state to open the branch.

**Privacy and Security.** The GLB Act establishes a minimum federal standard of financial privacy by, among other provisions, requiring banks to adopt and disclose privacy policies with respect to consumer information and setting forth certain rules with respect to the disclosure to third parties of consumer information. The Company has adopted and disseminated its privacy policies pursuant to the GLB Act. Regulations adopted under the GLB Act set standards for protecting the security, confidentiality and integrity of customer information, and require notice to regulators, and in some cases, to customers, in the event of security breaches. A number of states have adopted their own statutes requiring notification of security breaches. In addition, the GLB Act requires the disclosure of agreements reached with community groups that relate to the CRA, and contains various other provisions designed to improve the delivery of financial services to consumers while maintaining an appropriate level of safety in the financial services industry.

#### First Mid Bank

**General.** First Mid Bank is a national bank, chartered under the National Bank Act. The FDIC insures the deposit accounts of First Mid Bank. As a national bank, First Mid Bank is a member of the Federal Reserve System and is subject to the examination, supervision, reporting and enforcement requirements of the OCC, as the primary federal regulator of national banks, and the FDIC, as administrator of the deposit insurance fund.

**Deposit Insurance.** As an FDIC-insured institution, First Mid Bank is required to pay deposit insurance premium assessments to the FDIC.

On October 3, 2008, the FDIC temporarily increased the standard maximum deposit insurance amount (SMDIA) from \$100,000 to \$250,000 per depositor. On July 21, 2010, The Dodd-Frank Act permanently raised the SMDIA to \$250,000. On November 9, 2010, the FDIC issued a final rule to implement Section 343 of the Dodd-Frank Act, which provides unlimited deposit insurance coverage for “noninterest-bearing transaction accounts” from December 31, 2010 through December 31, 2012. Also, the FDIC will no longer charge a separate assessment for the insurance of these accounts under the Dodd-Frank Act. The Company expensed \$0, \$95,000 and \$49,000 for this program during 2011, 2010 and 2009, respectively.

On February 27, 2009, the FDIC adopted a final rule setting initial base assessment rates beginning April 1, 2009, at 12 to 45 basis points and, due to extraordinary circumstances, extended the period of the restoration plan to increase the deposit insurance fund to seven years. Also on February 27, 2009, the FDIC issued final rules on changes to the risk-based assessment system which imposes rates based on an institution’s risk to the deposit insurance fund. The new rates increased the range of annual risk based assessment rates from 5 to 7 basis points to 7 to 24 basis points. The final rules both increase base assessment rates and incorporate additional assessments for excess reliance on brokered deposits and FHLB advances. This new assessment took effect April 1, 2009. The Company expensed \$1.06 million,

\$1.31 million and \$1.26 million for this assessment during 2011, 2010 and 2009, respectively.

Also on February 27, 2009, the FDIC adopted an interim rule to impose a 20 basis point emergency special assessment payable September 30, 2009 based on the second quarter 2009 assessment base, to help shore up the Deposit Insurance Fund (DIF). This assessment equates to a one-time cost of \$200,000 per \$100 million in assessment base. The interim rule also allows the Board to impose possible additional special assessments of up to 10 basis points thereafter to maintain public confidence in the DIF. Subsequently, the FDIC's Treasury borrowing authority increased from \$30 billion to \$100 billion, allowing the agency to cut the planned special assessment from 20 to 10 basis points. On May 22, 2009, the FDIC adopted a final rule which established a special assessment of five basis points on each FDIC-insured depository institution's assets, minus its Tier 1 capital, as of September 30, 2009. The assessment was capped at 10 basis points of an institution's domestic deposits so that no institution would pay an amount higher than it would have under the interim rule. The Company expensed \$522,000 in 2009 for this special assessment. There were no special assessments during 2011 or 2010.

In addition to its insurance assessment, each insured bank was subject to quarterly debt service assessments in connection with bonds issued by a government corporation that financed the federal savings and loan bailout. The Company expensed \$103,000, \$99,000 and \$112,000 during 2011, 2010 and 2009, respectively, for this assessment.

On September 29, 2009, the FDIC Board proposed a DIF restoration plan that required banks to prepay, on December 30, 2009, their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011 and 2012. Under the plan—which applies to all banks except those with liquidity problems—banks were assessed through 2010 according to the risk-based premium schedule adopted in 2009. Beginning January 1, 2011, the base rate increases by 3 basis points. The Company recorded a prepaid expense asset of \$4,855,000 as of December 31, 2009 as a result of this plan. This asset is being amortized to non-interest expense over three years. The balance of this asset was \$2,183,000 as of December 31, 2011.

**OCC Assessments.** All national banks are required to pay supervisory fees to the OCC to fund the operations of the OCC. The amount of such supervisory fees is based upon each institution's total assets, including consolidated subsidiaries, as reported to the OCC. During the year ended December 31, 2011, First Mid Bank paid supervisory fees to the OCC totaling \$309,000.

**Capital Requirements.** The OCC has established the following minimum capital standards for national banks, such as First Mid Bank: a leverage requirement consisting of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly-rated banks with minimum requirements of at least 4% for all others, and a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8%, at least one-half of which must be Tier 1 capital. For purposes of these capital standards, Tier 1 capital and total capital consists of substantially the same components as Tier 1 capital and total capital under the Federal Reserve Board's capital guidelines for bank holding companies (See "The Company—Capital Requirements").

The capital requirements described above are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual institutions. For example, the regulations of the OCC provide that additional capital may be required to take adequate account of, among other things, interest rate risk or the risks posed by concentrations of credit, nontraditional activities or securities trading activities.

During the year ended December 31, 2011, First Mid Bank was not required by the OCC to increase its capital to an amount in excess of the minimum regulatory requirements, and its capital ratios exceeded those required for categorization as well-capitalized under the capital adequacy guidelines established by bank regulatory agencies with a total risk-based capital ratio of 12.83%, a Tier 1 risk-based ratio of 11.71% and a leverage ratio of 7.85%.

**Prompt Corrective Action.** Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators' powers depends on whether the institution in question is "well-capitalized," "adequately-capitalized," "undercapitalized," "significantly undercapitalized" or "critically undercapitalized." Depending upon the capital category to which an institution is assigned, the regulators' corrective powers include: requiring the submission of a capital restoration plan; placing limits on asset growth and restrictions on activities; requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; restricting transactions with affiliates; restricting the interest rate the institution may pay on deposits; ordering a new election of directors of the institution; requiring that senior executive officers or directors be dismissed; prohibiting the institution from accepting deposits from correspondent banks; requiring the institution to divest certain subsidiaries; prohibiting the payment of principal or interest on subordinated debt; and in the most severe cases, appointing a conservator or receiver for the institution.

**Dividends.** The National Bank Act imposes limitations on the amount of dividends that may be paid by a national bank, such as First Mid Bank. Generally, a national bank may pay dividends out of its undivided profits, in such amounts and at such times as the bank's board of directors deems prudent. Without prior OCC approval, however, a national bank may not pay dividends in any calendar year which, in the aggregate, exceed the bank's year-to-date net income plus the bank's adjusted retained net income for the two preceding years.

The payment of dividends by any financial institution or its holding company is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, First Mid Bank exceeded its minimum capital requirements under applicable guidelines as of December 31, 2011. As of December 31, 2011, approximately \$24.3 million was available to be paid as dividends to the Company by First Mid Bank. Notwithstanding the availability of funds for dividends, however, the OCC may prohibit the payment of any dividends by First Mid Bank if the OCC determines that such payment would constitute an unsafe or unsound practice.



**Affiliate and Insider Transactions.** First Mid Bank is subject to certain restrictions under federal law, including Regulation W of the Federal Reserve Board, on extensions of credit to the Company and its subsidiaries, on investments in the stock or other securities of the Company and its subsidiaries and the acceptance of the stock or other securities of the Company or its subsidiaries as collateral for loans. Certain limitations and reporting requirements are also placed on extensions of credit by First Mid Bank to its directors and officers, to directors and officers of the Company and its subsidiaries, to principal stockholders of the Company, and to “related interests” of such directors, officers and principal stockholders.

First Mid Bank is subject to restrictions under federal law that limits certain transactions with the Company, including loans, other extensions of credit, investments or asset purchases. Such transactions by a banking subsidiary with any one affiliate are limited in amount to 10% of the bank’s capital and surplus and, with all affiliates together, to an aggregate of 20% of the bank’s capital and surplus. Furthermore, such loans and extensions of credit, as well as certain other transactions, are required to be secured in specified amounts. These and certain other transactions, including any payment of money to the Company, must be on terms and conditions that are or in good faith would be offered to nonaffiliated companies.

In addition, federal law and regulations may affect the terms upon which any person becoming a director or officer of the Company or one of its subsidiaries or a principal stockholder of the Company may obtain credit from banks with which First Mid Bank maintains a correspondent relationship.

**Safety and Soundness Standards.** The federal banking agencies have adopted guidelines that establish operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines set forth standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings. In general, the guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails to comply with any of the standards set forth in the guidelines, the institution’s primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. The preamble to the guidelines states that the agencies expect to require a compliance plan from an institution whose failure to meet one or more of the guidelines are of such severity that it could threaten the safety and soundness of the institution. Failure to submit an acceptable plan, or failure to comply with a plan that has been accepted by the appropriate federal regulator, would constitute grounds for further enforcement action.

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Community Reinvestment Act. First Mid Bank is subject to the Community Reinvestment Act (CRA). The CRA and the regulations issued thereunder are intended to encourage banks to help meet the credit needs of their service areas, including low and moderate income neighborhoods, consistent with the safe and sound operations of the banks. These regulations also provide for regulatory assessment of a bank's record in meeting the needs of its service area when considering applications to establish branches, merger applications and applications to acquire the assets and assume the liabilities of another bank. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 requires federal banking agencies to make public a rating of a bank's performance under the CRA. In the case of a bank holding company, the CRA performance record of its bank subsidiaries is reviewed by federal banking agencies in connection with the filing of an application to acquire ownership or control of shares or assets of a bank or thrift or to merge with any other bank holding company. An unsatisfactory record can substantially delay or block the transaction. First Mid Bank received a satisfactory CRA rating from its regulator in its most recent CRA examination.

Consumer Laws and Regulations. In addition to the laws and regulations discussed above, First Mid Bank is also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the list set forth herein is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Fair Credit Reporting Act, the Fair and Accurate Credit Transactions Act and the Real Estate Settlement Procedures Act, among others. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans to or marketing to or engaging in other types of transactions with such customers. Failure to comply with these laws and regulations could lead to substantial penalties, operating restrictions and reputational damage to the financial institution.

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Supplemental Item – Executive Officers of the Registrant

The executive officers of the Company are elected annually by the Company’s board of directors and are identified below.

| Name (Age)                  | Position With Company   |
|-----------------------------|---|
|                             | Chairman of the Board of Directors, President and Chief Executive Officer |
| William S. Rowland (64)     | Executive Officer   |
| Joseph R. Dively (52)       | Senior Executive Vice President   |
| Michael L. Taylor (43)      | Executive Vice President and Chief Financial Officer                      |
| John W. Hedges (63)         | Executive Vice President  |
| Laurel G. Allenbaugh (51)   | Executive Vice President  |
| Eric S. McRae (46)          | Executive Vice President  |
| Charles A. LeFebvre (42)    | Executive Vice President  |
| Kelly A. Downs (44)         | Senior Vice President   |
| Christopher L. Slabach (49) | Senior Vice President   |

William S. Rowland, age 64, has been Chairman of the Board of Directors, President and Chief Executive Officer of the Company since May 1999. He served as Executive Vice President of the Company from 1997 to 1999 and as Treasurer and Chief Financial Officer from 1989 to 1999. He also serves as Chairman of the Board of Directors and Chief Executive Officer of First Mid Bank.

Joseph R. Dively, age 52, has been the Senior Executive Vice President of the Company and the President of First Mid Bank since May 2011. He was with Consolidated Communications Holdings, Inc. in Mattoon, Illinois from 2003 to May 2011.

Michael L. Taylor, age 43, has been the Executive Vice President and Chief Financial Officer of the Company since May 2007. He served as Vice President and Chief Financial Officer from May 2000 to May 2007. He was with AMCORE Bank in Rockford, Illinois from 1996 to 2000.

John W. Hedges, age 64, has been Executive Vice President of the Company since September 1999 and Senior Executive Vice President and Chief Credit Officer of First Mid Bank since May 2011. He served as President of First Mid Bank from September 1999 to May 2011. He was with National City Bank in Decatur, Illinois from 1976 to 1999.

Laurel G. Allenbaugh, age 51, has been Executive Vice President of Operations since April 2008. She served as Vice President of Operations from February 2000 to April 2008. She served as Controller of the Company and First Mid Bank from 1990 to February 2000 and has been President of MIDS since 1998.

Eric S. McRae, age 46, has been Executive Vice President of the Company and Executive Vice President, Senior Lender of First Mid Bank since December 2008. He served as President of the Decatur region from 2001 to December 2008.

Charles A. LeFebvre, age 42, has been Executive Vice President of the Company since 2008 and Executive Vice President of the Trust and Wealth Management Division of First Mid Bank since 2007. He was an attorney with the

law firm of Thomas, Mamer & Haughey from 2001 to 2007.

Kelly A. Downs, age 44, has been Senior Vice President of the Company since April 2008 and Senior Vice President, Retail Banking Services since 2011. She served as Senior Vice President of Human Resources from 2008 to 2011, and has been with the Company since 1991.

Christopher L. Slabach, age 49, has been Senior Vice President of the Company since 2007 and Senior Vice President, Risk Management of First Mid Bank since 2008. He served as Vice President, Audit of the Company from 1998 to 2007.

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## ITEM 1A. RISK FACTORS

Various risks and uncertainties, some of which are difficult to predict and beyond the Company's control, could negatively impact the Company. As a financial institution, the Company is exposed to interest rate risk, liquidity risk, credit risk, operational risk, risks from economic or market conditions, and general business risks among others. Adverse experience with these or other risks could have a material impact on the Company's financial condition and results of operations, as well as the value of its common stock.

Difficult economic conditions and market disruption have adversely impacted the banking industry and financial markets generally and may continue to significantly affect the business, financial condition, or results of operations of the Company. The Company's success depends, to a certain extent, upon economic and political conditions, local and national, as well as governmental monetary policies. Conditions such as inflation, recession, unemployment, changes in interest rates, money supply and other factors beyond the Company's control may adversely affect its asset quality, deposit levels and loan demand and, therefore, its earnings.

Dramatic declines in the housing market beginning in the latter half of 2007, with falling home prices and increasing foreclosures, unemployment and underemployment, have negatively impacted the credit performance of mortgage loans and resulted in significant write-downs of asset values by some financial institutions. The resulting write-downs to assets of financial institutions have caused many financial institutions to merge with other institutions and, in some cases, to seek government assistance or bankruptcy protection.

The capital and credit markets, including the fixed income markets, have been experiencing volatility and disruption for over two years. In some cases, the markets have produced downward pressure on stock prices and credit capacity for certain issuers without regard to those issuers' financial strength.

Many lenders and institutional investors have reduced and, in some cases, ceased to provide funding to borrowers, including to other financial institutions because of concern about the stability of the financial markets and the strength of counterparties. It is difficult to predict how long these economic conditions will exist, and which of our markets, products or other businesses will ultimately be affected. Accordingly, the resulting lack of available credit, lack of confidence in the financial sector, decreased consumer confidence, increased volatility in the financial markets and reduced business activity could materially and adversely affect the Company's business, financial condition and results of operations.

As a result of the challenges presented by economic conditions, the Company has faced the following risks in connection with these events:

- Inability of borrowers to make timely repayments of their loans, or decreases in value of real estate collateral securing the payment of such loans resulting in significant credit losses, which results in increased delinquencies, foreclosures and customer bankruptcies, any of which could have a material adverse effect on the Company's operating results.
- Increased regulation of the banking industry, including heightened legal standards and regulatory requirements. Compliance with such regulation increases costs and may limit the Company's ability to pursue business opportunities.
- Further disruptions in the capital markets or other events, including actions by rating agencies and deteriorating investor expectations, may result in an inability to borrow on favorable terms or at all from other financial institutions.

The Company's profitability depends significantly on economic conditions in the geographic region in which it operates. A large percentage of the Company's loans are to individuals and businesses in Illinois, consequently, any decline in the economy of this market area could have a materially adverse effect on the Company's financial condition and results of operations.

Decline in the strength and stability of other financial institutions may adversely affect the Company's business. The actions and commercial soundness of other financial institutions could affect the Company's ability to engage in routine funding transactions. Financial services institutions are interrelated as a result of clearing, counterparty or other relationships. The Company has exposure to different counterparties, and executes transactions with various counterparties in the financial industry. Recent defaults by financial services institutions, and even rumors or questions about one or more financial services institutions or the financial services industry in general, have led to market-wide liquidity problems and could lead to losses or defaults by the Company or by other institutions. Many of these transactions expose the Company to credit risk in the event of default of its counterparty or client. Any such losses could materially and adversely affect the Company's results of operations.

Changes in interest rates may negatively affect our earnings. Changes in market interest rates and prices may adversely affect the Company's financial condition or results of operations. The Company's net interest income, its largest source of revenue, is highly dependent on achieving a positive spread between the interest earned on loans and investments and the interest paid on deposits and borrowings. Changes in interest rates could negatively impact the Company's ability to attract deposits, make loans, and achieve a positive spread resulting in compression of the net interest margin.

The Company may not have sufficient cash or access to cash to satisfy current and future financial obligations, including demands for loans and deposit withdrawals, funding operating costs, payment of preferred stock dividends and for other corporate purposes. This type of liquidity risk arises whenever the maturities of financial instruments included in assets and liabilities differ. The Company's liquidity can be affected by a variety of factors, including general economic conditions, market disruption, operational problems affecting third parties or the Company, unfavorable pricing, competition, the Company's credit rating and regulatory restrictions. (See "Liquidity" herein for management's actions to mitigate this risk.)

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If the Company were unable to borrow funds through access to capital markets, it may not be able to meet the cash flow requirements of its depositors, creditors, and borrowers, or the operating cash needed to fund corporate expansion and other corporate activities. Starting in the middle of 2007, there has been significant turmoil and volatility in worldwide financial markets which, although there has been some improvement, is still ongoing. These conditions have resulted in a disruption in the liquidity of financial markets, and could directly impact the Company to the extent it needs to access capital markets to raise funds to support its business and overall liquidity position. This situation could affect the cost of such funds or the Company's ability to raise such funds. If the Company were unable to access any of these funding sources when needed, it might be unable to meet customers' needs, which could adversely impact its financial condition, results of operations, cash flows, and level of regulatory-qualifying capital. For further discussion, see the "Liquidity" section.

Loan customers or other counter-parties may not be able to perform their contractual obligations resulting in a negative impact on the Company's earnings. Overall economic conditions affecting businesses and consumers, including the current difficult economic conditions and market disruptions, could impact the Company's credit losses. In addition, real estate valuations could also impact the Company's credit losses as the Company maintains \$619 million in loans secured by commercial, agricultural, and residential real estate. A significant decline in real estate values could have a negative effect on the Company's financial condition and results of operations. In addition, the Company's total loan balances by industry exceeded 25% of total risk-based capital for each of four industries as of December 31, 2011. A listing of these industries is contained in under "Item 6. Management's Discussion and Analysis of Financial Condition and Results of Operations -- Loans" herein. A significant change in one of these industries such as a significant decline in agricultural crop prices, could adversely impact the Company's credit losses.

Continued deterioration in the real estate market could lead to additional losses, which could have a material adverse effect on the business, financial condition and results of operations or the Company. Commercial and commercial real estate loans generally involve higher credit risks than residential real estate and consumer loans. Because payments on loans secured by commercial real estate or equipment are often dependent upon the successful operation and management of the underlying assets, repayment of such loans may be influenced to a great extent by conditions in the market or the economy. Continued increases in commercial and consumer delinquency levels or continued declines in real estate market values would require increased net charge-offs and increases in the allowance for loan and lease losses, which could have a material adverse effect on our business, financial condition and results of operations and prospects.

The allowance for loan losses may prove inadequate or be negatively affected by credit risk exposures. The Company's business depends on the creditworthiness of its customers. Management periodically reviews the allowance for loan and lease losses for adequacy considering economic conditions and trends, collateral values and credit quality indicators, including past charge-off experience and levels of past due loans and nonperforming assets. There is no certainty that the allowance for loan losses will be adequate over time to cover credit losses in the portfolio because of unanticipated adverse changes in the economy, market conditions or events adversely affecting specific customers, industries or markets. If the credit quality of the customer base materially decreases, if the risk profile of a market, industry or group of customers changes materially, or if the allowance for loan losses is not adequate, the Company's business, financial condition, liquidity, capital, and results of operations could be materially adversely affected.

Declines in the value of securities held in the investment portfolio may negatively affect the Company's earnings. The value of an investment in the portfolio could decrease due to changes in market factors. The market value of certain investment securities is volatile and future declines or other-than-temporary impairments could materially adversely affect the Company's future earnings and regulatory capital. Continued volatility in the market value of certain of the investment securities, whether caused by changes in market perceptions of credit risk, as reflected in the expected market yield of the security, or actual defaults in the portfolio could result in significant fluctuations in the value of the securities. This could have a material adverse impact on the Company's accumulated other comprehensive loss and

shareholders' equity depending upon the direction of the fluctuations.

Furthermore, future downgrades or defaults in these securities could result in future classifications as other-than-temporarily impaired. The Company has invested in trust preferred securities issued by financial institutions and insurance companies, corporate securities of financial institutions, and stock in the Federal Home Loan Bank of Chicago and Federal Reserve Bank of Chicago. Deterioration of the financial stability of the underlying financial institutions for these investments could result in other-than-temporary impairment charges to the Company and could have a material impact on future earnings. For further discussion of the Company's investments, see Note 4 – "Investment Securities."

If the Company's stock price declines from levels at December 31, 2011, management will evaluate the goodwill balances for impairment, and if the values of the businesses have declined, the Company could recognize an impairment charge for its goodwill. Management performed an annual goodwill impairment assessment as of September 30, 2011. Based on these analyses, management concluded that the fair value of the Company's reporting units exceeded the fair value of its assets and liabilities and, therefore, goodwill was not considered impaired. It is possible that management's assumptions and conclusions regarding the valuation of the Company's lines of business could change adversely, which could result in the recognition of impairment for goodwill, which could have a material effect on the Company's financial position and future results of operations.

The Series B Preferred Stock and Series C Preferred Stock impacts net income available to common stockholders and earnings per share. As long as shares of the Series B Preferred Stock and Series C Preferred Stock are outstanding, no dividends may be paid on the Company's common stock unless all dividends on the Series B and Series C Preferred Stock have been paid in full. The dividends declared on the Series B Preferred Stock and Series C Preferred Stock reduce the net income available to common stockholders and earnings per share.

Holders of the Series B Preferred Stock and Series C Preferred Stock have rights that are senior to those of common stockholders. The Series B Preferred Stock and Series C Preferred Stock is senior to the shares of common stock and holders of the Series B Preferred Stock and Series C Preferred Stock have certain rights and preferences that are senior to holders of common stock. The Series B Preferred Stock and Series C Preferred Stock will rank senior to the common stock and all other equity securities designated as ranking junior to the Series B Preferred Stock and Series C Preferred Stock. So long as any shares of the Series B Preferred Stock and Series C Preferred Stock remain outstanding, unless all accrued and unpaid dividends for all prior dividend periods have been paid or are contemporaneously declared and paid in full, no dividend shall be paid or declared on common stock or other junior stock, other than a dividend payable solely in common stock.

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The Company also may not purchase, redeem or otherwise acquire for consideration any shares of its common stock or other junior stock unless it has paid in full all accrued dividends on the Series B Preferred Stock and Series C Preferred Stock for all prior dividend periods. The Series B Preferred Stock and Series C Preferred Stock are entitled to a liquidation preference over shares of common stock in the event of the Company's liquidation, dissolution or winding up.

The Company may issue additional common stock or other equity securities in the future which could dilute the ownership interest of existing stockholders. In order to maintain capital at desired or regulatory-required levels or to replace existing capital, the Company may be required to issue additional shares of common stock, or securities convertible into, exchangeable for or representing rights to acquire shares of common stock. The Company may sell these shares at prices below the current market price of shares, and the sale of these shares may significantly dilute stockholder ownership. The Company could also issue additional shares in connection with acquisitions of other financial institutions.

Human error, inadequate or failed internal processes and systems, and external events may have adverse effects on the Company. Operational risk includes compliance or legal risk, which is the risk of loss from violations of, or noncompliance with, laws, rules, regulations, prescribed practices, or ethical standards. Operational risk also encompasses transaction risk, which includes losses from fraud, error, the inability to deliver products or services, and loss or theft of information. Losses resulting from operational risk could take the form of explicit charges, increased operational costs, harm to the Company's reputation or forgone opportunities. Any of these could potentially have a material adverse effect on the Company's financial condition and results of operations.

The Company is exposed to various business risks that could have a negative effect on the financial performance of the Company. These risks include: changes in customer behavior, changes in competition, new litigation or changes to existing litigation, claims and assessments, environmental liabilities, real or threatened acts of war or terrorist activity, adverse weather, changes in accounting standards, legislative or regulatory changes, taxing authority interpretations, and an inability on the Company's part to retain and attract skilled employees.

In addition to these risks identified by the Company, investments in the Company's common stock involve risk. The market price of the Company's common stock may fluctuate significantly in response to a number of factors including: volatility of stock market prices and volumes, rumors or erroneous information, changes in market valuations of similar companies, changes in securities analysts' estimates of financial performance, and variations in quarterly or annual operating results.

If the Company is unable to make favorable acquisitions or successfully integrate our acquisitions, the Company's growth could be impacted. In the past several years, the Company has completed acquisitions of banks and bank branches from other institutions. We may continue to make such acquisitions in the future. When the Company evaluates acquisition opportunities, the Company evaluates whether the target institution has a culture similar to the Company, experienced management and the potential to improve the financial performance of the Company. If the Company fails to successfully identify, complete and integrate favorable acquisitions, the Company could experience slower growth. Acquiring other banks or bank branches involves various risks commonly associated with acquisitions, including, among other things: potential exposure to unknown or contingent liabilities or asset quality issues of the target institution, difficulty and expense of integrating the operations and personnel of the target institution, potential disruption to the Company (including diversion of management's time and attention), difficulty in estimating the value of the target institution, and potential changes in banking or tax laws or regulations that may affect the target institution.

#### ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

## ITEM 2. PROPERTIES

During 2011, the Company purchased a building located at 1421 Charleston Avenue, Mattoon Illinois and moved its headquarters to this location. This location is also used by the loan and deposit operations departments of First Mid Bank. In addition, the Company owns a facility located at 1500 Wabash Avenue, Mattoon, Illinois, which it is currently leasing to a non-affiliated third party.

The main office of First Mid Bank is located at 1515 Charleston Avenue, Mattoon, Illinois and is owned by First Mid Bank. First Mid Bank also owns a building located at 1520 Charleston Avenue, which is used by MIDS for its data processing and by the Company and First Mid Bank for back room operations. First Mid Bank also conducts business through numerous facilities, owned and leased, located in seventeen counties throughout Illinois. Of the thirty-six other banking offices operated by First Mid Bank, twenty-three are owned and thirteen are leased from non-affiliated third parties.

First Mid Insurance leases a facility located at 100 Lerna Road South, Mattoon, Illinois.

None of the properties owned by the Corporation are subject to any major encumbrances. The Company believes these facilities are suitable and adequate to operate its banking and related business. The net investment of the Company and subsidiaries in real estate and equipment at December 31, 2011 was \$30,717,000.

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ITEM 3. LEGAL PROCEEDINGS

Deanna Williamson, on behalf of herself and all others similarly situated v. First Mid-Illinois Bancshares, Inc. and First Mid Bank & Trust, N.A. (Circuit Court, Third Judicial Circuit, Madison County, Illinois, No. 11-L-1079): On October 20, 2011, a lawsuit was filed against the Company and First Mid Bank in the Circuit Court of Madison County, Illinois. The lawsuit is styled as a class action lawsuit. The suit alleges that the Company and First Mid Bank unfairly assessed and collected overdraft fees and sought restitution of the overdraft fees, an unspecified amount of compensatory and punitive damages, prejudgment interest and additional relief. This case was dismissed by agreement of the parties on February 17, 2012.

Since First Mid Bank acts as a depository of funds, it is named from time to time as a defendant in lawsuits (such as garnishment proceedings) involving claims as to the ownership of funds in particular accounts. Management believes that all such litigation as well as other pending legal proceedings in which the Company is involved constitute ordinary, routine litigation incidental to the business of the Company and that such litigation will not materially adversely affect the Company's consolidated financial condition or results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

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## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER OF PURCHASES OF EQUITY SECURITIES

The Company's common stock was held by approximately 588 shareholders of record as of December 31, 2011 and is included for quotation on the over-the-counter electronic bulletin board.

The following table shows the high and low bid prices per share of the Company's common stock for the indicated periods. These quotations represent inter-dealer prices without retail mark-ups, mark-downs or commissions and may not necessarily represent actual transactions.

| Quarter | High    | Low     |
|---------|---------|---------|
| 2011    |         |         |
| 4th     | \$20.00 | \$18.00 |
| 3rd     | \$18.95 | \$18.00 |
| 2nd     | \$19.00 | \$17.80 |
| 1st     | \$19.00 | \$16.85 |
| 2010    |         |         |
| 4th     | \$18.50 | \$16.85 |
| 3rd     | \$19.00 | \$17.50 |
| 2nd     | \$19.90 | \$16.50 |
| 1st     | \$17.50 | \$16.50 |

The following table sets forth the cash dividends per share on the Company's common stock for the last two years.

| Date Declared | Date Paid | Dividend Per Share |
|---------------|-----------|--------------------|
| 12-13-2011    | 1-09-2012 | \$.210             |
| 4-27-2011     | 6-07-2011 | \$.190             |
| 12-21-2010    | 1-06-2011 | \$.190             |
| 4-28-2010     | 6-07-2010 | \$.190             |

The Company's shareholders are entitled to receive such dividends as are declared by the Board of Directors, which considers payment of dividends semi-annually. The ability of the Company to pay dividends, as well as fund its operations, is dependent upon receipt of dividends from First Mid Bank. Regulatory authorities limit the amount of dividends that can be paid by First Mid Bank without prior approval from such authorities. For further discussion of First Mid Bank's dividend restrictions, see Item 1 – "Business" – "First Mid Bank" – "Dividends" and Note 16 – "Dividend Restrictions" herein. The Board of Directors of the Company declared cash dividends semi-annually during the two years ended December 31, 2011.



The following table summarizes share repurchase activity for the fourth quarter of 2011:

## ISSUER PURCHASES OF EQUITY SECURITIES

| Period                               | (a) Total<br>Number of<br>Shares<br>Purchased | (b)<br>Average<br>Price Paid<br>per Share | (c) Total<br>Number of<br>Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | (d)   |
|--------------------------------------|---|---|--|---|
|                                      |   |   |  | Approximate<br>Dollar Value<br>of Shares that<br>May Yet Be<br>Purchased<br>Under the<br>Plans or<br>Programs at<br>End of Period |
| October 1, 2011 – October 31, 2011   | 0   | \$0.00                                    | 0  | \$ 3,903,000  |
| November 1, 2011 – November 30, 2011 | 14,570  | \$18.47                                   | 14,570   | \$ 3,634,000  |
| December 1, 2011 – December 31, 2011 | 5,297   | \$19.15                                   | 5,297  | \$ 3,352,000  |
| Total                                | 19,867  | \$18.65                                   | 19,867   | \$ 3,352,000  |

Since August 5, 1998, the Board of Directors has approved repurchase programs pursuant to which the Company may repurchase a total of approximately \$56.7 million of the Company's common stock. The repurchase programs approved by the Board of Directors are as follows:

- On August 5, 1998, repurchases of up to 3%, or \$2 million, of the Company's common stock.
- In March 2000, repurchases up to an additional 5%, or \$4.2 million of the Company's common stock.
- In September 2001, repurchases of \$3 million of additional shares of the Company's common stock.
- In August 2002, repurchases of \$5 million of additional shares of the Company's common stock.
- In September 2003, repurchases of \$10 million of additional shares of the Company's common stock.
- On April 27, 2004, repurchases of \$5 million of additional shares of the Company's common stock.
- On August 23, 2005, repurchases of \$5 million of additional shares of the Company's common stock.
- On August 22, 2006, repurchases of \$5 million of additional shares of the Company's common stock.
- On February 27, 2007, repurchases of \$5 million of additional shares of the Company's common stock.
- On November 13, 2007, repurchases of \$5 million of additional shares of the Company's common stock.
- On December 16, 2008, repurchases of \$2.5 million of additional shares of the Company's common stock.
- On May 26, 2009, repurchases of \$5 million of additional shares of the Company's common stock.

- On February 22, 2011, repurchases of \$5 million of additional shares of the Company's common stock.
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## ITEM 6. SELECTED FINANCIAL DATA

The following sets forth a five-year comparison of selected financial data (dollars in thousands, except per share data).

|   | 2011        | 2010        | 2009        | 2008        | 2007        |
|---|-------------|-------------|-------------|-------------|-------------|
| <b>Summary of Operations</b>                          |             |             |             |             |             |
| Interest income                                       | \$56,772    | \$50,883    | \$51,409    | \$57,066    | \$59,931    |
| Interest expense                                      | 8,504       | 10,756      | 15,837      | 21,344      | 28,429      |
| Net interest income                                   | 48,268      | 40,127      | 35,572      | 35,722      | 31,502      |
| Provision for loan losses                             | 3,101       | 3,737       | 3,594       | 3,559       | 862         |
| Other income  | 15,787      | 13,820      | 13,455      | 15,264      | 14,661      |
| Other expense   | 43,053      | 36,927      | 33,212      | 31,460      | 30,055      |
| Income before income taxes                            | 17,901      | 13,283      | 12,221      | 15,967      | 15,246      |
| Income tax expense                                    | 6,529       | 4,522       | 4,007       | 5,443       | 5,087       |
| Net income  | 11,372      | 8,761       | 8,214       | 10,524      | 10,159      |
| Dividends on preferred shares                         | 3,576       | 2,240       | 1,821       | -           | -           |
| Net income available to common stockholders           | \$7,796     | \$6,521     | \$6,393     | \$10,524    | \$10,159    |
| <b>Per Common Share Data (1)</b>                      |             |             |             |             |             |
| Basic earnings per share                              | \$1.29      | \$1.07      | \$1.04      | \$1.69      | \$1.60      |
| Diluted earnings per share                            | 1.29        | 1.07        | 1.04        | 1.67        | 1.57        |
| Dividends per share                                   | .40         | .38         | .38         | .38         | .38         |
| Book value per common share                           | 16.18       | 14.46       | 14.23       | 13.50       | 12.82       |
| <b>Capital Ratios</b>                                 |             |             |             |             |             |
| Total capital to risk-weighted assets                 | 14.48       | % 12.84     | % 15.76     | % 11.99     | % 11.13     |
| Tier 1 capital to risk-weighted assets                | 13.37       | % 11.71     | % 14.57     | % 11.02     | % 10.32     |
| Tier 1 capital to average assets                      | 8.99        | % 7.42      | % 10.63     | % 8.41      | % 7.89      |
| <b>Financial Ratios</b>                               |             |             |             |             |             |
| Net interest margin                                   | 3.45        | % 3.51      | % 3.40      | % 3.73      | % 3.43      |
| Return on average assets                              | .76         | % .72       | % .74       | % 1.03      | % 1.03      |
| Return on average common equity                       | 8.36        | % 7.20      | % 9.56      | % 12.87     | % 13.06     |
| Dividend on common shares payout ratio                | 31.01       | % 35.51     | % 36.54     | % 22.49     | % 23.75     |
| Average equity to average assets                      | 8.88        | % 9.44      | % 9.59      | % 8.00      | % 7.90      |
| Allowance for loan losses as a percent of total loans | 1.29        | % 1.29      | % 1.35      | % 1.02      | % 0.82      |
| <b>Year End Balances</b>                              |             |             |             |             |             |
| Total assets  | \$1,500,956 | \$1,468,245 | \$1,095,155 | \$1,049,700 | \$1,016,338 |
| Net loans, including loans held for sale              | 848,954     | 794,188     | 691,288     | 734,351     | 742,043     |
| Total deposits  | 1,170,734   | 1,212,710   | 840,410     | 806,354     | 770,583     |
| Total equity  | 140,967     | 112,265     | 111,221     | 82,778      | 80,452      |
| <b>Average Balances</b>                               |             |             |             |             |             |
| Total assets  | \$1,502,794 | \$1,219,353 | \$1,108,669 | \$1,022,734 | \$985,230   |
| Net loans, including loans held for sale              | 796,520     | 708,367     | 692,961     | 733,681     | 722,672     |
| Total deposits  | 1,212,206   | 972,811     | 744,043     | 795,786     | 771,561     |
| Total equity  | 133,444     | 115,151     | 106,295     | 81,793      | 77,787      |

(1) All share and per share data have been restated to reflect the 3-for-2 stock split effective June 29, 2007.





## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis is intended to provide a better understanding of the consolidated financial condition and results of operations of the Company and its subsidiaries for the years ended December 31, 2011, 2010 and 2009. This discussion and analysis should be read in conjunction with the consolidated financial statements, related notes and selected financial data appearing elsewhere in this report.

### Forward-Looking Statements

This report may contain certain forward-looking statements, such as discussions of the Company's pricing and fee trends, credit quality and outlook, liquidity, new business results, expansion plans, anticipated expenses and planned schedules. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are identified by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project," or similar expressions. Actual results could differ materially from the results indicated by these statements because the realization of those results is subject to many risks and uncertainties, including those described in Item 1A—"Risk Factors" and other sections of the Company's Annual Report on Form 10-K and the Company's other filings with the SEC, and changes in interest rates, general economic conditions and those in the Company's market area, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios and the valuation of the investment portfolio, the Company's success in raising capital, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area and accounting principles, policies and guidelines. Furthermore, forward-looking statements speak only as of the date they are made. Except as required under the federal securities laws or the rules and regulations of the SEC, we do not undertake any obligation to update or review any forward-looking information, whether as a result of new information, future events or otherwise.

For the Years Ended December 31, 2011, 2010 and 2009

### Overview

This overview of management's discussion and analysis highlights selected information in this document and may not contain all of the information that is important to you. For a more complete understanding of trends, events, commitments, uncertainties, liquidity, capital resources, and critical accounting estimates, you should carefully read this entire document. These have an impact on the Company's financial condition and results of operations.

Net income was \$11.37 million, \$8.76 million, and \$8.21 million and diluted earnings per share were \$1.29, \$1.07, and \$1.04 for the years ended December 31, 2011, 2010, and 2009, respectively. The increases in net income and earnings per share in 2011 was primarily the result of an increase in net interest income due to an increase in the size of the balance sheet and lower interest rates on deposit balances resulting in less interest expense for the year. The following table shows the Company's annualized performance ratios for the years ended December 31, 2011, 2010 and 2009:

|   | 2011 |   | 2010 |   | 2009 |   |
|---|------|---|------|---|------|---|
| Return on average assets                | .76  | % | .72  | % | .74  | % |
| Return on average common equity         | 8.36 | % | 7.20 | % | 9.56 | % |
| Average common equity to average assets | 8.88 | % | 9.44 | % | 9.59 | % |

Total assets at December 31, 2011, 2010, and 2009 were \$1.50 billion, \$1.47 billion, and \$1.10 billion, respectively. The increase in net assets during 2010 was due to the acquisition of the Branches completed during the third quarter of 2010. Net loan balances increased to \$847.9 million at December 31, 2011, from \$794.1 million at December 31, 2010 and compared to \$691.3 million at December 31, 2009. Of the increase in 2011, \$53.8 million or 6.8% was due to increases in loans secured by real estate and commercial and industrial loans. Of the increase in 2010, \$103 million or 14.9% was due to \$133 million of loan balances acquired in the acquisition offset by a decline in the balances of loans secured by real estate.

Total deposit balances decreased to \$1,170.7 million at December 31, 2011 from \$1,212.7 million at December 31, 2010 and from \$840.4 million at December 31, 2009. The decrease in 2011 was due to a decline in money market balances and higher rate CDs that matured and were not replaced. The increase in 2010 was primarily due to balances acquired in the acquisition of \$337 million, as well as increases in interest bearing transaction accounts and money market accounts offset by declines in consumer time deposits.

Net interest margin, defined as net interest income divided by average interest-earning assets, was 3.45% for 2011, 3.51% for 2010 and 3.40% for 2009. The decrease during 2011 was primarily the result of the impact of the increase in liquidity resulting from the acquisition of the Branches as the difference between loans (\$135 million) and deposits (\$337 million) was initially held as Federal Funds sold and interest bearing balances until deployed. The increase in interest margin during 2010 was due to a greater decline in interest-earning liabilities rates compared to the decline in rates on interest-earning assets.

Net interest income increased to \$48.3 million in 2011 from \$40.1 million in 2010 and \$35.6 million in 2009. The ability of the Company to continue to grow net interest income is largely dependent on management's ability to succeed in its overall business development efforts. Management expects these efforts to continue but does not intend to compromise credit quality and prudent management of the maturities of interest-earning assets and interest-paying liabilities in order to achieve growth.

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Non-interest income increased to \$15.8 million in 2011 compared to \$13.8 million in 2010 and \$13.5 million in 2009. The primary reasons for the increase of \$2 million or 14.2% from 2010 to 2011 were increases in ATM and debit fees, an increase in trust revenues and less other-than-temporary impairment charges on investment securities. The primary reasons for the increase of \$.3 million or 2.7% from 2009 to 2010 were increases in ATM and debit fees, an increase in trust revenues and less other-than-temporary impairment charges on investment securities offset by no non-recurring gain such as occurred in 2009.

Non-interest expenses increased \$6.1 million, to \$43.0 million in 2011 compared to \$36.9 million in 2010 and \$33.2 million in 2009. The increase during 2011 was primarily due to additional expenses incurred as a result of operating the acquisition of the Branches for a full year, as well as increases in other real estate owned expenses. The primary factor for the increase during 2010 was additional expenses incurred as a result of the acquisition of the Branches offset by the special FDIC assessment during 2009 that did not occur in 2010.

Following is a summary of the factors that contributed to the changes in net income (in thousands):

|   | 2011 vs<br>2010 | 2010 vs<br>2009 |
|---|-----------------|-----------------|
| Net interest income                             | \$8,141         | \$4,555         |
| Provision for loan losses                       | 636             | (143 )          |
| Other income, including securities transactions | 1,967           | 365             |
| Other expenses                                  | (6,126 )        | (3,715 )        |
| Income taxes                                    | (2,007 )        | (515 )          |
| Increase in net income                          | \$2,611         | \$547           |

Credit quality is an area of importance to the Company. Year-end total nonperforming loans were \$7.4 million at December 31, 2011 compared to \$10.4 million at December 31, 2010 and \$12.7 million at December 31, 2009. The decrease in 2011 was primarily a result of loans that paid-off or became current during the year and loans transferred to other real estate owned during the year as a result of continued deterioration in economic conditions including increased unemployment, reduction in cash flow from increased vacancies in commercial properties, and declines in property values. Other real estate owned balances totaled \$4.6 million at December 31, 2011 compared to \$6.1 million at December 31, 2010 and \$2.9 million at December 31, 2009. The Company's provision for loan losses was \$3.1 million for 2011 compared to \$3.7 million for 2010. At December 31, 2011, the composition of the loan portfolio remained similar to 2010. Loans secured by both commercial and residential real estate comprised 72% and 73% of the loan portfolio as of December 31, 2011 and 2010, respectively.

The Company also held investments in four trust preferred securities with a fair value of \$719,000 and unrealized losses of \$4.9 million at December 31, 2011 compared to a fair value of \$581 million and unrealized losses of \$6 million at December 31, 2010. During 2011, the Company recorded \$886,000 of other-than-temporary impairment charges for the credit portion of the unrealized losses of these securities compared to \$1.4 million during 2010. These charges established a new, lower amortized cost basis for these securities and reduced non-interest income. See Note 4 – "Investment Securities" for additional details regarding these investments.

The Company's capital position remains strong and the Company has consistently maintained regulatory capital ratios above the "well-capitalized" standards. The Company's Tier 1 capital ratio to risk weighted assets ratio at December 31, 2011, 2010, and 2009 was 13.37%, 11.71%, and 14.57%, respectively. The Company's total capital to risk weighted assets ratio at December 31, 2011, 2010, and 2009 was 14.48%, 12.84%, and 15.76%, respectively. The increase in 2011 was primarily the result of an increase in retained earnings due to the Company's net income and the issuance of \$19,150,000 of Series C Preferred Stock. (See "Preferred Stock" in Note 1 to consolidated financial statements for more

detailed information.) The decrease in 2010 was primarily the result of an increase in risk weighted assets that resulted from the acquisition of the Branches in the third quarter of 2010.

The Company's liquidity position remains sufficient to fund operations and meet the requirements of borrowers, depositors, and creditors. The Company maintains various sources of liquidity to fund its cash needs. See "Liquidity" herein for a full listing of its sources and anticipated significant contractual obligations.

The Company enters into financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include lines of credit, letters of credit and other commitments to extend credit. The total outstanding commitments at December 31, 2011, 2010 and 2009 were \$228.6 million, \$169.3 million and \$132.9 million, respectively. See Note 17 – "Commitments and Contingent Liabilities" herein for further information.

#### Critical Accounting Policies and Use of Significant Estimates

The Company has established various accounting policies that govern the application of U.S. generally accepted accounting principles in the preparation of the Company's financial statements. The significant accounting policies of the Company are described in the footnotes to the consolidated financial statements. Certain accounting policies involve significant judgments and assumptions by management that have a material impact on the carrying value of certain assets and liabilities; management considers such accounting policies to be critical accounting policies. The judgments and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and assumptions made by management, actual results could differ from these judgments and assumptions, which could have a material impact on the carrying values of assets and liabilities and the results of operations of the Company.

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**Allowance for Loan Losses.** The Company believes the allowance for loan losses is the critical accounting policy that requires the most significant judgments and assumptions used in the preparation of its consolidated financial statements. An estimate of potential losses inherent in the loan portfolio are determined and an allowance for those losses is established by considering factors including historical loss rates, expected cash flows and estimated collateral values. In assessing these factors, the Company use organizational history and experience with credit decisions and related outcomes. The allowance for loan losses represents the best estimate of losses inherent in the existing loan portfolio. The allowance for loan losses is increased by the provision for loan losses charged to expense and reduced by loans charged off, net of recoveries. The Company evaluates the allowance for loan losses quarterly. If the underlying assumptions later prove to be inaccurate based on subsequent loss evaluations, the allowance for loan losses is adjusted.

The Company estimates the appropriate level of allowance for loan losses by separately evaluating impaired and nonimpaired loans. A specific allowance is assigned to an impaired loan when expected cash flows or collateral do not justify the carrying amount of the loan. The methodology used to assign an allowance to a nonimpaired loan is more subjective. Generally, the allowance assigned to nonimpaired loans is determined by applying historical loss rates to existing loans with similar risk characteristics, adjusted for qualitative factors including the volume and severity of identified classified loans, changes in economic conditions, changes in credit policies or underwriting standards, and changes in the level of credit risk associated with specific industries and markets. Because the economic and business climate in any given industry or market, and its impact on any given borrower, can change rapidly, the risk profile of the loan portfolio is continually assessed and adjusted when appropriate. Notwithstanding these procedures, there still exists the possibility that the assessment could prove to be significantly incorrect and that an immediate adjustment to the allowance for loan losses would be required.

**Other Real Estate Owned.** Other real estate owned acquired through loan foreclosure is initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. The adjustment at the time of foreclosure is recorded through the allowance for loan losses. Due to the subjective nature of establishing the fair value when the asset is acquired, the actual fair value of the other real estate owned or foreclosed asset could differ from the original estimate. If it is determined that fair value temporarily declines subsequent to foreclosure, a valuation allowance is recorded through noninterest expense. Operating costs associated with the assets after acquisition are also recorded as noninterest expense. Gains and losses on the disposition of other real estate owned and foreclosed assets are netted and posted to other noninterest expense.

**Investment in Debt and Equity Securities.** The Company classifies its investments in debt and equity securities as either held-to-maturity or available-for-sale in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities," which was codified into ASC 320. Securities classified as held-to-maturity are recorded at cost or amortized cost. Available-for-sale securities are carried at fair value. Fair value calculations are based on quoted market prices when such prices are available. If quoted market prices are not available, estimates of fair value are computed using a variety of techniques, including extrapolation from the quoted prices of similar instruments or recent trades for thinly traded securities, fundamental analysis, or through obtaining purchase quotes. Due to the subjective nature of the valuation process, it is possible that the actual fair values of these investments could differ from the estimated amounts, thereby affecting the financial position, results of operations and cash flows of the Company. If the estimated value of investments is less than the cost or amortized cost, the Company evaluates whether an event or change in circumstances has occurred that may have a significant adverse effect on the fair value of the investment. If such an event or change has occurred and the Company determines that the impairment is other-than-temporary, a further determination is made as to the portion of impairment that is related to credit loss. The impairment of the investment that is related to the credit loss is expensed in the period in which the event or change occurred. The remainder of the impairment is recorded in other comprehensive income.

Deferred Income Tax Assets/Liabilities. The Company's net deferred income tax asset arises from differences in the dates that items of income and expense enter into our reported income and taxable income. Deferred tax assets and liabilities are established for these items as they arise. From an accounting standpoint, deferred tax assets are reviewed to determine if they are realizable based on the historical level of taxable income, estimates of future taxable income and the reversals of deferred tax liabilities. In most cases, the realization of the deferred tax asset is based on future profitability. If the Company were to experience net operating losses for tax purposes in a future period, the realization of deferred tax assets would be evaluated for a potential valuation reserve.

Additionally, the Company reviews its uncertain tax positions annually under FASB Interpretation No. 48 (FIN No. 48), "Accounting for Uncertainty in Income Taxes," codified within ASC 740. An uncertain tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount actually recognized is the largest amount of tax benefit that is greater than 50% likely to be recognized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. A significant amount of judgment is applied to determine both whether the tax position meets the "more likely than not" test as well as to determine the largest amount of tax benefit that is greater than 50% likely to be recognized. Differences between the position taken by management and that of taxing authorities could result in a reduction of a tax benefit or increase to tax liability, which could adversely affect future income tax expense.

Impairment of Goodwill and Intangible Assets. Core deposit and customer relationships, which are intangible assets with a finite life, are recorded on the Company's balance sheets. These intangible assets were capitalized as a result of past acquisitions and are being amortized over their estimated useful lives of up to 15 years. Core deposit intangible assets, with finite lives will be tested for impairment when changes in events or circumstances indicate that its carrying amount may not be recoverable. Core deposit intangible assets were tested for impairment during 2011 as part of the goodwill impairment test and no impairment was deemed necessary.

As a result of the Company's acquisition activity, goodwill, an intangible asset with an indefinite life, is reflected on the balance sheets. Goodwill is evaluated for impairment annually, unless there are factors present that indicate a potential impairment, in which case, the goodwill impairment test is performed more frequently than annually.

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**Fair Value Measurements.** The fair value of a financial instrument is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The Company estimates the fair value of a financial instrument using a variety of valuation methods. Where financial instruments are actively traded and have quoted market prices, quoted market prices are used for fair value. When the financial instruments are not actively traded, other observable market inputs, such as quoted prices of securities with similar characteristics, may be used, if available, to determine fair value. When observable market prices do not exist, the Company estimates fair value. The Company's valuation methods consider factors such as liquidity and concentration concerns. Other factors such as model assumptions, market dislocations, and unexpected correlations can affect estimates of fair value. Imprecision in estimating these factors can impact the amount of revenue or loss recorded.

SFAS No. 157, "Fair Value Measurements", which was codified into ASC 820, establishes a framework for measuring the fair value of financial instruments that considers the attributes specific to particular assets or liabilities and establishes a three-level hierarchy for determining fair value based on the transparency of inputs to each valuation as of the fair value measurement date. The three levels are defined as follows:

- Level 1 — quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 — inputs include quoted prices for similar assets and liabilities in active markets, quoted prices of identical or similar assets or liabilities in markets that are not active, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 — inputs that are unobservable and significant to the fair value measurement.

At the end of each quarter, the Company assesses the valuation hierarchy for each asset or liability measured. From time to time, assets or liabilities may be transferred within hierarchy levels due to changes in availability of observable market inputs to measure fair value at the measurement date. Transfers into or out of hierarchy levels are based upon the fair value at the beginning of the reporting period. A more detailed description of the fair values measured at each level of the fair value hierarchy can be found in Note 11 – "Disclosures of Fair Values of Financial Instruments."

## Acquisition

On September 10, 2010, First Mid Bank completed the acquisition of certain assets and the assumption of certain liabilities with respect to 10 branches of First Bank located in Bartonville, Bloomington, Galesburg, Knoxville, Peoria and Quincy, Illinois. Excluding the purchase accounting adjustments, the acquisition included the assumption of approximately \$336 million in deposits and the purchase of approximately \$135 million of loans and \$5.3 million of premises and equipment associated with the acquired branch locations. First Mid Bank received cash of \$178.3 million to assume the net liabilities less the purchase price of \$15.7 million (4.77% of core deposits assumed). The acquisition resulted in goodwill of \$8.4 million. See Note 19—"Business Combinations" in the notes to the financial statements for additional information related to the transaction.

## Results of Operations

### Net Interest Income

The largest source of operating revenue for the Company is net interest income. Net interest income represents the difference between total interest income earned on earning assets and total interest expense paid on interest-bearing liabilities. The amount of interest income is dependent upon many factors, including the volume and mix of earning assets, the general level of interest rates and the dynamics of changes in interest rates. The cost of funds necessary to



support earning assets varies with the volume and mix of interest-bearing liabilities and the rates paid to attract and retain such funds.

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The Company's average balances, interest income and expense and rates earned or paid for major balance sheet categories are set forth in the following table (dollars in thousands):

|   | Year Ended<br>December 31, 2011 |                     |                 | Year Ended<br>December 31, 2010 |                     |                 | Year Ended<br>December 31, 2009 |                     |                 |
|---|---------------------------------|---------------------|-----------------|---------------------------------|---------------------|-----------------|---------------------------------|---------------------|-----------------|
|   | Average<br>Balance              | Average<br>Interest | Average<br>Rate | Average<br>Balance              | Average<br>Interest | Average<br>Rate | Average<br>Balance              | Average<br>Interest | Average<br>Rate |
| <b>ASSETS</b>                               |                                 |                     |                 |                                 |                     |                 |                                 |                     |                 |
| Interest-bearing deposits                   | \$83,877                        | \$213               | 0.25 %          | \$75,558                        | \$186               | 0.25 %          | \$55,504                        | \$106               | 0.19 %          |
| Federal funds sold                          | 78,227                          | 69                  | 0.09 %          | 65,644                          | 85                  | 0.13 %          | 54,630                          | 66                  | 0.12 %          |
| Certificates of deposit investments         | 11,651                          | 78                  | 0.67 %          | 9,473                           | 110                 | 1.16 %          | 4,093                           | 55                  | 1.34 %          |
| Investment securities                       |                                 |                     |                 |                                 |                     |                 |                                 |                     |                 |
| Taxable                                     | 388,108                         | 9,819               | 2.53 %          | 249,636                         | 7,746               | 3.10 %          | 207,025                         | 8,073               | 3.90 %          |
| Tax-exempt (1)                              | 30,971                          | 1,194               | 3.86 %          | 23,251                          | 953                 | 4.10 %          | 23,384                          | 963                 | 4.12 %          |
| Loans (2) (3)                               | 807,463                         | 45,399              | 5.62 %          | 718,669                         | 41,803              | 5.82 %          | 701,521                         | 42,146              | 6.01 %          |
| Total earning assets                        | 1,400,297                       | 56,772              | 4.05 %          | 1,142,231                       | 50,883              | 4.45 %          | 1,046,157                       | 51,409              | 4.91 %          |
| Cash and due from banks                     | 31,554                          |                     |                 | 21,378                          |                     |                 | 18,634                          |                     |                 |
| Premises and equipment                      | 29,374                          |                     |                 | 19,454                          |                     |                 | 15,333                          |                     |                 |
| Other assets                                | 52,512                          |                     |                 | 45,592                          |                     |                 | 37,105                          |                     |                 |
| Allowance for loan losses                   | (10,943 )                       |                     |                 | (10,302 )                       |                     |                 | (8,560 )                        |                     |                 |
| Total assets                                | \$1,502,794                     |                     |                 | \$1,219,353                     |                     |                 | \$1,108,669                     |                     |                 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b> |                                 |                     |                 |                                 |                     |                 |                                 |                     |                 |
| <b>Deposits:</b>                            |                                 |                     |                 |                                 |                     |                 |                                 |                     |                 |
| Demand deposits, interest-bearing           | \$499,184                       | 2,325               | 0.47 %          | \$421,743                       | 3,190               | 0.76 %          | \$332,751                       | 2,843               | 0.85 %          |
| Savings deposits                            | 251,268                         | 1,481               | 0.59 %          | 165,337                         | 1,279               | 0.77 %          | 106,539                         | 938                 | 0.88 %          |
| Time deposits                               | 264,508                         | 2,919               | 1.10 %          | 243,606                         | 4,002               | 1.64 %          | 304,753                         | 9,189               | 3.02 %          |
| <b>Securities sold under</b>                |                                 |                     |                 |                                 |                     |                 |                                 |                     |                 |
| agreements to repurchase                    | 108,240                         | 172                 | 0.16 %          | 76,758                          | 133                 | 0.17 %          | 72,589                          | 129                 | 0.18 %          |
| FHLB advances                               | 20,238                          | 765                 | 3.78 %          | 26,092                          | 1,090               | 4.18 %          | 36,175                          | 1,612               | 4.46 %          |
| Federal funds purchased                     | 14                              | -                   | .55 %           | 8                               | -                   | .79 %           | 3                               | -                   | .47 %           |
|   | 20,620                          | 770                 | 3.73 %          | 20,620                          | 1,053               | 5.11 %          | 20,620                          | 1,104               | 5.36 %          |

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|                                      |             |          |        |             |          |        |             |          |        |
|--------------------------------------|-------------|----------|--------|-------------|----------|--------|-------------|----------|--------|
| Subordinated debentures              |             |          |        |             |          |        |             |          |        |
| Other debt                           | 927         | 72       | 8.00 % | 642         | 9        | 1.46 % | 1,498       | 22       | 1.48 % |
| Total interest-bearing liabilities   | 1,164,999   | 8,504    | 0.73 % | 954,806     | 10,756   | 1.13 % | 874,928     | 15,837   | 1.81 % |
| Demand deposits                      | 197,246     |          |        | 142,125     |          |        | 119,537     |          |        |
| Other liabilities                    | 7,105       |          |        | 7,271       |          |        | 7,909       |          |        |
| Stockholders' equity                 | 133,444     |          |        | 115,151     |          |        | 106,295     |          |        |
| Total liabilities & equity           | \$1,502,794 |          |        | \$1,219,353 |          |        | \$1,108,669 |          |        |
| Net interest income                  |             | \$48,268 |        |             | \$40,127 |        |             | \$35,572 |        |
| Net interest spread                  |             |          | 3.32 % |             |          | 3.32 % |             |          | 3.10 % |
| Impact of non-interest bearing funds |             |          | .13 %  |             |          | .19 %  |             |          | .30 %  |
| Net yield on interest-earning assets |             |          | 3.45 % |             |          | 3.51 % |             |          | 3.40 % |

(1) The tax-exempt income is not recorded on a tax equivalent basis.

(2) Nonaccrual loans have been included in the average balances.

(3) Includes loans held for sale.

Changes in net interest income may also be analyzed by segregating the volume and rate components of interest income and interest expense. The following table summarizes the approximate relative contribution of changes in average volume and interest rates to changes in net interest income for the past two years (in thousands):

|                                      | 2011 Compared to 2010 |                |                | 2010 Compared to 2009 |                |                |
|--------------------------------------|-----------------------|----------------|----------------|-----------------------|----------------|----------------|
|                                      | Increase – (Decrease) |                |                | Increase – (Decrease) |                |                |
|                                      | Total Change          | Volume (1)     | Rate (1)       | Total Change          | Volume (1)     | Rate (1)       |
| <b>Earning Assets:</b>               |                       |                |                |                       |                |                |
| Interest-bearing deposits            | \$27                  | \$27           | \$-            | \$80                  | \$264          | \$(526)        |
| Federal funds sold                   | (16)                  | 14             | (30)           | 19                    | 238            | (508)          |
| Certificates of deposit investments  | (32)                  | 21             | (53)           | 55                    | 63             | (8)            |
| <b>Investment securities:</b>        |                       |                |                |                       |                |                |
| Taxable                              | 2,073                 | 3,694          | (1,621)        | (327)                 | 1,495          | (1,822)        |
| Tax-exempt (2)                       | 241                   | 301            | (60)           | (10)                  | (5)            | (5)            |
| Loans (3)                            | 3,596                 | 5,062          | (1,466)        | (343)                 | 1,013          | (1,356)        |
| <b>Total interest income</b>         | <b>5,889</b>          | <b>9,119</b>   | <b>(3,230)</b> | <b>(526)</b>          | <b>2,623</b>   | <b>(3,149)</b> |
| <b>Interest-Bearing Liabilities:</b> |                       |                |                |                       |                |                |
| <b>Deposits:</b>                     |                       |                |                |                       |                |                |
| Demand deposits, interest-bearing    | (865)                 | 514            | (1,379)        | 347                   | 677            | (330)          |
| Savings deposits                     | 202                   | 550            | (348)          | 341                   | 469            | (128)          |
| Time deposits                        | (1,083)               | 320            | (1,403)        | (5,187)               | (1,583)        | (3,604)        |
| <b>Securities sold under</b>         |                       |                |                |                       |                |                |
| agreements to repurchase             | 39                    | 48             | (9)            | 4                     | 10             | (6)            |
| FHLB advances                        | (325)                 | (228)          | (97)           | (522)                 | (426)          | (96)           |
| Federal funds purchased              | -                     | -              | -              | -                     | -              | -              |
| Subordinated debentures              | (283)                 | -              | (283)          | (51)                  | -              | (51)           |
| Other debt                           | 63                    | (5)            | 58             | (13)                  | (13)           | -              |
| <b>Total interest expense</b>        | <b>(2,252)</b>        | <b>1,209</b>   | <b>(3,461)</b> | <b>(5,081)</b>        | <b>(866)</b>   | <b>(4,215)</b> |
| <b>Net interest income</b>           | <b>\$8,141</b>        | <b>\$7,910</b> | <b>\$231</b>   | <b>\$4,555</b>        | <b>\$3,489</b> | <b>\$1,066</b> |

(1) Changes attributable to the combined impact of volume and rate have been allocated proportionately to the change due to volume and the change due to rate.

(2) The tax-exempt income is not recorded on a tax equivalent basis.

(3) Nonaccrual loans are not material and have been included in the average balances.

Net interest income increased \$8.1 million or 20.3% in 2011 compared to an increase of \$4.6 million or 12.8% in 2010. The increase in net interest income in 2011 was primarily due to an increase in earning assets. The increase in net interest income in 2010 was primarily due to a greater decline in rates on interest-bearing liabilities than the decline in rates on interest-bearing assets.

In 2011, average earning assets increased by \$258.1 million or 22.6% and average interest-bearing liabilities increased \$210.2 million or 22.0% compared with 2010. In 2010, average earning assets increased by \$96.1 million, or 9.2%, and average interest-bearing liabilities increased \$79.9 million or 9.1% compared with 2009. Changes in average balances are shown below:

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- Average interest-bearing deposits held by the Company increased \$8.3 million or 11.0% in 2011 compared to 2010. In 2010, average interest-bearing deposits held by the Company increased \$20.1 million or 36.2% compared to 2009.
  - Average federal funds sold increased \$12.6 million or 19.2% in 2011 compared to 2010. In 2010, average federal funds sold increased \$11.0 million or 20.1% compared to 2010.
  - Average certificates of deposit investments increased \$2.2 million or 23.2% in 2011 compared to 2010. In 2010, average certificates of deposit investments increased \$5.4 million or 131.9% compared to 2009.
  - Average loans increased by \$88.8 million or 12.4% in 2011 compared to 2010. In 2010, average loans increased by \$17.1 million or 2.4% compared to 2009.
-

- Average securities increased by \$146.2 million or 53.6% in 2011 compared to 2010. In 2010, average securities increased by \$42.5 million or 18.4% compared to 2009.
- Average deposits increased by \$184.3 million or 22.2% in 2011 compared to 2010. In 2010, average deposits increased by \$86.6 million or 11.6% compared to 2009.
- Average securities sold under agreements to repurchase increased by \$31.5 million or 41.0% in 2011 compared to 2010. In 2010, average securities sold under agreements to repurchase increased by \$4.2 million or 5.8% compared to 2009.
- Average borrowings and other debt decreased by \$5.6 million or 11.8% in 2011 compared to 2010. In 2010, average borrowings and other debt decreased by \$10.9 million or 18.7% compared to 2009.
  - The federal funds rate remained at a range of 0% to .25% at December 31, 2011, 2010 and 2009.
- Net interest margin decreased to 3.45% compared to 3.51% in 2010 and 3.40% in 2009. Asset yields decreased by 40 basis points in 2010, and interest-bearing liabilities decreased by 40 basis points.

To compare the tax-exempt yields on interest-earning assets to taxable yields, the Company also computes non-GAAP net interest income on a tax equivalent basis where the interest earned on tax-exempt securities is adjusted to an amount comparable to interest subject to normal income taxes, assuming a federal tax rate of 34% (referred to as the tax equivalent adjustment). The tax equivalent basis adjustments to net interest income for 2011, 2010 and 2009 were \$615,000, \$491,000 and \$497,000, respectively. The net yield on interest-earning assets on a tax equivalent basis was 3.51% in 2011, 3.57% in 2010 and 3.46% in 2009.

#### Provision for Loan Losses

The provision for loan losses in 2011 was \$3,101,000 compared to \$3,737,000 in 2010 and \$3,594,000 in 2009. Nonperforming loans decreased to \$7,440,000 at December 31, 2011 from \$10,434,000 at December 31, 2010 and compared to \$12,720,000 at December 31, 2009. The decrease in 2011 and 2010 was primarily due to loans that paid-off or became current during the year and loans transferred to other real estate owned during the year. Net charge-offs were \$2,374,000 during 2011, \$2,806,000 during 2010, and \$1,719,000 during 2009. For information on loan loss experience and nonperforming loans, see “Nonperforming Loans and Repossessed Assets” and “Loan Quality and Allowance for Loan Losses” herein.

#### Other Income

An important source of the Company’s revenue is derived from other income. The following table sets forth the major components of other income for the last three years (in thousands):

|                       |         |         |         | \$ Change From Prior Year |       |
|-----------------------|---------|---------|---------|---------------------------|-------|
|                       | 2011    | 2010    | 2009    | 2011                      | 2010  |
| Trust                 | \$3,030 | \$2,601 | \$2,229 | \$429                     | \$372 |
| Brokerage             | 650     | 536     | 424     | 114                       | 112   |
| Insurance commissions | 1,786   | 1,779   | 1,912   | 7                         | (133) |
| Service charges       | 4,817   | 4,662   | 4,952   | 155                       | (290) |
| Securities gains      | 486     | 543     | 637     | (57)                      | (94)  |

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|  |          |          |          |         |          |
|--|----------|----------|----------|---------|----------|
| Impairment losses on securities            | (886 )   | (1,418 ) | (1,812 ) | 532     | 394      |
| Gain on sale of merchant banking portfolio | -        | -        | 1,000    | -       | (1,000 ) |
| Mortgage banking                           | 788      | 776      | 664      | 12      | 112      |
| ATM / debit card revenue                   | 3,483    | 2,869    | 2,333    | 614     | 536      |
| Other                                      | 1,633    | 1,472    | 1,116    | 161     | 356      |
| Total other income                         | \$15,787 | \$13,820 | \$13,455 | \$1,967 | \$365    |

Total non-interest income increased to \$15,787,000 in 2011 compared to \$13,820,000 in 2010 and \$13,455,000 in 2009. The primary reasons for the more significant year-to-year changes in other income components are as follows:

- Trust revenues increased \$429,000 or 16.5% to \$3,030,000 in 2011 from \$2,601,000 in 2010, compared to \$2,229,000 in 2009. The increase from 2010 to 2011 in trust revenues was due to an increase in revenues from Investment Management & Advisory Agency accounts and increases in market value related fees during the year. Trust assets were \$546.7 million at December 31, 2011 compared to \$507.5 million and \$459.1 million at December 31, 2010 and 2009, respectively.

- Revenue from brokerage annuity sales increased \$114,000 or 21.3% to \$650,000 in 2011 from \$536,000 in 2010, compared to \$424,000 in 2009. The increase from 2010 to 2011 was due an increase in commissions received from the sale of annuities.
- Insurance commissions increased \$7,000 or 0.4% to \$1,786,000 in 2011 from \$1,779,000 in 2010, compared to \$1,912,000 in 2009. The increase from 2010 to 2011 was due to an increase in property and casualty insurance commissions during 2011 compared to the same period in 2010.
- Fees from service charges increased \$155,000 or 3.3% to \$4,817,000 in 2011 from \$4,662,000 in 2010, compared to \$4,952,000 in 2010. This increase from 2010 to 2011 was primarily due to an increase in the number of accounts resulting from the Branches acquired during the third quarter of 2010.
- Net securities gains in 2011 were \$486,000 compared to net securities gains of \$543,000 in 2010, and \$637,000 in 2009. Several securities in the investment portfolio were sold to improve the overall portfolio mix and the margin in 2011, 2010 and 2009.
- During 2011, the Company recorded other-than-temporary impairment charges amounting to \$886,000 for its investments in four trust preferred securities compared to \$1,418,000 during 2010 and \$1,812,000 during 2009. See Note 4 - "Investment Securities" for a more detailed description of these charges.
- During the first quarter of 2009, the Company had a \$1 million gain on the sale of First Mid Bank's merchant card servicing portfolio. There were no gains on sales of other assets during 2011 or 2010.
- Mortgage banking income increased \$12,000 or 1.5% to \$788,000 in 2011 from \$776,000 in 2010, compared to \$664,000 in 2009. This increase from 2010 to 2011 was due to an increase in origination fees for loans originated and sold by First Mid Bank from a greater spread obtained on various loan types. Loans sold balances are as follows:
  - \$60 million (representing 500 loans) in 2011
  - \$64 million (representing 570 loans) in 2010
  - \$63 million (representing 552 loans) in 2009
- Revenue from ATMs and debit cards increased \$614,000 or 21.4% to \$3,483,000 in 2011 from \$2,869,000 in 2010, compared to \$2,333,000 in 2009. This increase from 2010 to 2009 was due to increased usage primarily as a result of the increase in customers after the Branches acquired during the third quarter of 2010.
- Other income increased \$161,000 or 10.9% to \$1,633,000 in 2011 from \$1,472,000 in 2010, compared to \$1,116,000 in 2009. This increase from 2011 to 2010 and 2009 was primarily due to an increase in rental income from buildings acquired in the Branches acquired during the third quarter of 2010 offset by a decrease in rental income in 2010 from a repossessed property sold during 2011.

#### Other Expense

The major categories of other expense include salaries and employee benefits, occupancy and equipment expenses and other operating expenses associated with day-to-day operations. The following table sets forth the major components of other expense for the last three years (in thousands):

|  | \$ Change From Prior<br>Year |
|--|------------------------------|
|--|------------------------------|



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|                                   | 2011     | 2010     | 2009     | 2011    | 2010    |
|-----------------------------------|----------|----------|----------|---------|---------|
| Salaries and benefits             | \$22,247 | \$18,649 | \$16,830 | \$3,598 | \$1,819 |
| Occupancy and equipment           | 7,960    | 5,851    | 4,989    | 2,109   | 862     |
| Other real estate owned, net      | 1,471    | 1,076    | 470      | 395     | 606     |
| FDIC insurance assessment expense | 1,167    | 1,508    | 1,943    | (341 )  | (435 )  |
| Amortization of other intangibles | 1,134    | 814      | 730      | 320     | 84      |
| Stationery and supplies           | 581      | 610      | 563      | (29 )   | 47      |
| Legal and professional fees       | 2,070    | 2,361    | 2,021    | (291 )  | 340     |
| Marketing and promotion           | 1,050    | 940      | 963      | 110     | (23 )   |
| Other                             | 5,373    | 5,118    | 4,703    | 255     | 415     |
| Total other expense               | \$43,053 | \$36,927 | \$33,212 | \$6,126 | \$3,715 |

Total non-interest expense increased to \$43,053,000 in 2011 from \$36,927,000 in 2010 and \$33,212,000 in 2009. The primary reasons for the more significant year-to-year changes in other expense components are as follows:

- Salaries and employee benefits, the largest component of other expense, increased \$3,598,000 or 19.3% to \$22,247,000 in 2011 from \$18,649,000 in 2010, compared to \$16,830,000 in 2009. The increase in 2011 was as primarily due to the addition of 76 full-time equivalent employees resulting from the Branches acquired at the end of the third quarter of 2010, an increase in incentive compensation expense as a result of achieving desired objectives in 2011 compared to during the year 2010 and merit raises for continuing employees during 2011. There were 402 full-time equivalent employees at December 31, 2011 compared to 419 at December 31, 2010 and 347 at December 31, 2009.
- Occupancy and equipment expense increased \$2,109,000 or 36.0% to \$7,960,000 in 2011 from \$5,851,000 in 2010, compared to \$4,989,000 in 2009. The increase in 2011 was primarily due to increases in building rent and expenses for computer software and software maintenance for existing and newly acquired Branches and expenses associated with the Company's purchase of a building in Mattoon, Illinois in 2011.
- Net other real estate owned expense increased \$395,000 or 36.7% to \$1,471,000 in 2011 from \$1,076,000 in 2010, compared to \$470,000 in 2009. The increase in 2011 was due to more write downs on properties held and an increase in repairs and real estate tax expenses on properties held during 2011 compared to the same period in 2010.
- FDIC insurance expense decreased \$341,000 or 22.6% to \$1,167,000 in 2011 from \$1,508,000 in 2010, compared to \$1,943,000 in 2009. The decrease in 2011 was due to a decrease in expense resulting from a change in the calculation of the insurance assessment.
- Amortization of other intangibles expense increased \$320,000 or 39.3% to \$1,134,000 in 2010, compared to \$814,000 in 2010 and compared to \$730,000 in 2009. The increase in 2011 was due to amortization of the additional core deposit intangible asset resulting from the Branches acquired in the third quarter of 2010.
- Other operating expenses increased \$255,000 or 5.0% to \$5,373,000 in 2011 from \$5,118,000 in 2010, compared to \$4,703,000 in 2009. In 2011, this increase was primarily due to additional expenses incurred following the acquisition of the Branches.
- On a net basis, all other categories of operating expenses decreased \$210,000 or 5.4% to \$3,701,000 in 2011 from \$3,911,000 in 2010, compared to \$3,547,000 in 2009. The decrease was primarily due to a decrease in legal expenses associated with the acquisition of the Branches during 2010 partially offset by increased legal and other professional expenses associated with the Company's issuance of Series C Preferred Stock during 2011.

#### Income Taxes

Income tax expense amounted to \$6,529,000 in 2011 compared to \$4,522,000 in 2010 and \$4,007,000 in 2009. Effective tax rates were 36.5%, 34.0% and 32.8%, respectively, for 2011, 2010 and 2009. Beginning January 1, 2011, the State of Illinois increased the corporate income tax rate to 9.5% compared to 7.3% previously. This was the primary cause of the increase in the Company's effective tax rate in 2011.

The Company adopted the provisions of FASB Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes," which was codified within ASC 740, on January 1, 2007. The implementation of FIN 48 did not impact the Company's financial statements. The Company files U.S. federal and state of Illinois income tax returns. The Company is no longer subject to U.S. federal or state income tax examinations by tax authorities for years before 2008.



## Analysis of Balance Sheets

## Securities

The Company's overall investment objectives are to insulate the investment portfolio from undue credit risk, maintain adequate liquidity, insulate capital against changes in market value and control excessive changes in earnings while optimizing investment performance. The types and maturities of securities purchased are primarily based on the Company's current and projected liquidity and interest rate sensitivity positions.

The following table sets forth the year-end amortized cost of the Company's securities for the last three years (dollars in thousands):

|   | December 31,   |                        |                |                        |                |                        |
|---|----------------|------------------------|----------------|------------------------|----------------|------------------------|
|   | 2011           |                        | 2010           |                        | 2009           |                        |
|   | Amortized Cost | Weighted Average Yield | Amortized Cost | Weighted Average Yield | Amortized Cost | Weighted Average Yield |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | \$ 164,812     | 1.99 %                 | \$ 152,086     | 1.90 %                 | \$ 89,640      | 3.27 %                 |
| Obligations of states and political subdivisions                                      | 38,879         | 3.92 %                 | 26,599         | 4.05 %                 | 23,530         | 4.13 %                 |
| Mortgage-backed securities:   |                |                        |                |                        |                |                        |
| GSE residential   | 254,930        | 3.17 %                 | 158,936        | 3.72 %                 | 111,301        | 4.36 %                 |
| Trust preferred securities  | 5,625          | 4.05 %                 | 6,595          | 3.74 %                 | 7,758          | 4.22 %                 |
| Other securities  | 9,561          | 1.92 %                 | 2,035          | 2.48 %                 | 6,166          | 4.56 %                 |
| Total securities  | \$473,807      | 2.81 %                 | \$346,251      | 2.94 %                 | \$238,395      | 3.93 %                 |

At December 31, 2011, the Company's investment portfolio showed an increase of \$127.6 million from December 31, 2010 primarily due to the purchase of mortgage-backed securities. When purchasing investment securities, the Company considers its overall liquidity and interest rate risk profile, as well as the adequacy of expected returns relative to the risks assumed.

The table below presents the credit ratings as of December 31, 2011, for all investment securities:

|  | Amortized Cost | Estimated Fair Value | Average Credit Rating of Fair Value at December 31, 2011 (1) |          |     |     |         |         |           |
|--|----------------|----------------------|--|----------|-----|-----|---------|---------|-----------|
|  |                |                      | AAA  | AA +/-   | A   | +/- | BBB +/- | < BBB - | Not rated |
| U.S. Treasury securities and obligations of U.S. government corporations and | \$ 164,812     | \$ 166,066           | \$156,037  | \$10,029 | \$- | \$- | \$-     | \$-     |           |

agencies

|   |            |            |            |           |          |          |        |            |
|---|------------|------------|------------|-----------|----------|----------|--------|------------|
| Obligations of state and political subdivisions | 38,879     | 41,253     | 3,165      | 30,246    | 3,093    | 1,377    | -      | 3,372      |
| Mortgage-backed securities: GSE residential (2) | 254,930    | 261,833    | -          | -         | -        | -        | -      | 261,833    |
| Trust preferred securities                      | 5,625      | 719        | -          | -         | -        | -        | 719    | -          |
| Other securities                                | 9,561      | 9,096      | -          | 3,884     | 5,182    | -        | -      | 30         |
| Total investments                               | \$ 473,807 | \$ 478,967 | \$ 159,202 | \$ 44,160 | \$ 8,275 | \$ 1,377 | \$ 719 | \$ 265,234 |

(1) Credit ratings reflect the lowest current rating assigned by a nationally recognized credit rating agency.

(2) Mortgage-backed securities include mortgage-backed securities (MBS) and collateralized mortgage obligation (CMO) issues from the following government sponsored enterprises: FHLMC, FNMA, GNMA and FHLB. While MBS and CMOs are no longer explicitly rated by credit rating agencies, the industry recognizes that they are backed by agencies which have an implied government guarantee.

The trust preferred securities are four trust preferred pooled securities issued by FTN Financial Securities Corp. (“FTN”). The following table contains information regarding these securities as of December 31, 2011:

| Deal name  | PreTSL I       | PreTSL II      | PreTSL VI      | PreTSL XXVIII  |
|--|----------------|----------------|----------------|----------------|
| Class  | Mezzanine      | Mezzanine      | Mezzanine      | C1             |
| Book value   | \$746,900      | \$1,026,800    | \$199,500      | \$3,652,100    |
| Fair value   | \$314,400      | \$184,800      | \$91,700       | \$127,900      |
| Unrealized gains/(losses)                                    | \$(432,500)    | \$(842,000)    | \$(107,800)    | \$(3,524,200)  |
| Other-than-temporary impairment recorded in earnings         | \$691,000      | \$2,186,531    | \$127,146      | \$1,111,303    |
| Lowest credit rating assigned                                | Ca             | Ca             | Ca             | C              |
| Number of performing banks                                   | 17             | 16             | 3              | 28             |
| Number of issuers in default                                 | 4              | 6              | -              | 9              |
| Number of issuers in deferral                                | 3              | 6              | 2              | 8              |
| Original collateral  | \$303,112,000  | \$334,170,000  | \$519,250,000  | \$360,850,000  |
| Actual defaults & deferrals as a % of original collateral    | 27.9%          | 34.3%          | 5.4%           | 24.2%          |
| Remaining collateral   | \$228,500,000  | \$246,600,000  | \$40,750,000   | \$360,850,000  |
| Actual defaults & deferrals as a % of remaining collateral   | 38.1%          | 48.3%          | 73.6%          | 24.9%          |
| Expected defaults & deferrals as a % of remaining collateral | 42.1%          | 52.1%          | 75.5%          | 36.0%          |
| Performing collateral  | \$141,500,000  | \$127,600,000  | \$16,673,685   | \$271,840,463  |
| Current balance of class                                     | \$95,375,156   | \$117,426,972  | \$26,723,143   | \$36,596,520   |
| Subordination  | \$187,463,319  | \$216,842,414  | \$26,723,143   | \$303,754,643  |
| Excess subordination   | \$(45,963,319) | \$(89,242,414) | \$(10,049,458) | \$(31,914,180) |
| Excess subordination as a % of performing collateral         | -32.5%         | -69.9%         | -60.3%         | -11.7%         |

#### Cash Flow Analysis Assumptions:

|  |           |           |                 |                 |
|--|-----------|-----------|-----------------|-----------------|
| Discount margin (1)  | 9.74%     | 9.68%     | 2.439% – 5.098% | 1.928% – 4.587% |
| Expected defaults & deferrals as a % of remaining collateral (2) | 2% / .36% | 2% / .36% | 2% / .36%       | 2% / .36%       |
| Recovery assumption (3)  | 10%       | 10%       | 10%             | 10%             |
| Prepayment assumption (4)  | 5%        | 5%        | 5%              | 5%              |

(1) The discount rate for floating rate bonds is a compound interest formula based on the LIBOR forward curve for each payment date

(2) 2% annually for 2 years and 36 basis points annually thereafter

(3) With 2 year lag

(4) Every 5 years beginning after 2013

The trust preferred pooled securities are Collateralized Debt Obligations backed by a pool of debt securities issued by financial institutions. The collateral consists of trust-preferred securities and subordinated debt securities issued by banks, bank holding companies and insurance companies. Performing collateral is the amount of remaining collateral less the balances of collateral in deferral or default. Subordination is the amount of performing collateral in excess of the current balance of a specified class of notes and all classes senior to the specified class. Excess subordination is the amount that the performing collateral balance exceeds the outstanding bonds in the current class, plus all senior classes. It is a static measure of credit enhancement, but does not incorporate all of the structural elements of the security deal. This amount can also be impacted by future defaults and deferrals, deferring balances that cure or redemptions of securities by issuers. A negative excess subordination indicates that the current performing collateral of the security would be insufficient to pay the current principal balance of the class notes after all of the senior classes notes were paid. However, the performing collateral balance excludes the collateral of issuers currently deferring their interest payments. Because these issuers are expected to resume payment in the future (within five years of the first deferred interest period), a negative excess subordination does not necessarily mean a class note holder will not receive a greater than projected or even full payment of cash flow at maturity.

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At December 31, 2011 and 2010 the Company was receiving “payment in kind” (“PIK”), in lieu of cash interest on all of its trust preferred securities investments. The Company’s use of “PIK” does not indicate that additional securities have been issued in satisfaction of any outstanding obligation; rather, it indicates that a coverage test of a class or tranche directly senior to the class in question has failed and interest received on the PIK note is being capitalized, which means the principal balance is being increased. Once the coverage test is met, the capitalized interest will be paid in cash and current cash interest payments will resume.

The Company’s trust preferred securities investments all allow, under the terms of the issue, for issuers to defer interest for up to five consecutive years. After five years, if not cured, the securities are considered to be in default and the trustee may demand payment in full of principal and accrued interest. Issuers are also considered to be in default in the event of the failure of the issuer or a subsidiary. The structuring of these trust preferred securities provides for a waterfall approach to absorbing losses whereby lower classes or tranches are initially impacted and more senior tranches are only impacted after lower tranches can no longer absorb losses. Likewise, the waterfall approach also applies to principal and interest payments received, as senior tranches have priority over lower tranches in the receipt of payments. Both deferred and defaulted issuers are considered non-performing, and the trustee calculates, on a quarterly or semi-annual basis, certain coverage tests prior to the payment of cash interest to owners of the various tranches of the securities. The coverage tests are compared to an over-collateralization target that states the balance of performing collateral as a percentage of the tranche balance plus the balance of all senior tranches. The tests must show that performing collateral is sufficient to meet requirements for the senior tranches, both in terms of cash flow and collateral value, before cash interest can be paid to subordinate tranches. As a result of the cash flow waterfall provisions within the structure of these securities, when a senior tranche fails its coverage test, all of the cash flows that would have been paid to lower tranches are paid to the senior tranche and recorded as a reduction of the senior tranches’ principal. This principal reduction in the senior tranche continues until the coverage test of the senior tranche is passed or the principal of the tranche is paid in full. For so long as the cash flows are being diverted to the senior tranches, the amount of interest due and payable to the subordinate tranches is capitalized and recorded as an increase in the principal value of the tranche. The Company’s trust preferred securities investments are in the mezzanine tranches or classes which are subordinate to one of more senior tranches of their respective issues. The Company is receiving PIK for these securities due to failure of the required senior tranche coverage tests described. These securities are projected to remain in full or partial PIK status for a period of one to eleven years.

The impact of payment of PIK to subordinate tranches is to strengthen the position of the senior tranches by reducing the senior tranches’ principal balances relative to available collateral and cash flow. The impact to the subordinate tranches is to increase principal balances, decrease cash flow, and increase credit risk to the tranches receiving the PIK. The risk to holders of a security of a tranche in PIK status is that the total cash flow will not be sufficient to repay all principal and capitalized interest related to the investment.

During the fourth quarter of 2010, after analysis of the expected future cash flows and the timing of resumed interest payments, the Company determined that placing all four of the trust preferred securities on non-accrual status was the most prudent course of action. The Company stopped all accrual of interest and ceased to capitalize any PIK interest payments to the principal balance of the securities. The Company intends to keep these securities on non-accrual status until the scheduled interest payments resume on a regular basis and any previously recorded PIK has been paid. The PIK status of these securities, among other factors, indicates potential other-than-temporary impairment (“OTTI”) and accordingly, the Company performed further detailed analysis of the investments’ cash flows and the credit conditions of the underlying issuers. This analysis incorporates, among other things, the waterfall provisions and any resulting PIK status of these securities to determine if cash flow will be sufficient to pay all principal and interest due to the investment tranche held by the Company. See discussion below and Note 4 – Investment Securities in the notes to the financial statements for more detail regarding this analysis. Based on this analysis, the Company believes the amortized costs recorded for its trust preferred securities investments accurately reflects the position of these securities at December 31, 2011 and 2010.



### Other-than-temporary Impairment of Securities

Declines in the fair value, or unrealized losses, of all available for sale investment securities, are reviewed to determine whether the losses are either a temporary impairment or OTTI. Temporary adjustments are recorded when the fair value of a security fluctuates from its historical cost. Temporary adjustments are recorded in accumulated other comprehensive income, and impact the Company's equity position. Temporary adjustments do not impact net income. A recovery of available for sale security prices also is recorded as an adjustment to other comprehensive income for securities that are temporarily impaired, and results in a positive impact to the Company's equity position.

OTTI is recorded when the fair value of an available for sale security is less than historical cost, and it is probable that all contractual cash flows will not be collected. Investment securities are evaluated for OTTI on at least a quarterly basis. In conducting this assessment, the Company evaluates a number of factors including, but not limited to:

- how much fair value has declined below amortized cost;
    - how long the decline in fair value has existed;
      - the financial condition of the issuers;
    - contractual or estimated cash flows of the security;
      - underlying supporting collateral;
      - past events, current conditions and forecasts;
    - significant rating agency changes on the issuer; and
  - the Company's intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value.
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If the Company intends to sell the security or if it is more likely than not the Company will be required to sell the security before recovery of its amortized cost basis, the entire amount of OTTI is recorded to noninterest income, and therefore, results in a negative impact to net income. Because the available for sale securities portfolio is recorded at fair value, the conclusion as to whether an investment decline is other-than-temporarily impaired, does not significantly impact the Company's equity position, as the amount of the temporary adjustment has already been reflected in accumulated other comprehensive income/loss.

If the Company does not intend to sell the security and it is not more-likely-than-not it will be required to sell the security before recovery of its amortized cost basis only the amount related to credit loss is recognized in earnings. In determining the portion of OTTI that is related to credit loss, the Company compares the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. The remaining portion of impairment, related to other factors, is recognized in other comprehensive earnings, net of applicable taxes. The Company recognized \$886,000, \$1.4 million and \$1.8 million of OTTI in earnings during 2011, 2010 and 2009, respectively.

The term OTTI is not intended to indicate that the decline is permanent but instead indicates that the prospects for a near-term recovery of value are not necessarily favorable or that there is a general lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. See Note 4 -- "Investment Securities" to the Financial Statements for a discussion of the Company's evaluation and subsequent charges for OTTI.

## Loans

The loan portfolio (net of unearned discount) is the largest category of the Company's earning assets. The following table summarizes the composition of the loan portfolio for the last five years (in thousands):

|                                    | 2011      | %<br>Outstanding<br>Loans |   | 2010      | 2009      | 2008      | 2007      |
|------------------------------------|-----------|---------------------------|---|-----------|-----------|-----------|-----------|
| Construction and land development  | \$23,136  | 2.7                       | % | \$20,379  | \$28,041  | \$40,362  | \$55,581  |
| Farm loans                         | 72,585    | 8.4                       | % | 64,992    | 62,330    | 65,647    | 61,898    |
| 1-4 Family residential properties  | 181,849   | 21.1                      | % | 179,527   | 180,415   | 200,204   | 193,065   |
| Multifamily residential properties | 19,846    | 2.3                       | % | 22,146    | 19,467    | 23,833    | 30,795    |
| Commercial real estate             | 321,001   | 37.3                      | % | 300,825   | 226,400   | 217,307   | 203,282   |
| Loans secured by real estate       | 618,417   | 71.9                      | % | 587,869   | 516,653   | 547,353   | 544,621   |
| Agricultural loans                 | 63,257    | 7.4                       | % | 58,307    | 54,144    | 54,098    | 51,793    |
| Commercial and industrial loans    | 150,716   | 17.5                      | % | 126,319   | 105,351   | 109,324   | 116,176   |
| Consumer loans                     | 16,271    | 1.9                       | % | 19,655    | 20,815    | 25,806    | 29,903    |
| All other loans                    | 11,413    | 1.3                       | % | 12,431    | 3,787     | 5,357     | 5,668     |
| Total loans                        | \$860,074 | 100.0                     | % | \$804,581 | \$700,750 | \$741,938 | \$748,161 |

Loan balances increased by \$55.5 million or 6.9% from December 31, 2010 to December 31, 2011 primarily due to originations of loans secured by real estate and commercial and industrial loans. Loan balances increased by \$103.8 million or 14.8% from December 31, 2009 to December 31, 2010 primarily due to approximately \$133 million of loans (recorded at fair value) acquired in the acquisition of the Branches offset by decreases in loans secured by real estate due to a lack of demand from quality borrowers and First Mid Bank's enhanced underwriting standards as a result of economic conditions. The balances of loans sold into the secondary market were \$60 million in 2011, compared to \$64 million in 2010. The balance of real estate loans held for sale, included in the balances shown above, amounted to \$1,046,000 and \$114,000 as of December 31, 2011 and 2010, respectively.

All of the loans acquired in the acquisition of the Branches were performing loans. The fair value of the loans acquired was determined using a discounted cash flow analysis. The difference between the fair value and acquired value of the purchased loans of \$2.1 million (a discount of approximately 1.6% of the total loans acquired) is being accreted to interest income over the remaining term of the loans. The unaccreted balance of this discount at December 31, 2011 is \$906,000.

Commercial and commercial real estate loans generally involve higher credit risks than residential real estate and consumer loans. Because payments on loans secured by commercial real estate or equipment are often dependent upon the successful operation and management of the underlying assets, repayment of such loans may be influenced to a great extent by conditions in the market or the economy. The Company does not have any sub-prime mortgages or credit card loans outstanding which are also generally considered to be higher credit risk.

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The following table summarizes the loan portfolio geographically by branch region as of December 31, 2011 and 2010 (dollars in thousands):

|                   | 2011                 |                      |   | 2010                 |                      |   |
|-------------------|----------------------|----------------------|---|----------------------|----------------------|---|
|                   | Principal<br>balance | Outstanding<br>loans | % | Principal<br>balance | Outstanding<br>loans | % |
| Mattoon region    | \$163,446            | 19.0                 | % | \$148,682            | 18.4                 | % |
| Charleston region | 48,716               | 5.7                  | % | 54,649               | 6.8                  | % |
| Sullivan region   | 120,369              | 14.0                 | % | 68,300               | 14.1                 | % |
| Effingham region  | 75,750               | 8.8                  | % | 86,542               | 10.8                 | % |
| Decatur region    | 197,063              | 22.9                 | % | 201,246              | 20.6                 | % |
| Peoria region     | 143,955              | 16.7                 | % | 133,736              | 15.5                 | % |
| Highland region   | 110,775              | 12.9                 | % | 111,426              | 13.8                 | % |
| Total all regions | \$860,074            | 100.0                | % | \$804,581            | 100.0                | % |

Loans are geographically dispersed among these regions located in central and southwestern Illinois. During 2011, certain branch facilities were moved from the Decatur region to the Sullivan region for internal classification purposes which primarily accounts for the increase in 2011 for the Sullivan region. While these regions have experienced some economic stress during 2011 and 2010, the Company does not consider these locations high risk areas since these regions have not experienced the significant declines in real estate values seen in other areas in the United States.

The Company does not have a concentration, as defined by the regulatory agencies, in construction and land development loans or commercial real estate loans as a percentage of total risk-based capital for the periods shown above. At December 31, 2011 and 2010, the Company did have industry loan concentrations in excess of 25% of total risk-based capital in the following industries (dollars in thousands):

|  | 2011                 |                      |   | 2010                 |                      |   |
|--|----------------------|----------------------|---|----------------------|----------------------|---|
|  | Principal<br>balance | Outstanding<br>loans | % | Principal<br>balance | Outstanding<br>Loans | % |
| Other grain farming                          | \$120,061            | 13.17                | % | \$108,149            | 13.44                | % |
| Lessors of non-residential buildings         | 82,557               | 9.50                 | % | 87,236               | 10.84                | % |
| Lessors of residential buildings & dwellings | 44,009               | 5.06                 | % | 49,484               | 6.15                 | % |
| Hotels and motels                            | 46,842               | 5.64                 | % | 49,679               | 6.17                 | % |

The Company had no further industry loan concentrations in excess of 25% of total risk-based capital.

The following table presents the balance of loans outstanding as of December 31, 2011, by contractual maturities (in thousands):

|  | Maturity (1)           |                              |                 | Total |
|--|------------------------|------------------------------|-----------------|-------|
|  | One year<br>or less(2) | Over 1<br>through 5<br>years | Over<br>5 years |       |
|  |                        |                              |                 |       |

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|                                    |           |           |           |           |
|------------------------------------|-----------|-----------|-----------|-----------|
| Construction and land development  | \$12,286  | \$10,724  | \$126     | \$23,136  |
| Farm loans                         | 6,798     | 44,974    | 20,813    | 72,585    |
| 1-4 Family residential properties  | 22,326    | 90,552    | 68,971    | 181,849   |
| Multifamily residential properties | 2,678     | 13,408    | 3,760     | 19,846    |
| Commercial real estate             | 39,671    | 197,203   | 84,127    | 321,001   |
| Loans secured by real estate       | 83,759    | 356,861   | 177,797   | 618,417   |
| Agricultural loans                 | 44,064    | 18,679    | 514       | 63,257    |
| Commercial and industrial loans    | 98,091    | 43,825    | 8,800     | 150,716   |
| Consumer loans                     | 4,028     | 11,982    | 261       | 16,271    |
| All other loans                    | 2,577     | 2,218     | 6,618     | 11,413    |
| Total loans                        | \$232,519 | \$433,565 | \$193,990 | \$860,074 |

(1) Based upon remaining contractual maturity.

(2) Includes demand loans, past due loans and overdrafts.

As of December 31, 2011, loans with maturities over one year consisted of \$566.4 million in fixed rate loans and \$61.2 million in variable rate loans. The loan maturities noted above are based on the contractual provisions of the individual loans. The Company has no general policy regarding renewals and borrower requests, which are handled on a case-by-case basis.

#### Nonperforming Loans and Repossessed Assets

Nonperforming loans include: (a) loans accounted for on a nonaccrual basis; (b) accruing loans contractually past due ninety days or more as to interest or principal payments; and (c) loans not included in (a) and (b) above which are defined as “restructured loans”. Repossessed assets include primarily repossessed real estate and automobiles.

The Company’s policy is to discontinue the accrual of interest income on any loan for which principal or interest is ninety days past due. The accrual of interest is discontinued earlier when, in the opinion of management, there is reasonable doubt as to the timely collection of interest or principal. Once interest accruals are discontinued, accrued but uncollected interest is charged to current year income. Subsequent receipts on non-accrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured. Nonaccrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collection of interest or principal.

Restructured loans are loans on which, due to deterioration in the borrower’s financial condition, the original terms have been modified in favor of the borrower or either principal or interest has been forgiven.

Repossessed assets represent property acquired as the result of borrower defaults on loans. These assets are recorded at estimated fair value, less estimated selling costs, at the time of foreclosure or repossession. Write-downs occurring at foreclosure are charged against the allowance for loan losses. On an ongoing basis, properties are appraised as required by market indications and applicable regulations. Write-downs for subsequent declines in value are recorded in non-interest expense in other real estate owned along with other expenses related to maintaining the properties.

The following table presents information concerning the aggregate amount of nonperforming loans and repossessed assets (in thousands):

|  | December 31, |          |          |         |         |
|--|--------------|----------|----------|---------|---------|
|  | 2011         | 2010     | 2009     | 2008    | 2007    |
| Nonaccrual loans   | \$6,723      | \$9,332  | \$12,720 | \$7,285 | \$7,460 |
| Restructured loans which are performing in accordance          |              |          |          |         |         |
| with revised terms   | 717          | 1,102    | -        | -       | 21      |
| Total nonperforming loans                                      | 7,440        | 10,434   | 12,720   | 7,285   | 7,481   |
| Repossessed assets   | 4,606        | 6,199    | 2,896    | 2,400   | 524     |
| Total nonperforming loans and repossessed assets               | \$12,046     | \$16,633 | \$15,616 | \$9,685 | \$8,005 |
| Nonperforming loans to loans, before allowance for loan losses | 0.87         | % 1.30   | % 1.82   | % .98   | % 1.00  |
| Nonperforming loans and repossessed assets to loans,           |              |          |          |         |         |
| before allowance for loan losses                               | 1.40         | % 2.07   | % 2.23   | % 1.31  | % 1.07  |

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The \$2,609,000 decrease in nonaccrual loans during 2011 resulted from the net of \$3,740,000 of loans put on nonaccrual status, offset by \$1,627,000 of loans transferred to other real estate owned, \$1,603,000 of loans charged off and \$3,119,000 of loans becoming current or paid-off. The following table summarizes the composition of nonaccrual loans (in thousands):

|                                    | December 31, 2011 |            | December 31, 2010 |            |   |
|------------------------------------|-------------------|------------|-------------------|------------|---|
|                                    | Balance           | % of Total | Balance           | % of Total |   |
| Construction and land development  | \$833             | 12.4       | % \$1,955         | 20.9       | % |
| Farm loans                         | 532               | 7.9        | % 540             | 5.8        | % |
| 1-4 Family residential properties  | 1,712             | 25.5       | % 2,565           | 27.5       | % |
| Multifamily residential properties | -                 | -          | % 573             | 6.1        | % |
| Commercial real estate             | 2,245             | 33.4       | % 2,149           | 23.0       | % |
| Loans secured by real estate       | 5,322             | 79.2       | % 7,782           | 83.3       | % |
| Agricultural loans                 | 673               | 10.0       | % 828             | 8.9        | % |
| Commercial and industrial loans    | 720               | 10.7       | % 708             | 7.6        | % |
| Consumer loans                     | 8                 | 0.1        | % 14              | 0.2        | % |
| Total nonaccrual loans             | \$6,723           | 100.0      | % \$9,332         | 100.0      | % |

Interest income that would have been reported if nonaccrual and restructured loans had been performing totaled \$239,000, \$428,000 and \$672,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

The \$1,593,000 decrease in repossessed assets during 2011 resulted from the net of \$2,646,000 of additional assets repossessed, \$1,207,000 of further write-downs of repossessed assets to current market value and \$3,032,000 of repossessed assets sold. The following table summarizes the composition of repossessed assets (in thousands):

|                                    | December 31, 2011 |            | December 31, 2010 |            |   |
|------------------------------------|-------------------|------------|-------------------|------------|---|
|                                    | Balance           | % of Total | Balance           | % of Total |   |
| Construction and land development  | \$694             | 15.1       | % \$1,234         | 19.9       | % |
| 1-4 Family residential properties  | 571               | 12.4       | % 514             | 8.3        | % |
| Multifamily residential properties | 43                | 0.9        | % 170             | 2.7        | % |
| Commercial real estate             | 3,298             | 71.6       | % 4,209           | 67.9       | % |
| Total real estate                  | 4,606             | 100.0      | % 6,127           | 98.8       | % |
| Other collateral                   | -                 | -          | % 72              | 1.2        | % |
| Total repossessed collateral       | \$4,606           | 100.0      | % \$6,199         | 100.0      | % |

Repossessed assets sold during 2011 resulted in net gains of \$173,000, of which a net gain of \$174,000 was related to real estate asset sales and a net loss of \$1,000 was related to other repossessed asset sales. Repossessed assets sold during 2010 resulted in net gains of \$15,000, of which \$12,000 was related to real estate asset sales and \$3,000 was related to other repossessed asset sales.

#### Loan Quality and Allowance for Loan Losses

The allowance for loan losses represents management's estimate of the reserve necessary to adequately account for the estimate of potential losses inherent in the current portfolio. The provision for loan losses is the charge against current earnings that is determined by management as the amount needed to maintain an adequate allowance for loan losses. In determining the adequacy of the allowance for loan losses, and therefore the provision to be charged to current earnings, management relies predominantly on a disciplined credit review and approval process that extends to the full range of the Company's credit exposure. The review process is directed by overall lending policy and is intended to identify, at the earliest possible stage, borrowers who might be facing financial difficulty. Once identified, the magnitude of exposure to individual borrowers is quantified in the form of specific allocations of the allowance for loan losses. Management considers collateral values and guarantees in the determination of such specific allocations. Additional factors considered by management in evaluating the overall adequacy of the allowance include historical net loan losses, the level and composition of nonaccrual, past due and renegotiated loans, trends in volumes and terms of loans, effects of changes in risk selection and underwriting standards or lending practices, lending staff changes, concentrations of credit, industry conditions and the current economic conditions in the region where the Company operates.

Given the state of the economy, management did assess the impact of the recent recession on each category of loans and adjusted historical loss factors for more recent economic trends. Management utilizes a five-year loss history as one component in assessing the probability of inherent future losses. Given the decline in economic conditions, management also increased its allocation to various loan categories for economic factors during 2010 and 2009. Some of the economic factors include the potential for reduced cash flow for commercial operating loans from reduction in sales or increased operating costs, decreased occupancy rates for commercial buildings, reduced levels of home sales for commercial land developments, the uncertainty regarding grain prices and increased operating costs for farmers, and increased levels of unemployment and bankruptcy impacting consumer's ability to pay. Each of these economic



uncertainties was taken into consideration in developing the level of the reserve. Management considers the allowance for loan losses a critical accounting policy.

Management recognizes there are risk factors that are inherent in the Company's loan portfolio. All financial institutions face risk factors in their loan portfolios because risk exposure is a function of the business. The Company's operations (and therefore its loans) are concentrated in east central Illinois, an area where agriculture is the dominant industry. Accordingly, lending and other business relationships with agriculture-based businesses are critical to the Company's success. At December 31, 2011, the Company's loan portfolio included \$135.8 million of loans to borrowers whose businesses are directly related to agriculture. Of this amount, \$120.1 million was concentrated in other grain farming. Total loans to borrowers whose businesses are directly related to agriculture increased \$12.5 million from \$123.3 million at December 31, 2010 while loans concentrated in other grain farming increased \$12.0 million from \$108.1 million at December 31, 2010. While the Company adheres to sound underwriting practices, including collateralization of loans, any extended period of low commodity prices, significantly reduced yields on crops and/or reduced levels of government assistance to the agricultural industry could result in an increase in the level of problem agriculture loans and potentially result in loan losses within the agricultural portfolio.

In addition, the Company has \$46.8 million of loans to motels and hotels. The performance of these loans is dependent on borrower specific issues as well as the general level of business and personal travel within the region. While the Company adheres to sound underwriting standards, a prolonged period of reduced business or personal travel could result in an increase in nonperforming loans to this business segment and potentially in loan losses. The Company also has \$82.6 million of loans to lessors of non-residential buildings and \$44.0 million of loans to lessors of residential buildings and dwellings.

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Analysis of the allowance for loan losses for the past five years and of changes in the allowance for these periods is summarized as follows (dollars in thousands):

|  | 2011       | 2010       | 2009       | 2008       | 2007       |
|--|------------|------------|------------|------------|------------|
| Average loans outstanding, net of unearned income                        | \$ 807,463 | \$ 718,669 | \$ 701,521 | \$ 740,083 | \$ 728,790 |
| Allowance-beginning of year  | \$ 10,393  | \$ 9,462   | \$ 7,587   | \$ 6,118   | \$ 5,876   |
| Charge-offs:   |            |            |            |            |            |
| Real estate-mortgage   | 2,625      | 2,551      | 1,240      | 1,640      | 368        |
| Commercial, financial and agricultural                                   | 881        | 287        | 287        | 479        | 180        |
| Installment  | 92         | 103        | 176        | 119        | 100        |
| Other  | 162        | 181        | 176        | 184        | 215        |
| Total charge-offs  | 3,760      | 3,122      | 1,879      | 2,422      | 863        |
| Recoveries:  |            |            |            |            |            |
| Real estate-mortgage   | 1,171      | 146        | 6          | 75         | 9          |
| Commercial, financial and agricultural                                   | 97         | 35         | 27         | 98         | 48         |
| Installment  | 28         | 29         | 31         | 38         | 33         |
| Other  | 90         | 106        | 96         | 121        | 153        |
| Total recoveries   | 1,386      | 316        | 160        | 332        | 243        |
| Net charge-offs  | 2,374      | 2,806      | 1,719      | 2,090      | 620        |
| Provision for loan losses  | 3,101      | 3,737      | 3,594      | 3,559      | 862        |
| Allowance-end of year  | \$ 11,120  | \$ 10,393  | \$ 9,462   | \$ 7,587   | \$ 6,118   |
| Ratio of net charge-offs to average loans                                | .29        | % .39      | % .25      | % .28      | % .09      |
| Ratio of allowance for loan losses to loans outstanding (at end of year) | 1.29       | % 1.29     | % 1.35     | % 1.02     | % .82      |
| Ratio of allowance for loan losses to nonperforming loans                | 149.5      | % 99.6     | % 74.4     | % 104.1    | % 81.8     |

The ratio of the allowance for loan losses to nonperforming loans is 149.5% as of December 31, 2011 compared to 99.6% as of December 31, 2010. As of December 31, 2011, the balance of non-performing loans decreased from December 31, 2010. Also, increases in the size of the loan portfolio and the estimated potential losses in the portfolio resulted in an increase in the allowance for loan losses as of December 31, 2011. The combination of these components resulted in the increase in the ratio of the allowance for loan losses to nonperforming loans.

The Company minimizes credit risk by adhering to sound underwriting and credit review policies. These policies are reviewed at least annually, and the Board of Directors approves all changes. Senior management is actively involved in business development efforts and the maintenance and monitoring of credit underwriting and approval. The loan review system and controls are designed to identify, monitor and address asset quality problems in an accurate and timely manner. At least quarterly, the Board of Directors reviews the status of problem loans. In addition to internal policies and controls, regulatory authorities periodically review asset quality and the overall adequacy of the allowance for loan losses.

During 2011, the Company had net charge-offs of \$2,374,000 compared to \$2,806,000 in 2010 and \$1,719,000 in 2009. During 2011, the Company's significant charge-offs included \$378,000 on commercial loans of two borrowers and \$1,746,000 of commercial real estate mortgage loans of six borrowers. The Company also had a significant recovery of \$1,050,000 on a commercial real estate loan of one borrower that was charged off in a prior year. During 2010, the Company's significant charge-offs included \$2,076,000 of commercial real estate mortgage loans of four borrowers. During 2009, the Company's significant charge-offs included \$173,000 on commercial loans of two

borrowers, \$107,000 of real estate mortgage loans of one borrower and \$902,000 of commercial real estate mortgage loans of four borrowers.

At December 31, 2011, the allowance for loan losses amounted to \$11,120,000, or 1.29% of total loans, and 149.5% of nonperforming loans. At December 31, 2010, the allowance for loan losses amounted to \$10,393,000, or 1.29% of total loans, and 99.6% of nonperforming loans.

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The allowance is allocated to the individual loan categories by a specific allocation for all classified loans plus a percentage of loans not classified based on historical losses and other factors. The allowance for loan losses, in management's judgment, is allocated as follows to cover probable loan losses (dollars in thousands):

|   | December 31, 2011         |                           | December 31, 2010         |                           | December 31, 2009         |                           |  |  |
|---|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|--|--|
|   | Allowance for loan losses | % of loans to total Loans | Allowance for loan losses | % of loans to total loans | Allowance for loan losses | % of loans to total loans |  |  |
| Residential real estate                 | \$636                     | 21.5 %                    | \$440                     | 25.1 %                    | \$488                     | 28.5 %                    |  |  |
| Commercial / Commercial real estate     | 8,791                     | 58.8 %                    | 8,307                     | 55.7 %                    | 7,428                     | 51.4 %                    |  |  |
| Agricultural / Agricultural real estate | 546                       | 15.2 %                    | 404                       | 15.3 %                    | 315                       | 16.6 %                    |  |  |
| Consumer                                | 239                       | 1.9 %                     | 282                       | 2.4 %                     | 312                       | 3.0 %                     |  |  |
| Other                                   | 139                       | 2.6 %                     | 110                       | 1.5 %                     | 98                        | .5 %                      |  |  |
| Total allocated                         | 10,351                    |                           | 9,543                     |                           | 8,641                     |                           |  |  |
| Unallocated                             | 769                       | N/A                       | 850                       | N/A                       | 821                       | N/A                       |  |  |
| Allowance at end of year                | \$11,120                  | 100.0 %                   | \$10,393                  | 100.0 %                   | \$9,462                   | 100.0 %                   |  |  |

|   | December 31, 2008         |                           | December 31, 2007         |                           |  |  |
|---|---------------------------|---------------------------|---------------------------|---------------------------|--|--|
|   | Allowance for loan losses | % of loans to total loans | Allowance for loan losses | % of loans to total loans |  |  |
| Residential real estate                 | \$510                     | 30.2 %                    | \$214                     | 29.9 %                    |  |  |
| Commercial / Commercial real estate     | 5,345                     | 49.5 %                    | 3,828                     | 50.1 %                    |  |  |
| Agricultural / Agricultural real estate | 223                       | 16.1 %                    | 531                       | 15.2 %                    |  |  |
| Consumer                                | 358                       | 3.5 %                     | 404                       | 4.0 %                     |  |  |
| Other                                   | 78                        | .7 %                      | 22                        | .8 %                      |  |  |
| Total allocated                         | 6,514                     |                           | 4,999                     |                           |  |  |
| Unallocated                             | 1,073                     | N/A                       | 1,119                     | N/A                       |  |  |
| Allowance at end of year                | \$7,587                   | 100.0 %                   | \$6,118                   | 100.0 %                   |  |  |

The unallocated allowance represents an estimate of the probable, inherent, but yet undetected, losses in the loan portfolio. It is based on factors that cannot necessarily be associated with a specific credit or loan category and represents management's estimate to ensure that the overall allowance of loan losses appropriately reflects a margin for the imprecision necessarily inherent in the estimates of expected credit losses. Fluctuations in the unallocated portion of the allowance result from qualitative factors such as economic conditions, expansionary activities, and portfolio composition that influence the level of risk in the portfolio but are not specifically quantified.



## Deposits

Funding of the Company's earning assets is substantially provided by a combination of consumer, commercial and public fund deposits. The Company continues to focus its strategies and emphasis on retail core deposits, the major component of funding sources. The following table sets forth the average deposits and weighted average rates for 2011, 2010 and 2009 (dollars in thousands):

|                        | 2011            |                       | 2010            |                       | 2009            |                       |
|------------------------|-----------------|-----------------------|-----------------|-----------------------|-----------------|-----------------------|
|                        | Average Balance | Weighted Average Rate | Average Balance | Weighted Average Rate | Average Balance | Weighted Average Rate |
| Demand deposits:       |                 |                       |                 |                       |                 |                       |
| Non-interest bearing   | \$197,246       | -                     | \$142,125       | -                     | \$119,537       | -                     |
| Interest bearing       | 499,184         | .47 %                 | 421,743         | .76 %                 | 332,751         | 1.26 %                |
| Savings                | 251,268         | .59 %                 | 165,337         | .77 %                 | 109,305         | .92 %                 |
| Time deposits          | 264,508         | 1.10 %                | 243,606         | 1.64 %                | 301,987         | 3.91 %                |
| Total average deposits | \$1,212,206     | .56 %                 | \$972,811       | .87 %                 | \$863,580       | 2.08 %                |

| (dollars in thousands)                    | December 31, |             |           |
|---|--------------|-------------|-----------|
|   | 2011         | 2010        | 2009      |
| High month-end balances of total deposits | \$1,233,633  | \$1,227,528 | \$906,853 |
| Low month-end balances of total deposits  | 1,170,734    | 842,653     | 831,157   |

In 2011, the average balance of deposits increased by \$239,000 from 2010. The increase was primarily attributable to increases in non-interest bearing, money market and savings account balances. Average non-interest bearing deposits increased by \$55.1 million, average money market account balances increased by \$55.1 million, and average savings account balances increased by \$85.9 million. In 2010, the average balance of deposits increased by \$109.2 million from 2009. The increase was primarily attributable to the addition of \$337 million of deposits assumed in the acquisition of the Branches offset by decreases in higher rate time deposits. Average non-interest bearing deposits increased by \$22.6 million, average money market account balances increased by \$64.8 million, average savings account balances increased by \$56 million and average NOW account balances increased by \$24.2 million offset by a decline in consumer CD balances.

The following table sets forth the maturity of time deposits of \$100,000 or more (in thousands):

|                          | December 31, |          |          |
|--------------------------|--------------|----------|----------|
|                          | 2011         | 2010     | 2009     |
| 3 months or less         | \$17,095     | \$31,277 | \$24,951 |
| Over 3 through 6 months  | 11,037       | 14,430   | 8,622    |
| Over 6 through 12 months | 22,126       | 24,906   | 29,852   |
| Over 12 months           | 17,596       | 18,315   | 18,267   |
| Total                    | \$67,854     | \$88,928 | \$81,692 |

The balance of time deposits of \$100,000 or more decreased \$21.1 million from December 31, 2010 to December 31, 2011. The decrease in balance was primarily attributable to higher rate time deposits that matured and were not replaced. The balance of time deposits of \$100,000 or more increased \$7.2 million from December 31, 2009 to December 31, 2010. The decrease in balances was primarily attributable to time deposits acquired in the acquisition of the Branches.

In 2011 the Company maintained account relationships with various public entities throughout its market areas. Four public entities had total balances of \$28.7 million in various checking accounts and time deposits as of December 31, 2011. These balances are subject to change depending upon the cash flow needs of the public entity.

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## Repurchase Agreements and Other Borrowings

Securities sold under agreements to repurchase are short-term obligations of First Mid Bank. First Mid Bank collateralizes these obligations with certain government securities that are direct obligations of the United States or one of its agencies. First Mid Bank offers these retail repurchase agreements as a cash management service to its corporate customers. Other borrowings consist of Federal Home Loan Bank (“FHLB”) advances, federal funds purchased, junior subordinated debentures and loans (short-term or long-term debt) that the Company has outstanding.

Information relating to securities sold under agreements to repurchase and other borrowings for the last three years is presented below (dollars in thousands):

|  | 2011              | 2010              | 2009              |
|--|-------------------|-------------------|-------------------|
| <b>At December 31:</b>                         |                   |                   |                   |
| Securities sold under agreements to repurchase | \$ 132,380        | \$ 94,057         | \$ 80,386         |
| Federal Home Loan Bank advances:               |                   |                   |                   |
| Fixed term – due in one year or less           | 14,750            | 3,000             | 10,000            |
| Fixed term – due after one year                | 5,000             | 19,750            | 22,750            |
| Junior subordinated debentures                 | 20,620            | 20,620            | 20,620            |
| Debt due in one year or less                   | 8,250             | -                 | -                 |
| <b>Total</b>                                   | <b>\$ 181,000</b> | <b>\$ 137,427</b> | <b>\$ 133,756</b> |
| Average interest rate at year end              | 1.13              | % 1.81            | % 2.10            |
| <b>Maximum Outstanding at Any Month-end</b>    |                   |                   |                   |
| Securities sold under agreements to repurchase | \$ 132,380        | \$ 94,530         | \$ 83,826         |
| Federal Home Loan Bank advances:               |                   |                   |                   |
| Fixed term – due in one year or less           | 14,750            | 10,000            | 15,000            |
| Fixed term – due after one year                | 14,750            | 22,750            | 32,750            |
| Junior subordinated debentures                 | 20,620            | 20,620            | 20,620            |
| Debt due in one year or less                   | 8,250             | 2,000             | -                 |
| Debt due after one year                        | -                 | -                 | 13,000            |
| <b>Averages for the Year</b>                   |                   |                   |                   |
| Federal funds purchased                        | 14                | 5                 | 3                 |
| Securities sold under agreements to repurchase | 108,240           | 76,758            | 72,589            |
| Federal Home Loan Bank advances:               |                   |                   |                   |
| Fixed term – due in one year or less           | 9,866             | 4,984             | 10,041            |
| Fixed term – due after one year                | 10,372            | 21,109            | 26,134            |
| Junior subordinated debentures                 | 20,620            | 20,620            | 20,620            |
| Debt due in one year or less                   | 927               | 645               | -                 |
| Debt due after one year                        | -                 | -                 | 1,498             |
| <b>Total</b>                                   | <b>\$ 150,039</b> | <b>\$ 124,121</b> | <b>\$ 130,885</b> |
| Average interest rate during the year          | 1.19              | % 1.94            | % 2.19            |

FHLB advances represent borrowings by First Mid Bank to economically fund loan demand. The fixed term advances consist of \$19.75 million as follows:

- \$5 million advance at 4.82% with a 5-year maturity, due January 19, 2012, two year lockout, callable quarterly
- \$5 million advance at 4.69% with a 5-year maturity, due February 23, 2012, two year lockout, callable quarterly
  - \$4.75 million advance at 1.60% with a 5-year maturity, due December 24, 2012
- \$5 million advance at 4.58% with a 10-year maturity, due July 14, 2016, one year lockout, callable quarterly





At December 31, 2011 and 2010, there was no outstanding loan balance on a revolving credit agreement with The Northern Trust Company. This loan was renewed on April 22, 2011. The revolving credit agreement has a maximum available balance of \$20 million with a term of one year from the date of closing. The interest rate (2.375% at December 31, 2011) is floating at 2.25% over the federal funds rate. The loan is unsecured and subject to a borrowing agreement containing requirements for the Company and First Mid Bank to maintain various operating and capital ratios. The Company and First Mid Bank were in compliance with all the existing covenants at December 31, 2011 and 2010.

On February 11, 2011, the Company accepted from certain accredited investors, including directors, executive officers, and certain major customers and holders of the Company's common stock (collectively, the "Investors"), subscriptions for the purchase of \$27,500,000, in the aggregate, of the Series C Preferred Stock. As of February 11, 2011, \$11,010,000 of the Series C Preferred Stock had been issued and sold by the Company to certain Investors. On March 2, 2011, three Investors subsequently completed the required bank regulatory process and an additional \$2,750,000 of Series C Preferred Stock was issued and sold by the Company to these Investors. On May 13, 2011, four additional Investors received the required bank regulatory approval and an additional \$5,490,000 of Series C Preferred Stock was issued and sold by the Company to these Investors. The balance of the Series C Preferred Stock will be issued to the remaining Investors upon the completion of the bank regulatory process, to which the issuance of the Series C Preferred Stock is subject, applicable to their purchases. These remaining Investors have not yet been issued their shares of Series C Preferred Stock because of unanticipated delays in applying for and obtaining the approval of the Federal Reserve Board. These Investors are (a) individuals who are members of the Lumpkin family, including Benjamin I. Lumpkin, a director of the Company, and (b) entities controlled by, and trusts created for the benefit of, individuals who are members of the Lumpkin family (collectively, the "Remaining Investors"). The Company has previously accepted from the Remaining Investors subscriptions for \$8,250,000 of the Series C Preferred Stock pursuant to their respective subscription agreements.

Pursuant to the terms of the Series C Preferred Stock, the Series C Preferred Stock is both redeemable and mandatorily convertible at the Company's discretion into common stock of the Company, subject to certain conditions being met, no earlier than 60 months following the date on which a majority of the Series C Preferred Stock has been issued. The date on which a majority of the Series C Preferred Stock became issued was May 13, 2011 (the "Majority Issuance Date"). As a result of the Remaining Investors not being issued their subscribed for shares of Series C Preferred Stock by the Majority Issuance Date, it is possible that, if certain conditions are met, the Company could redeem or mandatorily convert the Series C Preferred Stock into common stock of the Company prior to the Remaining Investors holding their subscribed shares of Series C Preferred Stock for 60 months, thus resulting in the Remaining Investors receiving less than 60 months of 8% dividends on the Series C Preferred Stock subscribed for.

In November 2011, the disinterested members of the Board of Directors of the Company approved and authorized, and the Remaining Investors agreed to, certain amendments to the Series C Preferred Stock subscription agreements resulting in the release to the Company of the funds escrowed by the Remaining Investors for their subscribed shares of the Series C Preferred Stock and the issuance by the Company of short-term unsecured promissory notes, which are dated November 21, 2011, to the Remaining Investors. The promissory notes (the "Notes") collectively have an aggregate principal amount of \$8,250,000 and each have an 8% annual interest rate. Each Note also contains a prepayment provision applicable when approval from the Federal Reserve Board is received to allow the Remaining Investors to purchase the shares of Series C Preferred Stock originally subscribed. Additionally, if the Company experiences an Event of Default as defined in the Note, such as becoming insolvent or generally failing to pay its debts as they become due, then a Remaining Investor may, at his, her or its option, declare the entire unpaid amount of the Note immediately due and payable, without presentment, demand, portents or notice of any kind, and the Remaining Investor shall be entitled to recover from the Company all costs and expenses, including reasonable attorneys' fees and disbursements and court costs, incurred in enforcing the Remaining Investor's rights under the Note.

On February 27, 2004, the Company completed the issuance and sale of \$10 million of floating rate trust preferred securities through Trust I, a statutory business trust and wholly-owned unconsolidated subsidiary of the Company, as part of a pooled offering. The Company established Trust I for the purpose of issuing the trust preferred securities. The \$10 million in proceeds from the trust preferred issuance and an additional \$310,000 for the Company's investment in common equity of the Trust, a total of \$10,310,000, was invested in junior subordinated debentures of the Company. The underlying junior subordinated debentures issued by the Company to Trust I mature in 2034, bear interest at three-month London Interbank Offered Rate ("LIBOR") plus 280 basis points, reset quarterly, and are callable, at the option of the Company, at par on or after April 7, 2009. At December 31, 2011 and 2010 the rate was 3.10% and 3.15%, respectively. The Company used the proceeds of the offering for general corporate purposes.

On April 26, 2006, the Company completed the issuance and sale of \$10 million of fixed/floating rate trust preferred securities through Trust II, a statutory business trust and wholly-owned unconsolidated subsidiary of the Company, as part of a pooled offering. The Company established Trust II for the purpose of issuing the trust preferred securities. The \$10 million in proceeds from the trust preferred issuance and an additional \$310,000 for the Company's investment in common equity of Trust II, a total of \$10,310,000, was invested in junior subordinated debentures of the Company. The underlying junior subordinated debentures issued by the Company to Trust II mature in 2036, bore interest at a fixed rate of 6.98% paid quarterly until June 15, 2011 and then converted to floating rate (LIBOR plus 160 basis points) after June 15, 2011 (1.95% at December 31, 2011). The net proceeds to the Company were used for general corporate purposes, including the Company's acquisition of Mansfield.

The trust preferred securities issued by Trust I and Trust II are included as Tier 1 capital of the Company for regulatory capital purposes. On March 1, 2005, the Federal Reserve Board adopted a final rule that allows the continued limited inclusion of trust preferred securities in the calculation of Tier 1 capital for regulatory purposes. The final rule provided a five-year transition period, ending September 30, 2010, for application of the revised quantitative limits. On March 17, 2009, the Federal Reserve Board adopted an additional final rule that delayed the effective date of the new limits on inclusion of trust preferred securities in the calculation of Tier 1 capital until September 30, 2011. The Company does not expect the application of the revised quantitative limits to have a significant impact on its calculation of Tier 1 capital for regulatory purposes or its classification as well-capitalized. The Dodd-Frank Act, signed into law July 21, 2010, removes trust preferred securities as a permitted component of a holding company's Tier 1 capital after a three-year phase-in period beginning January 1, 2013 for larger holding companies. For holding companies with less than \$15 billion in consolidated assets, existing issues of trust preferred securities are grandfathered and not subject to this new restriction. Therefore, the existing trust preferred securities issued by Trust I and Trust II will continue to count as Tier 1 capital. New issuances of trust preferred securities, however would not count as Tier 1 regulatory capital.

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## Interest Rate Sensitivity

The Company seeks to maximize its net interest margin while maintaining an acceptable level of interest rate risk. Interest rate risk can be defined as the amount of forecasted net interest income that may be gained or lost due to changes in the interest rate environment, a variable over which management has no control. Interest rate risk, or sensitivity, arises when the maturity or repricing characteristics of assets differ significantly from the maturity or repricing characteristics of liabilities.

The Company monitors its interest rate sensitivity position to maintain a balance between rate-sensitive assets and rate-sensitive liabilities. This balance serves to limit the adverse effects of changes in interest rates. The Company's asset/liability management committee ("ALCO") oversees the interest rate sensitivity position and directs the overall allocation of funds.

In the banking industry, a traditional way to measure potential net interest income exposure to changes in interest rates is through a technique known as "static GAP" analysis which measures the cumulative differences between the amounts of assets and liabilities maturing or repricing at various intervals. By comparing the volumes of interest-bearing assets and liabilities that have contractual maturities and repricing points at various times in the future, management can gain insight into the amount of interest rate risk embedded in the balance sheet.

The following table sets forth the Company's interest rate repricing gaps for selected maturity periods at December 31, 2011 (dollars in thousands):

|  | Rate Sensitive Within |                  |                  |                  |                  |                  | Total              | Fair Value         |
|--|-----------------------|------------------|------------------|------------------|------------------|------------------|--------------------|--------------------|
|  | 1 year                | 1-2 years        | 2-3 years        | 3-4 years        | 4-5 years        | Thereafter       |                    |                    |
| <b>Interest-earning assets:</b>                        |                       |                  |                  |                  |                  |                  |                    |                    |
| Federal funds sold and other interest-bearing deposits | \$29,746              | \$-              | \$-              | \$-              | \$-              | \$-              | \$29,746           | \$29,746           |
| Certificates of deposit investments                    | 13,231                | -                | -                | -                | -                | -                | 13,231             | 13,225             |
| Taxable investment securities                          | 25,142                | 11,220           | 11,992           | 34,600           | 24,187           | 330,573          | 437,714            | 437,714            |
| Nontaxable investment securities                       | 255                   | 528              | 368              | 583              | 826              | 38,693           | 41,253             | 41,253             |
| Loans  | 402,580               | 167,231          | 104,718          | 77,654           | 88,649           | 19,242           | 860,074            | 862,474            |
| <b>Total</b>   | <b>\$470,954</b>      | <b>\$178,979</b> | <b>\$117,078</b> | <b>\$112,837</b> | <b>\$113,662</b> | <b>\$388,508</b> | <b>\$1,382,018</b> | <b>\$1,384,412</b> |
| <b>Interest-bearing liabilities:</b>                   |                       |                  |                  |                  |                  |                  |                    |                    |
| Savings and N.O.W. accounts                            | \$85,081              | \$28,434         | \$29,472         | \$40,886         | \$42,048         | \$247,967        | \$473,888          | \$473,888          |
| Money market accounts                                  | 230,996               | 2,697            | 2,771            | 3,595            | 3,670            | 19,400           | 263,129            | 263,129            |
| Other time deposits                                    | 180,195               | 26,429           | 8,687            | 9,318            | 9,798            | 328              | 234,755            | 236,090            |

|  |             |            |           |          |           |           |             |             |
|--|-------------|------------|-----------|----------|-----------|-----------|-------------|-------------|
| Short-term borrowings/debt                             | 140,630     | -          | -         | -        | -         | -         | 140,630     | 140,633     |
| Long-term borrowings/debt                              | 35,370      | -          | -         | -        | 5,000     | -         | 40,370      | 32,588      |
| Total  | \$672,272   | \$57,560   | \$40,930  | \$53,799 | \$60,516  | \$267,695 | \$1,152,772 | \$1,138,078 |
| Rate sensitive assets – rate sensitive liabilities     | \$(201,318) | \$121,419  | \$76,148  | \$59,038 | \$53,146  | \$120,813 | \$229,246   |             |
| Cumulative GAP   | \$(201,318) | \$(79,899) | \$(3,751) | \$55,287 | \$108,433 | \$229,246 |             |             |
| Cumulative amounts as % of total rate sensitive assets | -14.6       | % 8.8      | % 5.5     | % 4.3    | % 3.8     | % 8.7     | %           |             |
| Cumulative Ratio                                       | -14.6       | % -5.8     | % -0.3    | % 4.0    | % 7.8     | % 16.6    | %           |             |

The static GAP analysis shows that at December 31, 2011, the Company was liability sensitive, on a cumulative basis, through the twelve-month time horizon. This indicates that future increases in interest rates, if any, could have an adverse effect on net interest income. Conversely, future decreases in interest rates could have a positive effect on net interest income.

There are several ways the Company measures and manages the exposure to interest rate sensitivity, static GAP analysis being one. The Company's ALCO also uses other financial models to project interest income under various rate scenarios and prepayment/extension assumptions consistent with First Mid Bank's historical experience and with known industry trends. ALCO meets at least monthly to review the Company's exposure to interest rate changes as indicated by the various techniques and to make necessary changes in the composition terms and/or rates of the assets and liabilities. Based on all information available, management does not believe that changes in interest rates which might reasonably be expected to occur in the next twelve months will have a material, adverse effect on the Company's net interest income.

## Capital Resources

At December 31, 2011, stockholders' equity increased \$28.7 million or 25.6% to \$140,967,000 from \$112,265,000 as of December 31, 2010. During 2011 net income contributed \$11,372,000 to equity before the payment of dividends to stockholders. The change in the market value of available-for-sale investment securities increased stockholders' equity by \$5,214,000, net of tax. Additional purchases of treasury stock (128,073 shares at an average cost of \$18.63 per share) decreased stockholders' equity by \$2,385,000.

During 2009, the Company sold to certain accredited investors including directors, executive officers, and certain major customers and holders of the Company's common stock, \$24,635,000, in the aggregate, of a newly authorized series of its preferred stock designated as Series B Preferred Stock. Additionally, during 2011, the Company accepted from certain accredited investors including directors, executive officers, and certain major customers and holders of the Company's common stock, subscriptions for the purchase of \$27,500,000, in the aggregate, of a newly authorized series of its preferred stock designated as Series C Preferred Stock. As of December 31, 2011, \$19,250,000 of the Series C Preferred Stock was issued and sold by the Company to certain investors. The balance of the Series C Preferred Stock will be issued to the Remaining Investors upon the completion of the bank regulatory process applicable to their purchases.

As a result of unanticipated delays in applying for and obtaining the approval of the Federal Reserve Board, in November 2011, the disinterested members of the Board of Directors of the Company approved and authorized, and the Remaining Investors agreed to, certain amendments to the Series C Preferred Stock subscription agreements resulting in the release to the Company of the funds escrowed by the Remaining Investors for their subscribed shares of the Series C Preferred Stock and the issuance by the Company of the Notes to the Remaining Investors. Each Note contains a prepayment provision applicable when approval from the Federal Reserve Board is received to allow the Remaining Investors to purchase the shares of Series C Preferred Stock originally subscribed. See the description above under the caption "Repurchase Agreements and Other Borrowings" and "Preferred Stock" in Note 1 to consolidated financial statements for more detailed information.

## Stock Plans

Deferred Compensation Plan. The Company follows the provisions of the Emerging Issues Task Force Issue No. 97-14, "Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested" ("EITF 97-14"), which was codified into ASC 710-10, for purposes of the First Mid-Illinois Bancshares, Inc. Deferred Compensation Plan ("DCP"). At December 31, 2010, the Company classified the cost basis of its common stock issued and held in trust in connection with the DCP of approximately \$2,928,000 as treasury stock. The Company also classified the cost basis of its related deferred compensation obligation of approximately \$2,928,000 as an equity instrument (deferred compensation).

The DCP was effective as of June 1984. The purpose of the DCP is to enable directors, advisory directors, and key employees the opportunity to defer a portion of the fees and cash compensation paid by the Company as a means of maximizing the effectiveness and flexibility of compensation arrangements. The Company invests all participants' deferrals in shares of common stock. Dividends paid on the shares are credited to participants' DCP accounts and invested in additional shares. The Company issued, pursuant to DCP:

- 5,920 common shares during 2011,
- 4,766 common shares during 2010 and
- 9,916 common shares during 2009.

First Retirement and Savings Plan. The First Retirement and Savings Plan (“401(k) plan”) was effective beginning in 1985. Employees are eligible to participate in the 401(k) plan after six months of service with the Company. The Company offers common stock as an investment option for participants of the 401(k) plan. The Company issued, pursuant to the 401(k) plan:

- 9,693 common shares during 2011,
- 19,414 common shares during 2010 and
- 19,000 common shares during 2009.

Dividend Reinvestment Plan. The Dividend Reinvestment Plan (“DRIP”) was effective as of October 1994. The purpose of the DRIP is to provide participating stockholders with a simple and convenient method of investing cash dividends paid by the Company on its common and preferred shares into newly issued common shares of the Company. All holders of record of the Company’s common or preferred stock are eligible to voluntarily participate in the DRIP. The DRIP is administered by Computershare Investor Services, LLC and offers a way to increase one’s investment in the Company. Of the \$2,304,000 in common stock dividends paid during 2011, \$618,000 or 26.8% was reinvested into shares of common stock of the Company through the DRIP. Of the \$3,191,000 in preferred stock dividends paid during 2011, \$190,000 or 5.9% was reinvested into shares of common stock through the DRIP. Events that resulted in common shares being reinvested in the DRIP:

- During 2011, 34,405 common shares were issued from common stock dividends and 10,116 common shares were issued from preferred stock dividends
  - During 2010, 33,879 common shares were issued from common stock dividends and 4,615 common shares were issued from preferred stock dividends
  - During 2009, 42,044 common shares were issued from common stock dividends and 2,617 common shares were issued from preferred stock dividends
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Stock Incentive Plan. At the Annual Meeting of Stockholders held May 23, 2007, the stockholders approved the First Mid-Illinois Bancshares, Inc. 2007 Stock Incentive Plan (“SI Plan”). The SI Plan was implemented to succeed the Company’s 1997 Stock Incentive Plan, which had a ten-year term that expired October 21, 2007. The SI Plan is intended to provide a means whereby directors, employees, consultants and advisors of the Company and its subsidiaries may sustain a sense of proprietorship and personal involvement in the continued development and financial success of the Company and its subsidiaries, thereby advancing the interests of the Company and its stockholders. Accordingly, directors and selected employees, consultants and advisors may be provided the opportunity to acquire shares of Common Stock of the Company on the terms and conditions established herein in the SI Plan.

On September 27, 2011, the Board of Directors passed a resolution authorizing and approving the Executive Long-Term Incentive Plan (“LTIP”). The LTIP was implemented to provide methodology for granting Stock Awards and Stock Unit Awards under the SI Plan to select senior executives of the Company or any subsidiary.

A maximum of 300,000 shares of common stock may be issued under the SI Plan. As of December 31, 2010, the Company had awarded 59,500 shares as stock options under the SI Plan. There were no shares awarded as stock options during 2011. During the third quarter of 2011, the Company awarded 8,161 shares as 50% Stock Awards and 50% Stock Unit Awards under the SI Plan. This SI Plan is more fully described in Note 13-“Stock Incentive Plan.”

Stock Repurchase Program. Since August 5, 1998, the Board of Directors has approved repurchase programs pursuant to which the Company may repurchase a total of approximately \$61.7 million of the Company’s common stock. The repurchase programs approved by the Board of Directors are as follows:

- On August 5, 1998, repurchases of up to 3%, or \$2 million, of the Company’s common stock.
- In March 2000, repurchases up to an additional 5%, or \$4.2 million of the Company’s common stock.
- In September 2001, repurchases of \$3 million of additional shares of the Company’s common stock.
  - In August 2002, repurchases of \$5 million of additional shares of the Company’s common stock.
- In September 2003, repurchases of \$10 million of additional shares of the Company’s common stock.
- On April 27, 2004, repurchases of \$5 million of additional shares of the Company’s common stock.
- On August 23, 2005, repurchases of \$5 million of additional shares of the Company’s common stock.
- On August 22, 2006, repurchases of \$5 million of additional shares of the Company’s common stock.
- On February 27, 2007, repurchases of \$5 million of additional shares of the Company’s common stock.
- On November 13, 2007, repurchases of \$5 million of additional shares of the Company’s common stock.
- On December 16, 2008, repurchases of \$2.5 million of additional shares of the Company’s common stock.
  - On May 26, 2009, repurchases of \$5 million of additional shares of the Company’s common stock.
- On February 22, 2011, repurchases of \$5 million of additional shares of the Company’s common stock.

During 2011, the Company repurchased 128,073 shares (2.1% of common shares) at a total price of \$2,385,000. During 2010, the Company repurchased 136,380 shares (2.3% of common shares) at a total price of \$2,499,000. As of December 31, 2011, approximately \$3.5 million remains available for purchase under the repurchase programs. Treasury stock is further affected by activity in the DCP.



## Capital Ratios

Minimum regulatory requirements for highly-rated banks that do not expect significant growth is 8% for the Total Capital to Risk-Weighted Assets ratio and 3% for the Tier 1 Capital to Average Assets ratio. The Company and First Mid Bank have capital ratios above the minimum regulatory capital requirements and, as of December 31, 2011, the Company and First Mid Bank had capital ratios above the levels required for categorization as well-capitalized under the capital adequacy guidelines established by the bank regulatory agencies.

A tabulation of the Company and First Mid Bank's capital ratios as of December 31, 2011 follows:

|  | Total   |   | Tier One |   | Tier One    |   |
|--|---------|---|----------|---|-------------|---|
|  | Capital | % | Capital  | % | Leverage    |   |
|  | Ratio   |   | Ratio    |   | Ratio       |   |
|  |         |   |          |   | (Capital to |   |
|  |         |   |          |   | Average     |   |
|  |         |   |          |   | Assets)     |   |
| First Mid-Illinois Bancshares, Inc. (Consolidated) | 14.48   | % | 13.37    | % | 8.99        | % |
| First Mid-Illinois Bank & Trust, N.A.              | 12.83   | % | 11.71    | % | 7.85        | % |

## Liquidity

Liquidity represents the ability of the Company and its subsidiaries to meet all present and future financial obligations arising in the daily operations of the business. Financial obligations consist of the need for funds to meet extensions of credit, deposit withdrawals and debt servicing. The Company's liquidity management focuses on the ability to obtain funds economically through assets that may be converted into cash at minimal costs or through other sources. The Company's other sources for cash include overnight federal fund lines, FHLB advances, deposits of the State of Illinois, the ability to borrow at the Federal Reserve Bank, and the Company's operating line of credit with The Northern Trust Company.

Details for the sources include:

- First Mid Bank has \$35 million available in overnight federal fund lines, including \$10 million from U.S. Bank, N.A., \$10 million from Wells Fargo Bank, N.A. and \$15 million from The Northern Trust Company. Availability of the funds is subject to the First Mid Bank's meeting minimum regulatory capital requirements for total capital to risk-weighted assets and Tier 1 capital to total assets. As of December 31, 2011, First Mid Bank met these regulatory requirements.
- In addition, the Company has a revolving credit agreement in the amount of \$20 million with The Northern Trust Company. The Company had an outstanding balance of \$0 with \$20 million in available funds as of December 31, 2011. This loan was renewed on April 22, 2011 for a one year term. The revolving credit agreement has a maximum available balance of \$20 million. The interest rate is floating at 2.25% over the federal funds rate. The loan is unsecured and subject to a borrowing agreement containing requirements for the Company and First Mid Bank, including requirements for operating and capital ratios. The Company and First Mid Bank were in compliance with all the existing covenants at December 31, 2011 and 2010.

- First Mid Bank can also borrow from the FHLB as a source of liquidity. Availability of the funds is subject to the pledging of collateral to the FHLB. Collateral that can be pledged includes 1-4 family residential real estate loans and securities. At December 31, 2011, the excess collateral at the FHLB could support approximately \$75.8 million of additional advances.
- First Mid Bank is also a member of the Federal Reserve System and can borrow funds provided sufficient collateral is pledged.

Management monitors its expected liquidity requirements carefully, focusing primarily on cash flows from:

- lending activities, including loan commitments, letters of credit and mortgage prepayment assumptions;
    - deposit activities, including seasonal demand of private and public funds;
  - investing activities, including prepayments of mortgage-backed securities and call assumptions on U.S. Treasuries and agencies; and
    - operating activities, including scheduled debt repayments and dividends to stockholders.
-

The following table summarizes significant contractual obligations and other commitments at December 31, 2010 (in thousands):

|                                   | Total     | Less than |           |           | More than |
|-----------------------------------|-----------|-----------|-----------|-----------|-----------|
|                                   |           | 1 year    | 1-3 years | 3-5 years | 5 years   |
| Time deposits                     | \$234,755 | \$171,266 | \$39,905  | \$23,256  | \$328     |
| Debt                              | 28,870    | 8,250     | -         | -         | 20,620    |
| Other borrowings                  | 150,246   | 150,246   | -         | -         | -         |
| Operating leases                  | 4,730     | 889       | 1,926     | 892       | 1,023     |
| Supplemental retirement liability | 918       | 50        | 200       | 200       | 468       |
|                                   | \$419,519 | \$330,701 | \$42,031  | \$24,348  | \$22,439  |

For the year ended December 31, 2011, net cash of \$19.0 million and \$14.1 million was provided from operating activities and financing activities, respectively and \$191.5 million was used in investing activities. In total, cash and cash equivalents decreased by \$158.4 million since year-end 2010. Generally, during 2011, the decrease in cash balances was due to cash received related to the acquisition of the Branches being invested in loans and investment securities.

For the year ended December 31, 2010, net cash of \$7.5 million, \$100.5 million and \$33.0 million was provided from operating activities, investing activities and financing activities, respectively. In total, cash and cash equivalents increased by \$141 million since year-end 2009. Generally, during 2010, the increase in cash balances was due to cash received related to the acquisition of the Branches.

For the years ended December 31, 2011 and 2010, the Company also had issued \$10 million of floating rate trust preferred securities through each of Trust I and Trust II. See Note 9 – “Borrowings” for a more detailed description.

#### Effects of Inflation

Unlike industrial companies, virtually all of the assets and liabilities of the Company are monetary in nature. As a result, interest rates have a more significant impact on the Company’s performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or experience the same magnitude of changes as goods and services, since such prices are affected by inflation. In the current economic environment, liquidity and interest rate adjustments are features of the Company’s assets and liabilities that are important to the maintenance of acceptable performance levels. The Company attempts to maintain a balance between monetary assets and monetary liabilities, over time, to offset these potential effects.

#### Adoption of New Accounting Guidance

Accounting Standards Update (“ASU”) No. 2011-02 – A Creditor’s Determination of Whether a Restructuring is a Troubled Debt Restructuring. In April 2011, the FASB issued ASU No. 2011-02. The provisions of ASU No. 2011-02 provide additional guidance related to determining whether a creditor has granted a concession, include factors and examples for creditors to consider in evaluating whether a restructuring results in a delay in payment that is insignificant, prohibit creditors from using the borrower’s effective rate test to evaluate whether a concession has been granted to the borrower, and add factors for creditors to use in determining whether a borrower is experiencing financial difficulties. A provision in ASU No. 2011-02 also ends the FASB’s deferral of the additional disclosures

about troubled debt restructurings as required by ASU No. 2010-20. The provisions of ASU No. 2011-02 are effective for reporting periods ending on or after September 30, 2011. The adoption of ASU No. 2011-02 guidance did not result in any additional loans being classified as TDRs and had no material impact on the Company's financial statements.

ASU No. 2011-04 -- Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. In May 2011, the FASB issued ASU No. 2011-04. ASU 2011-04 changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. Consequently, the amendments in this update result in common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards ("IFRS"). ASU 2011-04 is effective prospectively during interim and annual periods beginning on or after December 15, 2011. Early application by public entities is not permitted. The adoption of ASU No. 2011-04 is not expected to have a material impact on the Company's financial statements.

ASU No. 2011-05 – Presentation of Comprehensive Income. In June 2011, the FASB issued ASU No. 2011-05. The provisions of ASU No. 2011-05 allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The statement(s) are required to be presented with equal prominence as the other primary financial statements. ASU No. 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity but does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The provisions of ASU No. 2011-05 are effective for the Company's interim reporting period beginning on or after December 15, 2011, with retrospective application required. The adoption of ASU No. 2011-05 is expected to result in presentation changes to the Company's statements of changes in stockholders' equity and the addition of a statement of comprehensive income. The adoption of ASU No. 2011-05 will not have a material impact on the Company's financial statements.

ASU 2011-08 — Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment. In September 2011, the FASB issued ASU 2011-08. ASU 2011-08 amends Topic 350 to permit an entity the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. Under the amendments in this guidance, an entity has the option to bypass the qualitative assessment for any reporting unit in any period and proceed directly to performing the first step of the two-step goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period. The amendments do not change the current guidance for testing other indefinite lived intangible assets for impairment. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company's financial statements.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's market risk arises primarily from interest rate risk inherent in its lending, investing and deposit taking activities, which are restricted to First Mid Bank. The Company does not currently use derivatives to manage market or interest rate risks. For a discussion of how management of the Company addresses and evaluates interest rate risk see also "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Interest Rate Sensitivity."

Based on the financial analysis performed as of December 31, 2011, which takes into account how the specific interest rate scenario would be expected to impact each interest-earning asset and each interest-bearing liability, the Company estimates that changes in the prime interest rate would impact First Mid Bank's performance as follows:

|                           | Increase (Decrease) In |              |            |
|---------------------------|------------------------|--------------|------------|
|                           | Net Interest           | Net Interest | Return On  |
| December 31, 2011         | Income                 | Income       | Average    |
| Prime rate is 3.25%       | \$(000 )               | (%)          | Equity     |
|                           |                        |              | 2011=8.52% |
| Prime rate increase of:   |                        |              |            |
| 200 basis points to 5.25% | \$1,165                | 3.8          | .79        |
| 100 basis points to 4.25% | 1,736                  | 5.7          | 1.17       |
| Prime rate decrease of:   |                        |              |            |
| 200 basis points to 2.25% | 1,056                  | 3.4          | .72        |
| 100 basis points to 1.25% | 564                    | 1.8          | .39        |

The following table shows the same analysis performed as of December 31, 2010:

|                           | Increase (Decrease) In |              |            |
|---------------------------|------------------------|--------------|------------|
|                           | Net Interest           | Net Interest | Return On  |
| December 31, 2010         | Income                 | Income       | Average    |
| Prime rate is 3.25%       | \$(000 )               | (%)          | Equity     |
|                           |                        |              | 2010=7.92% |
| Prime rate increase of:   |                        |              |            |
| 200 basis points to 5.25% | \$(591 )               | (1.9 )       | (.42 )     |
| 100 basis points to 4.25% | (316 )                 | (1.0 )       | (.23 )     |
| Prime rate decrease of:   |                        |              |            |
| 200 basis points to 2.25% | (1,607 )               | (5.2 )       | (1.16 )    |
| 100 basis points to 1.25% | (553 )                 | (1.8 )       | (.40 )     |

First Mid Bank's Board of Directors has adopted an interest rate risk policy that establishes maximum decreases in the percentage change in net interest income of 5% in a 100 basis point rate shift and 10% in a 200 basis point rate shift.

No assurance can be given that the actual net interest income would increase or decrease by such amounts in response to a 100 or 200 basis point increase or decrease in the prime rate because it is also affected by many other factors. The results above are based on one-time “shock” moves and do not take into account any management response or mitigating action.

Interest rate sensitivity analysis is also used to measure the Company’s interest risk by computing estimated changes in the Economic Value of Equity (“EVE”) of First Mid Bank under various interest rate shocks. EVE is determined by calculating the net present value of each asset and liability category by rate shock. The net differential between assets and liabilities is the EVE. EVE is an expression of the long-term interest rate risk in the balance sheet as a whole.

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The following table presents First Mid Bank's projected change in EVE for the various rate shock levels at December 31, 2011 and 2010 (in thousands). All market risk sensitive instruments presented in the tables are held-to-maturity or available-for-sale. First Mid Bank has no trading securities.

|                   | Changes In Interest Rates (basis points) |    | Change in Economic Value of Equity |                   |    |
|-------------------|--|----|------------------------------------|-------------------|----|
|                   |  |    | Amount of Change (\$000)           | Percent of Change |    |
| December 31, 2011 | +200                                     | bp | \$9,354                            | 4.5               | %  |
|                   | +100                                     | bp | 9,297                              | 4.4               | %  |
|                   | -200                                     | bp | (43,161 )                          | (20.6             | )% |
|                   | -100                                     | bp | (23,606 )                          | (11.3             | )% |
| December 31, 2010 | +200                                     | bp | \$11,901                           | 5.4               | %  |
|                   | +100                                     | bp | 6,902                              | 3.1               | %  |
|                   | -200                                     | bp | (41,202 )                          | (18.7             | )% |
|                   | -100                                     | bp | (17,266 )                          | (7.8              | )% |

As indicated above, at December 31, 2011, in the event of a sudden and sustained increase in prevailing market interest rates, First Mid Bank's EVE would be expected to increase, and in the event of a sudden and sustained decrease in prevailing market interest rates, First Mid Bank's EVE would be expected to decrease. At December 31, 2011, First Mid Bank's estimated changes in EVE were within the First Mid Bank's policy guidelines that normally allow for a change in capital of +/-10% from the base case scenario under a 100 basis point shock and +/- 20% from the base case scenario under a 200 basis point shock. At December 31, 2011, First Mid Bank slightly exceeded policy guidelines for a decrease in interest rates. The general level of interest rates are at historically low levels and the bank is monitoring its position and the likelihood of further rate decreases.

Computation of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates, loan prepayments and declines in deposit balances, and should not be relied upon as indicative of actual results. Further, the computations do not contemplate any actions First Mid Bank may undertake in response to changes in interest rates.

Certain shortcomings are inherent in the method of analysis presented in the computation of EVE. Actual values may differ from those projections set forth in the table, should market conditions vary from assumptions used in the preparation of the table. Certain assets, such as adjustable-rate loans, have features that restrict changes in interest rates on a short-term basis and over the life of the asset. In addition, the proportion of adjustable-rate loans in First Mid Bank's portfolio change in future periods as market rates change. Further, in the event of a change in interest rates, prepayment and early withdrawal levels would likely deviate significantly from those assumed in the table. Finally, the ability of many borrowers to repay their adjustable-rate debt may decrease in the event of an interest rate increase.





## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

## Consolidated Balance Sheets

December 31, 2011 and 2010

(In thousands, except share data)

|  | 2011        | 2010        |
|--|-------------|-------------|
| Assets   |             |             |
| Cash and due from banks  |             |             |
| Non-interest bearing   | \$43,356    | \$21,008    |
| Interest bearing   | 8,749       | 130,485     |
| Federal funds sold   | 20,997      | 80,000      |
| Cash and cash equivalents  | 73,102      | 231,493     |
| Certificates of deposit investments  | 13,231      | 10,000      |
| Investment securities:   |             |             |
| Available-for-sale, at fair value  | 478,916     | 342,816     |
| Held-to-maturity, at amortized cost (estimated fair value of \$51 and \$53 at December 31, 2011 and 2010, respectively)    | 51          | 50          |
| Loans held for sale  | 1,046       | 114         |
| Loans  | 859,028     | 804,467     |
| Less allowance for loan losses   | (11,120 )   | (10,393 )   |
| Net loans  | 847,908     | 794,074     |
| Interest receivable  | 7,052       | 6,390       |
| Other real estate owned  | 4,606       | 6,127       |
| Premises and equipment, net  | 30,717      | 28,544      |
| Goodwill, net  | 25,753      | 25,753      |
| Intangible assets, net   | 3,934       | 5,068       |
| Other assets   | 14,640      | 17,816      |
| Total assets   | \$1,500,956 | \$1,468,245 |
| Liabilities and Stockholders' Equity   |             |             |
| Deposits:  |             |             |
| Non-interest bearing deposits  | \$198,962   | \$183,932   |
| Interest bearing deposits  | 971,772     | 1,028,778   |
| Total deposits   | 1,170,734   | 1,212,710   |
| Securities sold under agreements to repurchase   | 132,380     | 94,057      |
| Interest payable   | 510         | 701         |
| FHLB borrowings  | 19,750      | 22,750      |
| Other borrowings   | 8,250       | -           |
| Junior subordinated debentures   | 20,620      | 20,620      |
| Other liabilities  | 7,745       | 5,142       |
| Total liabilities  | 1,359,989   | 1,355,980   |
| Stockholders' Equity   |             |             |
| Preferred stock, no par value, authorized 1,000,000 shares;<br>issued 8,777 shares in 2011 and 4,927 shares in 2010        | 43,785      | 24,635      |
| Common stock, \$4 par value; authorized 18,000,000 shares;<br>issued 7,553,094 shares in 2011 and 7,477,132 shares in 2010 | 30,212      | 29,909      |
| Additional paid-in capital   | 29,368      | 28,223      |
| Retained earnings  | 71,739      | 66,356      |
| Deferred compensation  | 2,904       | 2,929       |
| Accumulated other comprehensive income (loss)  | 3,148       | (2,066 )    |
| Less treasury stock at cost, 1,546,529 shares in 2011 and 1,418,456 shares in 2010   | (40,189 )   | (37,721 )   |

|  |             |             |
|--|-------------|-------------|
| Total stockholders' equity                 | 140,967     | 112,265     |
| Total liabilities and stockholders' equity | \$1,500,956 | \$1,468,245 |

See accompanying notes to consolidated financial statements.

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## Consolidated Statements of Income

For the years ended December 31, 2011, 2010 and 2009

(In thousands, except per share data)

|   | 2011     | 2010     | 2009     |
|---|----------|----------|----------|
| Interest income:  |          |          |          |
| Interest and fees on loans  | \$45,399 | \$41,803 | \$42,146 |
| Interest on investment securities:                                    |          |          |          |
| Taxable   | 9,819    | 8,329    | 8,073    |
| Exempt from federal income tax  | 1,194    | 370      | 963      |
| Interest on certificates of deposit investments                       | 78       | 110      | 55       |
| Interest on federal funds sold  | 69       | 85       | 66       |
| Interest on deposits with other financial institutions                | 213      | 186      | 106      |
| Total interest income   | 56,772   | 50,883   | 51,409   |
| Interest expense:   |          |          |          |
| Interest on deposits  | 6,725    | 8,471    | 12,970   |
| Interest on securities sold under agreements to repurchase            | 172      | 133      | 129      |
| Interest on FHLB advances   | 765      | 1,090    | 1,612    |
| Interest on other borrowings  | 72       | 9        | 22       |
| Interest on subordinated debt   | 770      | 1,053    | 1,104    |
| Total interest expense  | 8,504    | 10,756   | 15,837   |
| Net interest income   | 48,268   | 40,127   | 35,572   |
| Provision for loan losses   | 3,101    | 3,737    | 3,594    |
| Net interest income after provision for loan losses                   | 45,167   | 36,390   | 31,978   |
| Other income:   |          |          |          |
| Trust revenues  | 3,030    | 2,601    | 2,229    |
| Brokerage commissions   | 650      | 536      | 424      |
| Insurance commissions   | 1,786    | 1,779    | 1,912    |
| Service charges   | 4,817    | 4,662    | 4,952    |
| Securities gains, net   | 486      | 543      | 637      |
| Total other-than-temporary impairment losses on securities            | (886 )   | (2,829 ) | (2,465 ) |
| Portion of loss recognized in other comprehensive loss (before taxes) | -        | 1,411    | 653      |
| Other-than-temporary impairment losses recognized in earnings         | (886 )   | (1,418 ) | (1,812 ) |
| Gain on sale of merchant banking portfolio                            | -        | -        | 1,000    |
| Mortgage banking revenue, net   | 788      | 776      | 664      |
| ATM / debit card income   | 3,483    | 2,869    | 2,333    |
| Other income  | 1,633    | 1,472    | 1,116    |
| Total other income  | 15,787   | 13,820   | 13,455   |
| Other expense:  |          |          |          |
| Salaries and employee benefits  | 22,247   | 18,649   | 16,830   |
| Net occupancy and equipment expense                                   | 7,960    | 5,851    | 4,989    |
| Net other real estate owned expense                                   | 1,471    | 1,076    | 470      |
| FDIC insurance expense  | 1,167    | 1,508    | 1,943    |
| Amortization of other intangible assets                               | 1,134    | 814      | 730      |
| Stationery and supplies   | 581      | 610      | 563      |
| Legal and professional  | 2,070    | 2,361    | 2,021    |
| Marketing and promotion   | 1,050    | 940      | 963      |
| Other expense   | 5,373    | 5,118    | 4,703    |
| Total other expense   | 43,053   | 36,927   | 33,212   |
| Income before income taxes  | 17,901   | 13,283   | 12,221   |

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|   |          |         |         |
|---|----------|---------|---------|
| Income taxes                                | 6,529    | 4,522   | 4,007   |
| Net income                                  | \$11,372 | \$8,761 | \$8,214 |
| Dividends on preferred shares               | 3,576    | 2,240   | 1,821   |
| Net income available to common stockholders | \$7,796  | \$6,521 | \$6,393 |
| Per common share data:                      |          |         |         |
| Basic earnings per share                    | \$1.29   | \$1.07  | \$1.04  |
| Diluted earnings per share                  | 1.29     | 1.07    | 1.04    |
| Cash dividends per share                    | .40      | .38     | .38     |

See accompanying notes to consolidated financial statements.

| Consolidated Statements<br>of Changes in<br>Stockholders' Equity<br>For the years ended<br>December 31, 2011, 2010<br>and 2009<br>(In thousands, except<br>share and per share data) |                    |                 |                     |                      |                          |   |                   |          |
|--|--------------------|-----------------|---------------------|----------------------|--------------------------|---|-------------------|----------|
|  | Additional         |                 |                     |                      | Accumulated              |   |                   |          |
|  | Preferred<br>Stock | Common<br>Stock | Paid-In-<br>Capital | Retained<br>Earnings | Deferred<br>Compensation | Other<br>Comprehensive<br>Income (Loss) | Treasury<br>Stock | Total    |
| December 31, 2008  | \$ -               | \$ 29,017       | \$25,289            | \$58,059             | \$2,787                  | \$(416)                                 | \$(31,958)        | \$82,778 |
| Comprehensive income:  |                    |                 |                     |                      |                          |   |                   |          |
| Net income   | -                  | -               | -                   | 8,214                | -                        | -                                       | -                 | 8,214    |
| Net unrealized change in<br>available-for-sale<br>investment securities  | -                  | -               | -                   | -                    | -                        | 880                                     | -                 | 880      |
| Total Comprehensive<br>Income  |                    |                 |                     |                      |                          |   |                   | 9,094    |
| Dividends on preferred<br>stock (\$370 per share)  | -                  | -               | -                   | (1,821)              | -                        | -                                       | -                 | (1,821)  |
| Dividends on common<br>stock (\$.38 per share)   | -                  | -               | -                   | (2,308)              | -                        | -                                       | -                 | (2,308)  |
| Issuance of 4,927 shares<br>of preferred stock   | 24,635             | -               | -                   | -                    | -                        | -                                       | -                 | 24,635   |
| Issuance of 44,661<br>common shares pursuant<br>to the Dividend<br>Reinvestment Plan   | -                  | 179             | 674                 | -                    | -                        | -                                       | -                 | 853      |
| Issuance of 9,916 common<br>shares pursuant to the<br>Deferred Compensation<br>Plan  | -                  | 40              | 136                 | -                    | -                        | -                                       | -                 | 176      |
| Issuance of 19,000<br>common shares pursuant<br>to the First Retirement &<br>Savings Plan  | -                  | 75              | 255                 | -                    | -                        | -                                       | -                 | 330      |
| Purchase of 160,803<br>treasury shares   | -                  | -               | -                   | -                    | -                        | -                                       | (3,122)           | (3,122)  |
| Deferred compensation  | -                  | -               | -                   | -                    | 107                      | -                                       | (107)             | -        |
| Tax benefit related to<br>deferred compensation<br>distributions   | -                  | -               | 67                  | -                    | -                        | -                                       | -                 | 67       |
| Issuance of 37,266<br>common shares pursuant<br>to the exercise of stock<br>options  | -                  | 149             | 239                 | -                    | -                        | -                                       | -                 | 388      |
| Tax benefit related to<br>exercise of incentive stock<br>options   | -                  | -               | 19                  | -                    | -                        | -                                       | -                 | 19       |

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|  |           |           |          |          |         |           |            |           |
|--|-----------|-----------|----------|----------|---------|-----------|------------|-----------|
| Tax benefit related to exercise of non-qualified stock options                   | -         | -         | 79       | -        | -       | -         | -          | 79        |
| Vested stock options compensation expense  | -         | -         | 53       | -        | -       | -         | -          | 53        |
| December 31, 2009  | \$ 24,635 | \$ 29,460 | \$26,811 | \$62,144 | \$2,894 | \$464     | \$(35,187) | \$111,221 |
| Comprehensive income:  |           |           |          |          |         |           |            |           |
| Net income   | -         | -         | -        | 8,761    | -       | -         | -          | 8,761     |
| Net unrealized change in available-for-sale investment securities                | -         | -         | -        | -        | -       | (2,530)   | -          | (2,530)   |
| Total Comprehensive Income   |           |           |          |          |         |           |            | 6,231     |
| Dividends on preferred stock (\$455 per share)                                   | -         | -         | -        | (2,240)  | -       | -         | -          | (2,240)   |
| Dividends on common stock (\$.38 per share)                                      | -         | -         | -        | (2,309)  | -       | -         | -          | (2,309)   |
| Issuance of 38,494 common shares pursuant to the Dividend Reinvestment Plan      | -         | 154       | 526      | -        | -       | -         | -          | 680       |
| Issuance of 4,766 common shares pursuant to the Deferred Compensation Plan       | -         | 19        | 63       | -        | -       | -         | -          | 82        |
| Issuance of 19,414 common shares pursuant to the First Retirement & Savings Plan | -         | 78        | 264      | -        | -       | -         | -          | 342       |
| Purchase of 136,380 treasury shares  | -         | -         | -        | -        | -       | -         | (2,499)    | (2,499)   |
| Deferred compensation  | -         | -         | -        | -        | 35      | -         | (35)       | -         |
| Tax benefit related to deferred compensation distributions                       | -         | -         | 33       | -        | -       | -         | -          | 33        |
| Issuance of 49,500 common shares pursuant to the exercise of stock options       | -         | 198       | 349      | -        | -       | -         | -          | 547       |
| Tax benefit related to exercise of incentive stock options                       | -         | -         | 80       | -        | -       | -         | -          | 80        |
| Tax benefit related to exercise of non-qualified stock options                   | -         | -         | 45       | -        | -       | -         | -          | 45        |
| Vested stock options compensation expense  | -         | -         | 52       | -        | -       | -         | -          | 52        |
| December 31, 2010  | \$ 24,635 | \$ 29,909 | \$28,223 | \$66,356 | \$2,929 | \$(2,066) | \$(37,721) | \$112,265 |



| Consolidated<br>Statements of Changes<br>in Stockholders' Equity<br>For the years ended<br>December 31, 2011,<br>2010 and 2009<br>(In thousands, except<br>share and per share<br>data) |                    |                 |                                   |                      |                          |   |                   |           |
|---|--------------------|-----------------|-----------------------------------|----------------------|--------------------------|---|-------------------|-----------|
|   | Accumulated        |                 |                                   |                      |                          |   |                   |           |
|   | Preferred<br>Stock | Common<br>Stock | Additional<br>Paid-In-<br>Capital | Retained<br>Earnings | Deferred<br>Compensation | Other<br>Comprehensive<br>Income (Loss) | Treasury<br>Stock | Total     |
| December 31, 2010   | \$ 24,635          | \$ 29,909       | \$28,223                          | \$66,356             | \$2,929                  | \$(2,066)                               | \$(37,721)        | \$112,265 |
| Comprehensive<br>income:  |                    |                 |                                   |                      |                          |   |                   |           |
| Net income  | -                  | -               | -                                 | 11,372               | -                        | -                                       | -                 | 11,372    |
| Net unrealized change<br>in available-for-sale<br>investment securities   | -                  | -               | -                                 | -                    | -                        | 5,214                                   | -                 | 5,214     |
| Total Comprehensive<br>Income   |                    |                 |                                   |                      |                          |   |                   | 16,586    |
| Dividends on preferred<br>stock (\$407 per share)   | -                  | -               | -                                 | (3,576)              | -                        | -                                       | -                 | (3,576)   |
| Dividends on common<br>stock (\$.40 per share)  | -                  | -               | -                                 | (2,413)              | -                        | -                                       | -                 | (2,413)   |
| Issuance of 3,850<br>shares of preferred<br>stock   | 19,150             | -               | -                                 | -                    | -                        | -                                       | -                 | 19,150    |
| Issuance of 44,521<br>common shares<br>pursuant to the<br>Dividend Reinvestment<br>Plan   | -                  | 178             | 629                               | -                    | -                        | -                                       | -                 | 807       |
| Issuance of 5,920<br>common shares<br>pursuant to the<br>Deferred Compensation<br>Plan  | -                  | 23              | 85                                | -                    | -                        | -                                       | -                 | 108       |
| Issuance of 9,693<br>common shares<br>pursuant to the First<br>Retirement & Savings<br>Plan   | -                  | 39              | 138                               | -                    | -                        | -                                       | -                 | 177       |
| Issuance of 4,436<br>restricted common<br>shares pursuant to the<br>2007 Stock Incentive<br>Plan  | -                  | 18              | 65                                | -                    | -                        | -                                       | -                 | 83        |
| Purchase of 128,073<br>treasury shares  | -                  | -               | -                                 | -                    | -                        | -                                       | (2,385)           | (2,385)   |



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|  |           |           |          |          |         |         |            |           |
|--|-----------|-----------|----------|----------|---------|---------|------------|-----------|
| Deferred compensation  | -         | -         | -        | -        | (25)    | -       | (83)       | (108)     |
| Tax benefit related to deferred compensation distributions                 | -         | -         | 19       | -        | -       | -       | -          | 193       |
| Grant of restricted stock units pursuant to the 2007 Stock Incentive Plan  | -         | -         | 70       | -        | -       | -       | -          | 70        |
| Issuance of 11,392 common shares pursuant to the exercise of stock options | -         | 45        | 76       | -        | -       | -       | -          | 121       |
| Tax benefit related to exercise of incentive stock options                 | -         | -         | 11       | -        | -       | -       | -          | 11        |
| Vested stock options compensation expense                                  | -         | -         | 52       | -        | -       | -       | -          | 52        |
| December 31, 2011  | \$ 43,785 | \$ 30,212 | \$29,368 | \$71,739 | \$2,904 | \$3,148 | \$(40,189) | \$140,967 |

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Cash Flows

For the years ended December 31, 2011, 2010 and 2009

| (In thousands)  | 2011       | 2010       | 2009       |
|---|------------|------------|------------|
| Cash flows from operating activities:   |            |            |            |
| Net income  | \$ 11,372  | \$ 8,761   | \$ 8,214   |
| Adjustments to reconcile net income to net cash provided by operating activities: |            |            |            |
| Provision for loan losses   | 3,101      | 3,737      | 3,594      |
| Depreciation, amortization and accretion, net                                     | 5,398      | 3,938      | 3,070      |
| Compensation expense for vested stock options                                     | 52         | 52         | 53         |
| Compensation expense for restricted stock and restricted stock units              | 92         | -          | -          |
| Gain on investment securities, net  | (486 )     | (543 )     | (637 )     |
| Other-than-temporary impairment losses on securities recognized in earnings       | 886        | 1,418      | 1,812      |
| (Gain) loss on sales of other real property owned, net                            | 853        | (12 )      | 353        |
| Loss on write down of fixed assets  | 2          | 4          | 80         |
| Gain on sale of merchant banking portfolio  | -          | -          | (1,000 )   |
| Gain on sales of loans held for sale, net   | (782 )     | (813 )     | (727 )     |
| Deferred income taxes   | (670 )     | (435 )     | (1,515 )   |
| (Increase) decrease in accrued interest receivable                                | (662 )     | 968        | 290        |
| Decrease in accrued interest payable  | (191 )     | (386 )     | (755 )     |
| Origination of loans held for sale  | (61,375 )  | (63,924 )  | (62,904 )  |
| Proceeds from sales of loans held for sale  | 61,225     | 64,772     | 64,019     |
| Increase in other assets  | (1,900 )   | (5,955 )   | (7,145 )   |
| Increase (decrease) in other liabilities  | 2,061      | (4,074 )   | 1,522      |
| Net cash provided by operating activities   | 18,976     | 7,508      | 8,324      |
| Cash flows from investing activities:   |            |            |            |
| Proceeds from maturities of certificates of deposit investments                   | 10,000     | 10,605     | 1,992      |
| Purchase of certificates of deposits investments                                  | (13,231 )  | (11,261 )  | (11,336 )  |
| Proceeds from sales of securities available-for-sale                              | 18,891     | 10,936     | 38,275     |
| Proceeds from maturities of securities available-for-sale                         | 184,564    | 107,525    | 63,321     |
| Proceeds from maturities of securities held-to-maturity                           | -          | 995        | 140        |
| Purchases of securities available-for-sale  | (333,222 ) | (229,482 ) | (171,440 ) |
| Net (increase) decrease in loans  | (56,935 )  | 26,445     | 39,081     |
| Purchases of premises and equipment   | (4,625 )   | (1,935 )   | (1,954 )   |
| Proceeds from sales of other real property owned                                  | 3,110      | 6,634      | 1,987      |
| Cash received related to acquisition, net of cash and cash equivalents acquired   | -          | 180,074    | -          |
| Net cash provided by (used in) investing activities                               | (191,448 ) | 100,536    | (39,934 )  |
| Cash flows from financing activities:   |            |            |            |
| Net increase (decrease) in deposits   | (41,976 )  | 34,745     | 34,056     |
| Increase (decrease) in repurchase agreements                                      | 38,323     | 13,671     | (322 )     |
| Repayment of long-term FHLB advances  | (3,000 )   | (10,000 )  | (5,000 )   |
| Proceeds from short-term debt   | 8,250      | -          | -          |
| Proceeds from long-term debt  | -          | 4,000      | -          |
| Repayment of long-term debt   | -          | (4,000 )   | (13,000 )  |
| Proceeds from issuance of common stock  | 406        | 971        | 894        |
| Proceeds from issuance of preferred stock   | 19,150     | -          | 24,635     |
| Purchase of treasury stock  | (2,385 )   | (2,499 )   | (3,122 )   |
| Dividends paid on preferred stock   | (2,990 )   | (2,136 )   | (1,242 )   |

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|  |            |           |          |
|--|------------|-----------|----------|
| Dividends paid on common stock                   | (1,697 )   | (1,714 )  | (1,521 ) |
| Net cash provided by financing activities        | 14,081     | 33,038    | 35,378   |
| Increase (decrease) in cash and cash equivalents | (158,391 ) | 141,082   | 3,768    |
| Cash and cash equivalents at beginning of year   | 231,493    | 90,411    | 86,643   |
| Cash and cash equivalents at end of year         | \$73,102   | \$231,493 | \$90,411 |

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|  | 2011    | 2010     | 2009     |
|--|---------|----------|----------|
| Supplemental disclosures of cash flow information                      |         |          |          |
| Cash paid during the year for:   |         |          |          |
| Interest   | \$8,695 | \$10,916 | \$16,592 |
| Income taxes   | 5,470   | 6,848    | 4,596    |
| Supplemental disclosure of noncash investing and financing activities: |         |          |          |
| Loans transferred to real estate owned                                 | \$2,622 | \$9,897  | \$2,847  |
| Dividends reinvested in common shares                                  | 807     | 680      | 853      |
| Net tax benefit related to option and deferred compensation plans      | 31      | 158      | 165      |

See accompanying notes to consolidated financial statements.

Notes To Consolidated Financial Statements  
December 31, 2011, 2010 and 2009  
(Table dollar amounts in thousands, except share data)

## Note 1 – Summary of Significant Accounting Policies

### Basis of Accounting and Consolidation

The accompanying consolidated financial statements include the accounts of First Mid-Illinois Bancshares, Inc. (“Company”) and its wholly-owned subsidiaries: Mid-Illinois Data Services, Inc. (“MIDS”), First Mid-Illinois Bank & Trust, N.A. (“First Mid Bank”) and The Checkley Agency, Inc. doing business as First Mid Insurance Group (“First Mid Insurance”). All significant intercompany balances and transactions have been eliminated in consolidation. Certain amounts in the prior years’ consolidated financial statements have been reclassified to conform to the 2011 presentation and there was no impact on net income or stockholders’ equity from these reclassifications. The Company operates as a one-segment entity for financial reporting purposes. The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America. Following is a description of the more significant of these policies.

### Current Economic Conditions

The current protracted economic decline continues to present financial institutions with circumstances and challenges, which in some cases have resulted in large and unanticipated declines in the fair values of investments and other assets, constraints on liquidity and capital and significant credit quality problems, including severe volatility in the valuation of real estate and other collateral supporting loans. The accompanying financial statements have been prepared using values and information currently available to the Company. Given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in asset values, the allowance for loan losses and capital that could negatively impact the Company’s ability to meet regulatory capital requirements and maintain sufficient liquidity.

At December 31, 2011, the Company held \$321.9 million in commercial real estate loans and \$23.1 million in construction and land development loans. Due to national, state and local economic conditions, values for commercial and development real estate have declined, and the market for these properties is depressed. Also, at December 31, 2011, the Company held \$63.2 million in agricultural production loans and \$72.6 million in agricultural real estate loans.

In addition, the Company had \$46.8 million of loans in the hospitality (motels and hotels) industry. Due to national, state and local economic conditions, values for commercial real estate and, specifically hotel properties, have declined and the market for these properties is depressed. The performance of these loans is also dependent on borrower specific issues as well as the general level of business and personal travel within the region. The Company also had \$82.6 million of loans to lessors of non-residential buildings and \$44.0 million of loans to lessors of residential buildings and dwellings. Due to national, state and local economic conditions, values for commercial real estate have declined and the market for these properties is also depressed.

### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The Company uses estimates and employs the judgments of management in determining the amount of its allowance for loan losses and income tax accruals and deferrals, in its fair value measurements of investment securities, and in the evaluation of impairment of loans, goodwill, investment

securities, and fixed assets. As with any estimate, actual results could differ from these estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses. In connection with the determination of the allowance for loan losses, management obtains independent appraisals for significant properties.

#### Fair Value Measurements

The fair value of a financial instrument is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The Company estimates the fair value of a financial instrument using a variety of valuation methods. Where financial instruments are actively traded and have quoted market prices, quoted market prices are used for fair value. When the financial instruments are not actively traded, other observable market inputs, such as quoted prices of securities with similar characteristics, may be used, if available, to determine fair value. When observable market prices do not exist, the Company estimates fair value. The Company's valuation methods consider factors such as liquidity and concentration concerns. Other factors such as model assumptions, market dislocations, and unexpected correlations can affect estimates of fair value. Imprecision in estimating these factors can impact the amount of revenue or loss recorded.

SFAS No. 157, Fair Value Measurements, which was codified into ASC 820, establishes a framework for measuring the fair value of financial instruments that considers the attributes specific to particular assets or liabilities and establishes a three-level hierarchy for determining fair value based on the transparency of inputs to each valuation as of the fair value measurement date. The three levels are defined as follows:

- Level 1 — quoted prices (unadjusted) for identical assets or liabilities in active markets.
  - Level 2 — inputs include quoted prices for similar assets and liabilities in active markets, quoted prices of identical or similar assets or liabilities in markets that are not active, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
    - Level 3 — inputs that are unobservable and significant to the fair value measurement.
-

At the end of each quarter, the Company assesses the valuation hierarchy for each asset or liability measured. From time to time, assets or liabilities may be transferred within hierarchy levels due to changes in availability of observable market inputs to measure fair value at the measurement date. Transfers into or out of hierarchy levels are based upon the fair value at the beginning of the reporting period. A more detailed description of the fair values measured at each level of the fair value hierarchy can be found in Note 11 – “Disclosures of Fair Values of Financial Instruments.”

#### Cash and Cash Equivalents

For purposes of reporting cash flows, cash equivalents include non-interest bearing and interest bearing cash and due from banks and federal funds sold. Generally, federal funds are sold for one-day periods.

#### Certificates of Deposit Investments

Certificates of deposit investments have original maturities of six to twelve months and are carried at cost.

#### Investment Securities

The Company classifies its investments in debt and equity securities as either held-to-maturity or available-for-sale in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, “Accounting for Certain Investments in Debt and Equity Securities,” which was codified into ASC 320. Securities classified as held-to-maturity are recorded at cost or amortized cost. Available-for-sale securities are carried at fair value. Fair value calculations are based on quoted market prices when such prices are available. If quoted market prices are not available, estimates of fair value are computed using a variety of techniques, including extrapolation from the quoted prices of similar instruments or recent trades for thinly traded securities, fundamental analysis, or through obtaining purchase quotes. Due to the subjective nature of the valuation process, it is possible that the actual fair values of these investments could differ from the estimated amounts, thereby affecting the financial position, results of operations and cash flows of the Company. If the estimated value of investments is less than the cost or amortized cost, the Company evaluates whether an event or change in circumstances has occurred that may have a significant adverse effect on the fair value of the investment. If such an event or change has occurred and the Company determines that the impairment is other-than-temporary, a further determination is made as to the portion of impairment that is related to credit loss. The impairment of the investment that is related to the credit loss is expensed in the period in which the event or change occurred. The remainder of the impairment is recorded in other comprehensive income.

#### Loans

Loans are stated at the principal amount outstanding net of unearned discounts, unearned income and the allowance for loan losses. Unearned income includes deferred loan origination fees reduced by loan origination costs and is amortized to interest income over the life of the related loan using methods that approximate the effective interest rate method. Interest on substantially all loans is credited to income based on the principal amount outstanding.

The Company’s policy is to discontinue the accrual of interest income on any loan that becomes ninety days past due as to principal or interest or earlier when, in the opinion of management there is reasonable doubt as to the timely collection of principal or interest. Nonaccrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collectability of interest or principal.

Loans expected to be sold are classified as held for sale in the consolidated financial statements and are recorded at the lower of aggregate cost or market value, taking into consideration future commitments to sell the loans.

#### Allowance for Loan Losses

The Company believes the allowance for loan losses is the critical accounting policy that requires the most significant judgments and assumptions used in the preparation of its consolidated financial statements. An estimate of potential losses inherent in the loan portfolio is determined and an allowance for those losses is established by considering factors including historical loss rates, expected cash flows and estimated collateral values. In assessing these factors, the Company use organizational history and experience with credit decisions and related outcomes. The allowance for loan losses represents the best estimate of losses inherent in the existing loan portfolio. The allowance for loan losses is increased by the provision for loan losses charged to expense and reduced by loans charged off, net of recoveries. The Company evaluates the allowance for loan losses quarterly. If the underlying assumptions later prove to be inaccurate based on subsequent loss evaluations, the allowance for loan losses is adjusted.

The Company estimates the appropriate level of allowance for loan losses by separately evaluating impaired and nonimpaired loans. A specific allowance is assigned to an impaired loan when expected cash flows or collateral do not justify the carrying amount of the loan. The methodology used to assign an allowance to a nonimpaired loan is more subjective. Generally, the allowance assigned to nonimpaired loans is determined by applying historical loss rates to existing loans with similar risk characteristics, adjusted for qualitative factors including the volume and severity of identified classified loans, changes in economic conditions, changes in credit policies or underwriting standards, and changes in the level of credit risk associated with specific industries and markets. Because the economic and business climate in any given industry or market, and its impact on any given borrower, can change rapidly, the risk profile of the loan portfolio is continually assessed and adjusted when appropriate. Notwithstanding these procedures, there still exists the possibility that the assessment could prove to be significantly incorrect and that an immediate adjustment to the allowance for loan losses would be required.

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## Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization is charged to expense and determined principally by the straight-line method over the estimated useful lives of the assets.

The estimated useful lives for each major depreciable classification of premises and equipment are as follows:

|                            |               |
|----------------------------|---------------|
| Buildings and improvements | 20 - 40 years |
| Leasehold improvements     | 5-15 years    |
| Furniture and equipment    | 3-7 years     |

## Goodwill and Intangible Assets

The Company has goodwill from business combinations, identifiable intangible assets assigned to core deposit relationships and customer lists acquired, and intangible assets arising from the rights to service mortgage loans for others.

Identifiable intangible assets generally arise from branches acquired that the Company accounted for as purchases. Such assets consist of the excess of the purchase price over the fair value of net assets acquired, with specific amounts assigned to core deposit relationships and customer lists primarily related to insurance agency. Intangible assets are amortized by the straight-line method over various periods up to fifteen years. Management reviews intangible assets for possible impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

In accordance with the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets," codified into ASC 350, the Company performed testing of goodwill for impairment as of September 30, 2011 and determined that, as of that date, goodwill was not impaired. Management also concluded that the remaining amounts and amortization periods were appropriate for all intangible assets.

## Other Real Estate Owned

Other real estate owned acquired through loan foreclosure is initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. The adjustment at the time of foreclosure is recorded through the allowance for loan losses. Due to the subjective nature of establishing the fair value when the asset is acquired, the actual fair value of the other real estate owned or foreclosed asset could differ from the original estimate. If it is determined that fair value temporarily declines subsequent to foreclosure, a valuation allowance is recorded through noninterest expense. Operating costs associated with the assets after acquisition are also recorded as noninterest expense. Gains and losses on the disposition of other real estate owned and foreclosed assets are netted and posted to other noninterest expense.

## Federal Home Loan Bank Stock

Federal Home Loan Bank stock is a required investment for institutions that are members of the Federal Home Loan Bank system. The required investment in the common stock is based on a predetermined formula.

At December 31, 2011, the Company owned approximately \$3.7 million of Federal Home Loan Bank of Chicago (“FHLB”) stock included in other assets as of December 31, 2011 and 2010. During the third quarter of 2007, the FHLB received a Cease and Desist Order from its regulator, the Federal Housing Finance Board. The FHLB will continue to provide liquidity and funding through advances; however, the order prohibited capital stock repurchases until a time to be determined by the Federal Housing Finance Board and requires Federal Housing Finance Board approval for dividends. On July 24, 2008, the Federal Housing Finance Board amended the order to allow the FHLB to repurchase or redeem any capital stock issued to support new advances after the repayment of those new advances if certain conditions are met. The amended order, however, provides that the Director of the Office of Supervision of the Federal Housing Finance Board may direct the FHLB to halt the repurchase or redemption of capital stock if, in his sole discretion, the continuation of such transactions would be inconsistent with maintaining the capital adequacy of the FHLB and its safe and sound operations. With regard to dividends, the FHLB continues to assess its dividend capacity each quarter and make appropriate request for approval. There were no dividends paid by the FHLB during 2010 or 2009; however in 2011 the FHLB began paying dividends at an annualized rate of 10 basis points per share. The Company evaluated its cost investment in FHLB stock and deemed it was ultimately recoverable.

Subsequently the FHLB announced it would repurchase approximately \$500 million in excess capital stock held by its members during the first quarter of 2012. On February 15, 2012, the Company redeemed approximately 51.5% or \$537,000 of its excess capital stock. The FHLB plans to offer additional stock repurchase opportunities in subsequent quarters, subject to meeting its financial targets.

#### Income Taxes

The Company and its subsidiaries file consolidated federal and state income tax returns with each organization computing its taxes on a separate company basis. Amounts provided for income tax expense are based on income reported for financial statement purposes rather than amounts currently payable under tax laws.

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Deferred tax assets and liabilities are recognized for future tax consequences attributable to the temporary differences existing between the financial statement carrying amounts of assets and liabilities and their respective tax basis, as well as operating loss and tax credit carry forwards. To the extent that current available evidence about the future raises doubt about the realization of a deferred tax asset, a valuation allowance is established. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as an increase or decrease in income tax expense in the period in which such change is enacted.

Additionally, the Company reviews its uncertain tax positions annually under FASB Interpretation No. 48 (FIN No. 48), "Accounting for Uncertainty in Income Taxes," codified within ASC 740. An uncertain tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount actually recognized is the largest amount of tax benefit that is greater than 50% likely to be recognized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. A significant amount of judgment is applied to determine both whether the tax position meets the "more likely than not" test as well as to determine the largest amount of tax benefit that is greater than 50% likely to be recognized. Differences between the position taken by management and that of taxing authorities could result in a reduction of a tax benefit or increase to tax liability, which could adversely affect future income tax expense.

#### Trust Department Assets

Assets held in fiduciary or agency capacities are not included in the consolidated balance sheets since such items are not assets of the Company or its subsidiaries. Fees from trust activities are recorded on a cash basis over the period in which the service is provided. Fees are a function of the market value of assets managed and administered, the volume of transactions, and fees for other services rendered, as set forth in the underlying client agreement with the Trust & Wealth Management Division of First Mid Bank. This revenue recognition involves the use of estimates and assumptions, including components that are calculated based on asset valuations and transaction volumes. Any out of pocket expenses or services not typically covered by the fee schedule for trust activities are charged directly to the trust account on a gross basis as trust revenue is incurred.

At December 31, 2011, the Company managed or administered 1,407 accounts with assets totaling approximately \$546,658,000. At December 31, 2010, the Company managed or administered 1,131 accounts with assets totaling approximately \$507,530,000.

#### Preferred Stock

Series B Convertible Preferred Stock. During 2009, the Company sold to certain accredited investors including directors, executive officers, and certain major customers and holders of the Company's common stock, \$24,635,000, in the aggregate, of a newly authorized series of its preferred stock designated as Series B 9% Non-Cumulative Perpetual Convertible Preferred Stock (the "Series B Preferred Stock"). The Series B Preferred Stock had an issue price of \$5,000 per share and no par value per share. The Series B Preferred Stock was issued in a private placement exempt from registration pursuant to Regulation D of the Securities Act of 1933, as amended.

The Series B Preferred Stock pays non-cumulative dividends semiannually in arrears, when, as and if authorized by the Board of Directors of the Company, at a rate of 9% per year. Holders of the Series B Preferred Stock will have no voting rights, except with respect to certain fundamental changes in the terms of the Series B Preferred Stock and certain other matters. In addition, if dividends on the Series B Preferred Stock are not paid in full for four dividend

periods, whether consecutive or not, the holders of the Series B Preferred Stock, acting as a class with any other of the Company's securities having similar voting rights, will have the right to elect two directors to the Company's Board of Directors. The terms of office of these directors will end when the Company has paid or set aside for payment full semi-annual dividends for four consecutive dividend periods.

Each share of the Series B Preferred Stock may be converted at any time at the option of the holder into shares of the Company's common stock. The number of shares of common stock into which each share of the Series B Preferred Stock is convertible is the \$5,000 liquidation preference per share divided by the Conversion Price initially set at \$21.94. The Conversion Price is subject to adjustment from time to time pursuant to the terms of the Certificate of Designation (the "Series B Certificate of Designation"). If at the time of conversion, there are any authorized, declared and unpaid dividends with respect to a converted share of Series B Preferred Stock, the holder will receive cash in lieu of the dividends, and a holder will receive cash in lieu of fractional shares of common stock following conversion.

After November 16, 2014, the Company may, at its option but subject to the Company's receipt of any required prior approvals from the Board of Governors of the Federal Reserve System or any other regulatory authority, redeem the Series B Preferred Stock. Any redemption will be in exchange for cash in the amount of \$5,000 per share, plus any authorized, declared and unpaid dividends, without accumulation of any undeclared dividends.

The Company also has the right at any time on or after November 16, 2014 to require the conversion of all (but not less than all) of the Series B Preferred Stock into shares of common stock if, on the date notice of mandatory conversion is given to holders, the book value of the Company's common stock equals or exceeds 115% of the book value of the Company's common stock at September 30, 2008. "Book value of the Company's common stock" at any date means the result of dividing the Company's total common stockholders' equity at that date, determined in accordance with U.S. generally accepted accounting principles, by the number of shares of common stock then outstanding, net of any shares held in the treasury. The book value of the Company's common stock at September 30, 2008 was \$13.03, and 115% of this amount is approximately \$14.98. The book value of the Company's common stock at December 31, 2011 was \$16.18.

Pursuant to Section 3(j) of the Series B Certification of Designation, the conversion price for the Series B Preferred Stock, which was initially set at \$21.94, was required to be adjusted if, among other things, the initial conversion price of any subsequently issued series of preferred stock was lower than the then current conversion price of the Series B Preferred Stock. As a result of the Series C Preferred Stock (see below) having an initial conversion price of less than \$21.94, the conversion price of the Series B Preferred Stock was adjusted pursuant to the terms of the Series B Certificate of Designation based on the amount of Series C Preferred Stock sold on February 11, 2011, March 2, 2011 and May 13, 2011. The new conversion price of the Series B Preferred Stock, certified by the Company's accountant pursuant to Section 3(j) of the Series B Certificate of Designation, is \$21.71. If additional Series C Preferred Stock is sold following an Investor's receipt of applicable bank regulatory approval, subsequent adjustments will be made to the conversion price of the Series B Preferred Stock

**Series C Convertible Preferred Stock.** On February 11, 2011, the Company accepted from certain accredited investors, including directors, executive officers, and certain major customers and holders of the Company's common stock (collectively, the "Investors"), subscriptions for the purchase of \$27,500,000, in the aggregate, of a newly authorized series of preferred stock designated as Series C 8% Non-Cumulative Perpetual Convertible Preferred Stock (the "Series C Preferred Stock"). As of February 11, 2011, \$11,010,000 of the Series C Preferred Stock had been issued and sold by the Company to certain Investors. On March 2, 2011, three Investors subsequently completed the required bank regulatory process and an additional \$2,750,000 of Series C Preferred Stock was issued and sold by the Company to these Investors. On May 13, 2011, four additional Investors received the required bank regulatory approval and an additional \$5,490,000 of Series C Preferred Stock was issued and sold by the Company to these Investors. The balance of the Series C Preferred Stock will be issued to the remaining Investors upon the completion of the bank regulatory process, to which the issuance of the Series C Preferred Stock is subject, applicable to their purchases. These remaining Investors have not yet been issued their shares of Series C Preferred Stock because of unanticipated delays in applying for and obtaining the approval of the Federal Reserve Board. These Investors are (a) individuals who are members of the Lumpkin family, including Benjamin I. Lumpkin, a director of the Company, and (b) entities controlled by, and trusts created for the benefit of, individuals who are members of the Lumpkin family (collectively, the "Remaining Investors"). The Company has previously accepted from the Remaining Investors subscriptions for \$8,250,000 of the Series C Preferred Stock pursuant to their respective subscription agreements.

The Series C Preferred Stock has an issue price of \$5,000 per share and no par value per share. The Series C Preferred Stock was issued in a private placement exempt from registration pursuant to Regulation D of the Securities Act of 1933, as amended.

The Series C Preferred Stock pays non-cumulative dividends semiannually in arrears, when, as and if authorized by the Board of Directors of the Company, at a rate of 8% per year. Holders of the Series C Preferred Stock will have no voting rights, except with respect to certain fundamental changes in the terms of the Series C Preferred Stock and certain other matters. In addition, if dividends on the Series C Preferred Stock are not paid in full for four dividend periods, whether consecutive or not, the holders of the Series C Preferred Stock, acting as a class with any other of the Company's securities having similar voting rights, including the Company's Series B Preferred Stock, will have the right to elect two directors to the Company's Board of Directors. The terms of office of these directors will end when the Company has paid or set aside for payment full semi-annual dividends for four consecutive dividend periods.

Each share of the Series C Preferred Stock may be converted at any time at the option of the holder into shares of the Company's common stock. The number of shares of common stock into which each share of the Series C Preferred Stock is convertible is the \$5,000 liquidation preference per share divided by the Conversion Price of \$20.29. The Conversion Price is subject to adjustment from time to time pursuant to the terms of the Series C Certificate of Designation. If at the time of conversion, there are any authorized, declared and unpaid dividends with respect to a converted share of Series C Preferred Stock, the holder will receive cash in lieu of the dividends, and a holder will receive cash in lieu of fractional shares of common stock following conversion.

After May 13, 2016 the Company may, at its option but subject to the Company's receipt of any required prior approvals from the Board of Governors of the Federal Reserve System or any other regulatory authority, redeem the Series C Preferred Stock. Any redemption will be in exchange for cash in the amount of \$5,000 per share, plus any authorized, declared and unpaid dividends, without accumulation of any undeclared dividends.

The Company also has the right at any time after May 13, 2016 to require the conversion of all (but not less than all) of the Series C Preferred Stock into shares of common stock if, on the date notice of mandatory conversion is given to holders, (a) the tangible book value per share of the Company's common stock equals or exceeds 115% of the tangible book value per share of the Company's common stock at December 31, 2010, and (b) the NASDAQ Bank Index (denoted by CBNK:IND) equals or exceeds 115% of the NASDAQ Bank Index at December 31, 2010. "Tangible book value per share of our common stock" at any date means the result of dividing the Company's total common stockholders equity at that date, less the amount of goodwill and intangible assets, determined in accordance with U.S. generally accepted accounting principles, by the number of shares of common stock then outstanding, net of any shares held in the treasury. The tangible book value of the Company's common stock at December 31, 2010 was \$9.38, and 115% of this amount is approximately \$10.79. The NASDAQ Bank Index value at December 31, 2010 was 1,847.35 and 115% of this amount is approximately 2,124.45. The tangible book value of the Company's common stock at December 31, 2011 was \$11.24 and the NASDAQ Bank Index value at December 31, 2011 was 1,617.83.

Pursuant to the terms of the Series C Preferred Stock, the Series C Preferred Stock is both redeemable and mandatorily convertible at the Company's discretion into common stock of the Company, subject to certain conditions being met, no earlier than 60 months following the date on which a majority of the Series C Preferred Stock has been issued. The date on which a majority of the Series C Preferred Stock became issued was May 13, 2011 (the "Majority Issuance Date"). As a result of the Remaining Investors not being issued their subscribed for shares of Series C Preferred Stock by the Majority Issuance Date, it is possible that, if certain conditions are met, the Company could redeem or mandatorily convert the Series C Preferred Stock into common stock of the Company prior to the Remaining Investors holding their subscribed shares of Series C Preferred Stock for 60 months, thus resulting in the Remaining Investors receiving less than 60 months of 8% dividends on the Series C Preferred Stock subscribed for.

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In November 2011, the disinterested members of the Board of Directors of the Company approved and authorized, and the Remaining Investors agreed to, certain amendments to the Series C Preferred Stock subscription agreements resulting in the release to the Company of the funds escrowed by the Remaining Investors for their subscribed shares of the Series C Preferred Stock and the issuance by the Company of short-term unsecured promissory notes, which are dated November 21, 2011, to the Remaining Investors. The promissory notes (the "Notes") collectively have an aggregate principal amount of \$8,250,000 and each have an 8% annual interest rate. Each Note also contains a prepayment provision applicable when approval from the Federal Reserve Board is received to allow the Remaining Investors to purchase the shares of Series C Preferred Stock originally subscribed. Additionally, if the Company experiences an Event of Default as defined in the Note, such as becoming insolvent or generally failing to pay its debts as they become due, then a Remaining Investor may, at his, her or its option, declare the entire unpaid amount of the Note immediately due and payable, without presentment, demand, portents or notice of any kind, and the Remaining Investor shall be entitled to recover from the Company all costs and expenses, including reasonable attorneys' fees and disbursements and court costs, incurred in enforcing the Remaining Investor's rights under the Note.

#### Treasury Stock

Treasury stock is stated at cost. Cost is determined by the first-in, first-out method.

#### Stock Incentive Awards

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123R, Accounting for Stock-Based Compensation," which was codified into ASC 718, using the modified prospective application method. Accordingly, after January 1, 2006, the Company began expensing the fair value of stock options granted, modified, repurchased or cancelled. Additionally, compensation cost for a portion of the awards for which requisite services had not yet been rendered that were outstanding as of January 1, 2006 are being recognized as the requisite service is rendered. As a result of this adoption, the Company's income before income taxes and net income for the year ended December 31, 2011 includes stock option compensation cost of \$52,000 and \$51,000, respectively, which represents \$.01 impact on basic and diluted earnings per share for the year. The Company's income before income taxes and net income for the year ended December 31, 2010 includes stock option compensation cost of \$52,000 and \$51,000, respectively, which represents \$.01 impact on basic and diluted earnings per share for the year. The Company's income before income taxes and net income for the year ended December 31, 2009 includes stock option compensation cost of \$53,000 and \$52,000, respectively, which represents \$.01 impact on basic and diluted earnings per share for the year.

On September 27, 2011, the Board of Directors passed a resolution authorizing and approving the Executive Long-Term Incentive Plan ("LTIP"). The LTIP was implemented to provide methodology for granting Stock Awards and Stock Unit Awards under the Stock Incentive Plan ("SI Plan") to select senior executives of the Company or any subsidiary. The Company's income before income taxes and net income for the year ended December 31, 2011 includes compensation cost for Stock Awards and Stock Unit Awards of \$92,000 and \$60,000, respectively, which represents \$.015 impact on basic and diluted earnings per share for the year.

A maximum of 300,000 shares of common stock may be issued under the SI Plan. As of December 31, 2011, the Company had awarded 59,500 shares as stock options under the SI Plan. During 2011, the Company awarded 17,409 shares as 50% Stock Awards and 50% Stock Unit Awards under the SI Plan. There were no shares awarded as stock options during 2011.

## Comprehensive Income

Comprehensive income consists of net income and other comprehensive income, net of applicable income taxes. Other comprehensive income includes unrealized appreciation (depreciation) on available-for-sale securities and unrealized appreciation (depreciation) on available-for-sale securities for which a portion of an other-than-temporary impairment has been recognized in income.

The Company's comprehensive income for the years ended December 31, 2011, 2010 and 2009 is as follows:

|  | 2011      | 2010     | 2009     |
|--|-----------|----------|----------|
| Net income   | \$ 11,372 | \$ 8,761 | \$ 8,214 |
| Other comprehensive income:  |           |          |          |
| Unrealized gains (losses) on securities available-for-sale   | 8,226     | (2,193 ) | 2,732    |
| Non-credit component of unrealized losses on securities available-for-sale for which a portion of an other-than-temporary impairment has been recognized in income | (81 )     | (2,829 ) | (2,465 ) |
| Other-than-temporary impairment losses recognized in earnings  | 886       | 1,418    | 1,812    |
| Reclassification adjustment for realized gains included in income  | (486 )    | (543 )   | (637 )   |
| Other comprehensive income (loss) before taxes   | 8,545     | (4,147 ) | 1,442    |
| Tax benefit (expense)  | (3,331 )  | 1,617    | (562 )   |
| Total other comprehensive income (loss)  | 5,214     | (2,530 ) | 880      |
| Comprehensive income   | \$ 16,586 | \$ 6,231 | \$ 9,094 |



The components of accumulated other comprehensive income (loss) included in stockholders' equity are as follows:

|   | Unrealized<br>Gain (Loss)<br>on<br>Available<br>for Sale<br>Securities | Other-Than-<br>Temporary<br>Impairment<br>Losses | Total      |
|---|--|--|------------|
| December 31, 2011                                     |  |  |            |
| Net unrealized gains on securities available-for-sale | \$10,066   | \$ -   | \$10,066   |
| Other-than-temporary impairment losses on securities  | -  | (4,906 )   | (4,906 )   |
| Tax benefit (expense)                                 | (3,924 )   | 1,912  | (2,012 )   |
| Balance at December 31, 2011                          | \$6,142  | \$(2,994 )                                       | \$3,148    |
| December 31, 2010                                     |  |  |            |
| Net unrealized gains on securities available-for-sale | \$2,629  | \$ -   | \$2,629    |
| Other-than-temporary impairment losses on securities  | -  | (6,014 )   | (6,014 )   |
| Tax benefit (expense)                                 | (1,025 )   | 2,344  | 1,319      |
| Balance at December 31, 2010                          | \$1,604  | \$(3,670 )                                       | \$(2,066 ) |

See Note 4 – “Investment Securities” for more detailed information regarding unrealized losses on available-for-sale securities.

#### Note 2 – Earnings Per Common Share

Basic earnings per common share (“EPS”) is calculated as net income available to common shareholders divided by the weighted average number of common shares outstanding. Diluted EPS is computed using the weighted average number of common shares outstanding, increased by the assumed conversion of the Company’s stock options, unless anti-dilutive.

The components of basic and diluted earnings per common share for the years ended December 31, 2011, 2010 and 2009 are as follows:

|   | 2011         | 2010        | 2009        |
|---|--------------|-------------|-------------|
| Basic Earnings per Common Share:                    |              |             |             |
| Net income  | \$11,372,000 | \$8,761,000 | \$8,214,000 |
| Preferred stock dividends                           | (3,576,000 ) | (2,240,000) | (1,821,000) |
| Net income available to common stockholders         | \$7,796,000  | \$6,521,000 | \$6,393,000 |
| Weighted average common shares outstanding          | 6,042,015    | 6,092,670   | 6,131,314   |
| Basic earnings per common share                     | \$1.29       | \$1.07      | \$1.04      |
| Diluted Earnings per Common Share:                  |              |             |             |
| Net income available to common stockholders         | \$7,796,000  | \$6,521,000 | \$6,393,000 |
| Effect of assumed preferred stock conversion        | -            | -           | -           |
| Net income applicable to diluted earnings per share | \$7,796,000  | \$6,521,000 | \$6,393,000 |
| Weighted average common shares outstanding          | 6,042,015    | 6,092,670   | 6,131,314   |

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Dilutive potential common shares:

|  |           |           |           |
|--|-----------|-----------|-----------|
| Assumed conversion of stock options                | 10,515    | 24,057    | 35,879    |
| Adjustment for fair value for stock awards         | 1,741     | -         | -         |
| Assumed conversion of preferred stock              | -         | -         | -         |
| Diluted weighted average common shares outstanding | 6,054,271 | 6,116,727 | 6,167,193 |
| Diluted earnings per common share                  | \$1.29    | \$1.07    | \$1.04    |

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The following shares were not considered in computing diluted earnings per share for the years ended December 31, 2011, 2010 and 2009 because they were anti-dilutive:

|  | 2011      | 2010      | 2009      |
|--|-----------|-----------|-----------|
| Stock options to purchase shares of common stock                                     | 202,970   | 202,970   | 202,970   |
| Average dilutive potential common shares associated with convertible preferred stock | 1,998,652 | 1,122,833 | 1,036,046 |

Note 3 – Cash and Due from Banks

Aggregate cash and due from bank balances of \$873,000, \$318,000 and \$686,000 were maintained in satisfaction of statutory reserve requirements of the Federal Reserve Bank at December 31, 2011, 2010 and 2009, respectively. Effective July 21, 2010, the FDIC's insurance limits were permanently increased to \$250,000. At December 31, 2011, the Company's cash accounts did not exceed the federally insured limits.

Pursuant to legislation enacted in 2010, the FDIC will fully insure all noninterest-bearing transaction accounts beginning December 31, 2010 through December 31, 2012, at all FDIC-insured institutions.

Note 4 – Investment Securities

The amortized cost, gross unrealized gains and losses and estimated fair values of available-for-sale and held-to-maturity securities by major security type at December 31, 2011 and 2010 were as follows:

|  | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|--|----------------|------------------------|-------------------------|----------------------|
| <b>2011</b>                                      |                |                        |                         |                      |
| Available-for-sale:                              |                |                        |                         |                      |
| U.S. Treasury securities and obligations of U.S. |                |                        |                         |                      |
| government corporations and Agencies             | \$164,812      | \$1,294                | \$(40)                  | \$166,066            |
| Obligations of states and political subdivisions | 38,828         | 2,374                  | -                       | 41,202               |
| Mortgage-backed securities: Government Sponsored |                |                        |                         |                      |
| Enterprise (GSE)-Residential                     | 254,930        | 6,940                  | (37)                    | 261,833              |
| Trust preferred securities                       | 5,625          | -                      | (4,906)                 | 719                  |
| Other securities                                 | 9,561          | -                      | (465)                   | 9,096                |
| Total available-for-sale                         | \$473,756      | \$10,608               | \$(5,448)               | \$478,916            |
| Held-to-maturity:                                |                |                        |                         |                      |
| Obligations of states and political subdivisions | \$51           | \$-                    | \$-                     | \$51                 |
| <b>2010</b>                                      |                |                        |                         |                      |
| Available-for-sale:                              |                |                        |                         |                      |
| U.S. Treasury securities and obligations of U.S. |                |                        |                         |                      |
| government corporations and Agencies             | \$152,086      | \$1,319                | \$(1,024)               | \$152,381            |
| Obligations of states and political subdivisions | 26,549         | 591                    | (226)                   | 26,914               |
| Mortgage-backed securities: GSE-Residential      | 158,936        | 3,477                  | (1,482)                 | 160,931              |

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|  |           |         |            |           |
|--|-----------|---------|------------|-----------|
| Trust preferred securities                       | 6,595     | -       | (6,014 )   | 581       |
| Other securities                                 | 2,035     | -       | (26 )      | 2,009     |
| Total available-for-sale                         | \$346,201 | \$5,387 | \$(8,772 ) | \$342,816 |
| Held-to-maturity:                                |           |         |            |           |
| Obligations of states and political subdivisions | \$50      | \$3     | \$-        | \$53      |

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The trust preferred securities are four trust preferred pooled securities issued by FTN Financial Securities Corp. (“FTN”). The unrealized losses of these securities, which have maturities ranging from nineteen years to twenty seven years, is primarily due to their long-term nature, a lack of demand or inactive market for these securities, and concerns regarding the underlying financial institutions that have issued the trust preferred securities. See the heading “Trust Preferred Securities” below for further information regarding these securities. Except as discussed below, management believes the declines in fair value for these securities are temporary.

Proceeds from sales of investment securities, realized gains and losses and income tax expense and benefit were as follows during the years ended December 31, 2011, 2010 and 2009:

|                     | 2011      | 2010      | 2009      |
|---------------------|-----------|-----------|-----------|
| Proceeds from sales | \$ 18,891 | \$ 10,936 | \$ 38,275 |
| Gross gains         | 486       | 543       | 637       |
| Gross losses        | -         | -         | -         |
| Income tax expense  | 170       | 190       | 223       |

The following table indicates the expected maturities of investment securities classified as available-for-sale and held-to-maturity, presented at amortized cost, at December 31, 2011 (dollars in thousands) and the weighted average yield for each range of maturities. Mortgage-backed securities are aged according to their weighted average life. All other securities are shown at their contractual maturity.

|  | One<br>year<br>or less | After 1<br>through<br>5 years | After 5<br>through<br>10 years | After<br>10<br>years | Total      |
|--|------------------------|-------------------------------|--------------------------------|----------------------|------------|
| <b>Available-for-sale:</b>                       |                        |                               |                                |                      |            |
| U.S. Treasury securities and obligations of U.S. |                        |                               |                                |                      |            |
| government corporations and agencies             | \$ 118,988             | \$ 45,824                     | \$ -                           | \$ -                 | \$ 164,812 |
| Obligations of state and political subdivisions  | 463                    | 16,371                        | 20,968                         | 1,026                | 38,828     |
| Mortgage-backed securities: GSE                  |                        |                               |                                |                      |            |
| residential                                      | 19,135                 | 202,110                       | 33,685                         | -                    | 254,930    |
| Trust preferred securities                       | -                      | -                             | -                              | 5,625                | 5,625      |
| Other securities                                 | -                      | 7,660                         | 1,866                          | 35                   | 9,561      |
| Total investments                                | \$ 138,586             | \$ 271,965                    | \$ 56,519                      | \$ 6,686             | \$ 473,756 |
| Weighted average yield                           | 2.34 %                 | 2.98 %                        | 3.03 %                         | 3.77 %               | 2.94 %     |
| Full tax-equivalent yield                        | 2.35 %                 | 3.10 %                        | 3.72 %                         | 3.88 %               | 3.09 %     |
| <b>Held-to-maturity:</b>                         |                        |                               |                                |                      |            |
| Obligations of state and political subdivisions  |                        |                               |                                |                      |            |
|  | \$ -                   | \$ 51                         | \$ -                           | \$ -                 | \$ 51      |
| Weighted average yield                           |                        | 4.75 %                        |                                |                      | 4.75 %     |
| Full tax-equivalent yield                        |                        | 6.58 %                        |                                |                      | 6.58 %     |

The weighted average yields are calculated on the basis of the amortized cost and effective yields weighted for the scheduled maturity of each security. Full tax-equivalent yields have been calculated using a 34% tax rate. With the exception of obligations of the U.S. Treasury and other U.S. government agencies and corporations, there were no investment securities of any single issuer the book value of which exceeded 10% of stockholders' equity at December 31, 2011.

Investment securities carried at approximately \$286,568,000 and \$240,838,000 at December 31, 2011 and 2010, respectively, were pledged to secure public deposits and repurchase agreements and for other purposes as permitted or required by law.

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The following table presents the aging of gross unrealized losses and fair value by investment category as of December 31, 2011 and 2010:

|   | Less than 12 months |                   | 12 months or more |                   | Total            |                   |
|---|---------------------|-------------------|-------------------|-------------------|------------------|-------------------|
|   | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value       | Unrealized Losses |
| <b>December 31, 2011:</b>   |                     |                   |                   |                   |                  |                   |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | \$19,960            | \$(40 )           | \$-               | \$-               | \$19,960         | \$(40 )           |
| Obligations of states and political subdivisions                                      | 690                 | -                 | -                 | -                 | 690              | -                 |
| Mortgage-backed securities:   |                     |                   |                   |                   |                  |                   |
| GSE residential   | 15,231              | (37 )             | -                 | -                 | 15,231           | (37 )             |
| Trust preferred securities  | -                   | -                 | 719               | (4,906 )          | 719              | (4,906 )          |
| Corporate bonds   | 7,190               | (372 )            | 1,907             | (93 )             | 9,096            | (465 )            |
| <b>Total</b>  | <b>\$43,071</b>     | <b>\$(449 )</b>   | <b>\$2,625</b>    | <b>\$(4,999 )</b> | <b>\$45,696</b>  | <b>\$(5,448 )</b> |
| <b>December 31, 2010:</b>   |                     |                   |                   |                   |                  |                   |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | \$58,782            | \$(1,024 )        | \$-               | \$-               | \$58,782         | \$(1,024 )        |
| Obligations of states and political subdivisions                                      | 7,263               | (216 )            | 252               | (10 )             | 7,515            | (226 )            |
| Mortgage-backed securities:   |                     |                   |                   |                   |                  |                   |
| GSE residential   | 62,171              | (1,482 )          | -                 | -                 | 62,171           | (1,482 )          |
| Trust preferred securities  | -                   | -                 | 581               | (6,014 )          | 581              | (6,014 )          |
| Corporate bonds   | 2,009               | (26 )             | -                 | -                 | 2,009            | (26 )             |
| <b>Total</b>  | <b>\$130,225</b>    | <b>\$(2,748 )</b> | <b>\$833</b>      | <b>\$(6,024 )</b> | <b>\$131,058</b> | <b>\$(8,772 )</b> |

U.S. Treasury Securities and Obligations of U.S. Government Corporations and Agencies. At December 31, 2011 and 2010, there were no U.S. Treasury securities and obligations of U.S. government corporations and agencies in a continuous unrealized loss position for twelve months or more.

Obligations of states and political subdivisions. At December 31, 2010, there were one obligation of states and political subdivisions with a fair value of \$252,000 and unrealized losses of \$10,000 in a continuous unrealized loss position for twelve months or more. This position was due to municipal rates increasing since the purchase of the securities resulting in the market value being lower than book value. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell these securities and it is not more-likely-than-not the Company will be required to sell these securities, before recovery of their amortized cost bases, which may be maturity, the Company does not consider these investments to be other than temporarily impaired at December 31, 2011.

Mortgage-backed Securities: GSE Residential. At December 31, 2011 and 2010, there were no mortgage-backed securities issued by Federal Home Loan Mortgage Corporation in a continuous unrealized loss position for twelve months or more.

Trust Preferred Securities. At December 31, 2011, there were four trust preferred securities with a fair value of \$719,000 and unrealized losses of \$4,906,000 in a continuous unrealized loss position for twelve months or more. At December 31, 2010, these trust preferred securities had a fair value of \$581,000 and unrealized losses of \$6,014,000 in a continuous unrealized loss position for twelve months or more. These unrealized losses were primarily due to the long-term nature of the trust preferred securities, a lack of demand or inactive market for these securities, and concerns regarding the underlying financial institutions that have issued the trust preferred securities. The Company recorded a total of \$886,000 and \$1,418,000 of OTTI for these securities during 2011 and 2010, respectively. These losses established a new, lower amortized cost basis for these securities and reduced non-interest income as of December 31, 2011 and 2010. Because the Company does not intend to sell these securities and it is not more-likely-than-not that the Company will be required to sell these securities before recovery of their new, lower amortized cost basis, which may be maturity, the Company does not consider the remainder of the investment in these securities to be other-than-temporarily impaired at December 31, 2011. However, future downgrades or additional deferrals and defaults in these securities, in particular PreTSL XXVIII, could result in additional OTTI and consequently, have a material impact on future earnings.

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Following are the details for each trust preferred security (in thousands):

|               | Book<br>Value<br>(Amortized<br>Cost) at<br>December<br>31, 2011 | Market<br>Value | Unrealized<br>Loss | Other-than-temporary<br>Impairment<br>Recorded prior to<br>December 31, 2011 |
|---------------|---|-----------------|--------------------|--|
| PreTSL I      | \$746   | \$314           | \$(432 )           | \$ 691   |
| PreTSL II     | 1,027   | 185             | (842 )             | 2,187  |
| PreTSL VI     | 200   | 92              | (108 )             | 127  |
| PreTSL XXVIII | 3,652   | 128             | (3,524 )           | 1,111  |
| Total         | \$5,625   | \$719           | \$(4,906 )         | \$ 4,116   |

Other securities. At December 31, 2011, there was one corporate bond with a fair value of \$1,907,000 and unrealized losses of \$93,000 in a continuous unrealized loss position for twelve months or more. The long-term nature of this security has led to increased supply, while demand has decreased, leading to devaluation of the security. Management has evaluated this security and believes the decline in market value is liquidity, and not credit, related. At December 31, 2010, there were no corporate bonds in a continuous unrealized loss position for twelve months or more.

The Company does not believe any other individual unrealized loss as of December 31, 2011 represents OTTI. However, given the continued disruption in the financial markets, the Company may be required to recognize OTTI losses in future periods with respect to its available for sale investment securities portfolio. The amount and timing of any additional OTTI will depend on the decline in the underlying cash flows of the securities. Should the impairment of any of these securities become other-than-temporary, the cost basis of the investment will be reduced and the resulting loss recognized in the period the other-than-temporary impairment is identified.

#### Other-than-temporary Impairment

Upon acquisition of a security, the Company decides whether it is within the scope of the accounting guidance for beneficial interests in securitized financial assets or will be evaluated for impairment under the accounting guidance for investments in debt and equity securities.

The accounting guidance for beneficial interests in securitized financial assets provides incremental impairment guidance for a subset of the debt securities within the scope of the guidance for investments in debt and equity securities. For securities where the security is a beneficial interest in securitized financial assets, the Company uses the beneficial interests in securitized financial asset impairment model. For securities where the security is not a beneficial interest in securitized financial assets, the Company uses debt and equity securities impairment model.

The Company routinely conducts periodic reviews to identify and evaluate each investment security to determine whether OTTI has occurred. Economic models are used to determine whether OTTI has occurred on these securities. While all securities are considered, the securities primarily impacted by OTTI testing are pooled trust preferred securities. For each pooled trust preferred security in the investment portfolio (including but not limited to those whose fair value is less than their amortized cost basis), an extensive, regular review is conducted to determine if OTTI has occurred. Various inputs to the economic models are used to determine if an unrealized loss is other-than-temporary. The most significant inputs are the following:

- Prepayments

- Defaults
- Loss severity

The pooled trust preferred securities relate to trust preferred securities issued by financial institutions. The pools typically consist of financial institutions throughout the United States. Other inputs may include the actual collateral attributes, which include credit ratings and other performance indicators of the underlying financial institutions including profitability, capital ratios, and asset quality.

To determine if the unrealized losses for pooled trust preferred securities is other-than-temporary, the Company considers the impact of each of these inputs. The Company considers the likelihood that issuers will prepay their securities. During the third quarter of 2010, the Dodd-Frank Act eliminated Tier 1 capital treatment for trust preferred securities issued by holding companies with consolidated assets greater than \$15 billion. As a result, issuers may prepay their securities which reduces the amount of expected cash flows. Additionally, the Company projects total estimated defaults of the underlying assets (the financial institutions) and multiplies that calculated amount by an estimate of realizable value upon sale in the marketplace (severity) in order to determine the projected collateral loss. The Company also evaluates the current credit enhancement underlying the security to determine the impact on cash flows. If the Company determines that a given pooled trust preferred security position will be subject to a write-down or loss, the Company records the expected credit loss as a charge to earnings.

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## Credit Losses Recognized on Investments

As described above, some of the Company's investments in trust preferred securities have experienced fair value deterioration due to credit losses but are not otherwise other-than-temporarily impaired. The following table provides information about those trust preferred securities for which only a credit loss was recognized in income and other losses are recorded in other comprehensive income (loss) for the years ended December 31, 2011, 2010 and 2009 (in thousands).

|   | Accumulated Credit Losses as of: |                      |                      |
|---|----------------------------------|----------------------|----------------------|
|   | December<br>31, 2011             | December<br>31, 2010 | December<br>31, 2009 |
| <b>Credit losses on trust preferred securities held</b>             |                                  |                      |                      |
| Beginning of year   | \$3,230                          | \$1,812              | \$-                  |
| Additions related to OTTI losses not previously recognized          | -                                | -                    | 1,812                |
| Reductions due to sales   | -                                | -                    | -                    |
| Reductions due to change in intent or likelihood of sale            | -                                | -                    | -                    |
| Additions related to increases in previously recognized OTTI losses | 886                              | 1,418                | -                    |
| End of year   | \$4,116                          | \$3,230              | \$1,812              |

Maturities of investment securities were as follows at December 31, 2011 (in thousands). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|   | Amortized<br>Cost | Estimated<br>Fair Value |
|---|-------------------|-------------------------|
| <b>Available-for-sale:</b>                  |                   |                         |
| Due in one year or less                     | \$119,450         | \$119,837               |
| Due after one-five years                    | 69,855            | 71,293                  |
| Due after five-ten years                    | 22,835            | 24,115                  |
| Due after ten years                         | 6,686             | 1,838                   |
|   | 218,826           | 217,083                 |
| Mortgage-backed securities: GSE residential | 254,930           | 261,833                 |
| Total available-for-sale                    | 473,756           | 478,916                 |
| <b>Held-to-maturity:</b>                    |                   |                         |
| Due in one year or less                     | -                 | -                       |
| Due after one-five years                    | 51                | 51                      |
| Due after five-ten years                    | -                 | -                       |
| Due after ten-years                         | -                 | -                       |
| Total held-to-maturity                      | 51                | 51                      |
| Total investment securities                 | \$473,807         | \$478,967               |



## Note 5 – Loans and Allowance for Loan Losses

A summary of loans including loans held for sale at December 31, 2011 and 2010 follows (in thousands):

|  | 2011      | 2010      |
|--|-----------|-----------|
| Construction and land development              | \$23,136  | \$20,382  |
| Farm loans                                     | 72,586    | 65,036    |
| 1-4 Family residential properties (1)          | 181,784   | 179,535   |
| Multifamily residential properties             | 19,847    | 22,159    |
| Commercial real estate                         | 321,908   | 302,220   |
| Loans secured by real estate                   | 619,261   | 589,332   |
| Agricultural loans                             | 63,182    | 58,246    |
| Commercial and industrial loans                | 150,631   | 126,391   |
| Consumer loans                                 | 16,274    | 19,668    |
| All other loans                                | 11,430    | 12,464    |
| Gross loans                                    | 860,778   | 806,101   |
| Less:  |           |           |
| Net deferred loan fees, premiums and discounts | 704       | 1,520     |
| Allowance for loan losses                      | 11,120    | 10,393    |
| Net loans                                      | \$848,954 | \$794,188 |

(1) Includes loans held for sale

Loans expected to be sold are classified as held for sale in the consolidated financial statements and are recorded at the lower of aggregate cost or market value, taking into consideration future commitments to sell the loans. The 1-4 family residential properties balance in the above table includes loans held for sale of \$1,046,000 and \$114,000 at December 31, 2011 and 2010, respectively.

Most of the Company's business activities are with customers located within central Illinois. At December 31, 2011, the Company's loan portfolio included \$135.8 million of loans to borrowers whose businesses are directly related to agriculture. Of this amount, \$120.1 million was concentrated in other grain farming. Total loans to borrowers whose businesses are directly related to agriculture increased \$12.5 million from \$123.3 million at December 31, 2011 while loans concentrated in other grain farming increased \$12.0 million from \$108.1 million at December 31, 2010. While the Company adheres to sound underwriting practices, including collateralization of loans, any extended period of low commodity prices, significantly reduced yields on crops and/or reduced levels of government assistance to the agricultural industry could result in an increase in the level of problem agriculture loans and potentially result in loan losses within the agricultural portfolio.

In addition, the Company has \$46.8 million of loans to motels and hotels. The performance of these loans is dependent on borrower specific issues as well as the general level of business and personal travel within the region. While the Company adheres to sound underwriting standards, a prolonged period of reduced business or personal travel could result in an increase in nonperforming loans to this business segment and potentially in loan losses. The Company also has \$82.6 million of loans to lessors of non-residential buildings and \$44.1 million of loans to lessors of residential buildings and dwellings.

The structure of the Company's loan approval process is based on progressively larger lending authorities granted to individual loan officers, loan committees, and ultimately the Board of Directors. Outstanding balances to one borrower or affiliated borrowers are limited by federal regulation; however, limits well below the regulatory

thresholds are generally observed. The vast majority of the Company's loans are to businesses located in the geographic market areas served by the Company's branch bank system. Additionally, a significant portion of the collateral securing the loans in the portfolio is located within the Company's primary geographic footprint. In general, the Company adheres to loan underwriting standards consistent with industry guidelines for all loan segments. The Company's lending can be summarized into the following primary areas:

**Commercial Real Estate Loans.** Commercial real estate loans are generally comprised of loans to small business entities to purchase or expand structures in which the business operations are housed, loans to owners of real estate who lease space to non-related commercial entities, loans for construction and land development, loans to hotel operators, and loans to owners of multi-family residential structures, such as apartment buildings. Commercial real estate loans are underwritten based on historical and projected cash flows of the borrower and secondarily on the underlying real estate pledged as collateral on the debt. For the various types of commercial real estate loans, minimum criteria have been established within the Company's loan policy regarding debt service coverage while maximum limits on loan-to-value and amortization periods have been defined. Maximum loan-to-value ratios range from 65% to 80% depending upon the type of real estate collateral, while the desired minimum debt coverage ratio is 1.20x. Amortization periods for commercial real estate loans are generally limited to twenty years. The Company's commercial real estate portfolio is well below the thresholds that would designate a concentration in commercial real estate lending, as established by the federal banking regulators.

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**Commercial and Industrial Loans.** Commercial and industrial loans are primarily comprised of working capital loans used to purchase inventory and fund accounts receivable that are secured by business assets other than real estate. These loans are generally written for one year or less. Also, equipment financing is provided to businesses with these loans generally limited to 80% of the value of the collateral and amortization periods limited to seven years. Commercial loans are often accompanied by a personal guaranty of the principal owners of a business. Like commercial real estate loans, the underlying cash flow of the business is the primary consideration in the underwriting process. The financial condition of commercial borrowers is monitored at least annually with the type of financial information required determined by the size of the relationship. Measures employed by the Company for businesses with higher risk profiles include the use of government-assisted lending programs through the Small Business Administration and U.S. Department of Agriculture.

**Agricultural and Agricultural Real Estate Loans.** Agricultural loans are generally comprised of seasonal operating lines to cash grain farmers to plant and harvest corn and soybeans and term loans to fund the purchase of equipment. Agricultural real estate loans are primarily comprised of loans for the purchase of farmland. Specific underwriting standards have been established for agricultural-related loans including the establishment of projections for each operating year based on industry developed estimates of farm input costs and expected commodity yields and prices. Operating lines are typically written for one year and secured by the crop. Loan-to-value ratios on loans secured by farmland generally do not exceed 70% and have amortization periods limited to twenty five years. Federal government-assistance lending programs through the Farm Service Agency are used to mitigate the level of credit risk when deemed appropriate.

**Residential Real Estate Loans.** Residential real estate loans generally include loans for the purchase or refinance of residential real estate properties consisting of 1-4 units and home equity loans and lines of credit. The Company sells substantially all of its long-term fixed rate residential real estate loans to secondary market investors. The Company also releases the servicing of these loans upon sale. The Company retains all residential real estate loans with balloon payment features. Balloon periods are limited to five years. Residential real estate loans are typically underwritten to conform to industry standards including criteria for maximum debt-to-income and loan-to-value ratios as well as minimum credit scores. Loans secured by first liens on residential real estate held in the portfolio typically do not exceed 80% of the value of the collateral and have amortization periods of twenty five years or less. The Company does not originate subprime mortgage loans.

**Consumer Loans.** Consumer loans are primarily comprised of loans to individuals for personal and household purposes such as the purchase of an automobile or other living expenses. Minimum underwriting criteria have been established that consider credit score, debt-to-income ratio, employment history, and collateral coverage. Typically, consumer loans are set up on monthly payments with amortization periods based on the type and age of the collateral.

**Other Loans.** Other loans consist primarily of loans to municipalities to support community projects such as infrastructure improvements or equipment purchases. Underwriting guidelines for these loans are consistent with those established for commercial loans with the additional repayment source of the taxing authority of the municipality.

#### Allowance for Loan Losses

The allowance for loan losses represents the Company's best estimate of the reserve necessary to adequately account for probable losses existing in the current portfolio. The provision for loan losses is the charge against current earnings that is determined by the Company as the amount needed to maintain an adequate allowance for loan losses. In determining the adequacy of the allowance for loan losses, and therefore the provision to be charged to current earnings, the Company relies predominantly on a disciplined credit review and approval process that extends to the full range of the Company's credit exposure. The review process is directed by the overall lending policy and is intended to identify, at the earliest possible stage, borrowers who might be facing financial difficulty. Once identified,

the magnitude of exposure to individual borrowers is quantified in the form of specific allocations of the allowance for loan losses. The Company considers collateral values and guarantees in the determination of such specific allocations. Additional factors considered by the Company in evaluating the overall adequacy of the allowance include historical net loan losses, the level and composition of nonaccrual, past due and troubled debt restructurings, trends in volumes and terms of loans, effects of changes in risk selection and underwriting standards or lending practices, lending staff changes, concentrations of credit, industry conditions and the current economic conditions in the region where the Company operates.

The Company estimates the appropriate level of allowance for loan losses by separately evaluating large impaired loans, large adversely classified loans and nonimpaired loans.

**Impaired loans.** The Company individually evaluates certain loans for impairment. In general, these loans have been internally identified via the Company's loan grading system as credits requiring management's attention due to underlying problems in the borrower's business or collateral concerns. This evaluation considers expected future cash flows, the value of collateral and also other factors that may impact the borrower's ability to make payments when due. For loans greater than \$100,000 in the commercial, commercial real estate, agricultural, agricultural real estate segments, impairment is individually measured each quarter using one of three alternatives: (1) the present value of expected future cash flows discounted at the loan's effective interest rate; (2) the loan's observable market price, if available; or (3) the fair value of the collateral less costs to sell for collateral dependent loans and loans for which foreclosure is deemed to be probable. A specific allowance is assigned when expected cash flows or collateral do not justify the carrying amount of the loan. The carrying value of the loan reflects reductions from prior charge-offs.

**Adversely classified loans.** A detailed analysis is also performed on each adversely classified (substandard or doubtful rated) borrower with an aggregate, outstanding balance of \$100,000 or more. This analysis includes commercial, commercial real estate, agricultural, and agricultural real estate borrowers who are not currently identified as impaired but pose sufficient risk to warrant in-depth review. Estimated collateral shortfalls are then calculated with allocations for each loan segment based on the five-year historical average of collateral shortfalls adjusted for environmental factors including changes in economic conditions, changes in credit policies or underwriting standards, and changes in the level of credit risk associated with specific industries and markets. Because the economic and business climate in any given industry or market, and its impact on any given borrower, can change rapidly, the risk profile of the loan portfolio is periodically assessed and adjusted when appropriate.

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Non-classified and Watch loans. For loans, in all segments of the portfolio, that are considered to possess levels of risk commensurate with a pass rating, management establishes base loss estimations which are derived from the historical loss experience over the past five years. Use of a five-year historical loss period eliminates the effect of any significant losses that can be attributed to a single event or borrower during a given reporting period. The base loss estimations for each loan segment are adjusted after consideration of several environmental factors influencing the level of credit risk in the portfolio. In addition, loans rated as watch are further segregated in the commercial / commercial real estate and agricultural / agricultural real estate segments. These loans possess potential weaknesses that, if unchecked, may result in deterioration to the point of becoming a problem asset. Due to the elevated risk inherent in these loans, an allocation of twice the adjusted base loss estimation of the applicable loan segment is determined appropriate.

Due to weakened economic conditions during recent years, the Company established allocations for each of the loan segments at levels above the base loss estimations. Some of the economic factors included the potential for reduced cash flow for commercial operating loans from reduction in sales or increased operating costs, decreased occupancy rates for commercial buildings, reduced levels of home sales for commercial land developments, the uncertainty regarding grain prices and increased operating costs for farmers, and increased levels of unemployment and bankruptcy impacting consumer's ability to pay. Each of these economic uncertainties was taken into consideration in developing the level of the reserve. The Company has not materially changed any aspect of its overall approach in the determination of the allowance for loan losses. However, on an on-going basis the Company continues to refine the methods used in determining management's best estimate of the allowance for loan losses.

The following tables present the balance in the allowance for loan losses and the recorded investment in loans (including loans held for sale) based on portfolio segment and impairment method as of December 31, 2011, 2010 and 2009 (in thousands):

| 2011  | Commercial/<br>Commercial<br>Real Estate | Agricultural/<br>Agricultural<br>Real Estate | Residential Real<br>Estate | Consumer  | Unallocated | Total      |
|---|--|--|----------------------------|-----------|-------------|------------|
| <b>Allowance for loan losses:</b>                     |  |  |                            |           |             |            |
| Balance, beginning of year                            | \$ 8,307                                 | \$ 404                                       | \$ 440                     | \$ 392    | \$ 850      | \$ 10,393  |
| Provision charged to<br>expense                       | 2,309                                    | 205  | 546                        | 122       | (81 )       | 3,101      |
| Losses charged off                                    | (3,077 )                                 | (66 )  | (363 )                     | (254 )    | -           | (3,760 )   |
| Recoveries  | 1,252                                    | 3  | 13                         | 118       | -           | 1,386      |
| Balance, end of year                                  | \$ 8,791                                 | \$ 546                                       | \$ 636                     | \$ 378    | \$ 769      | \$ 11,120  |
| <b>Ending balance:</b>                                |  |  |                            |           |             |            |
| Individually evaluated for<br>impairment              | \$ 575                                   | \$ -   | \$ -                       | \$ -      | \$ -        | \$ 575     |
| Collectively evaluated for<br>impairment              | \$ 8,216                                 | \$ 546                                       | \$ 636                     | \$ 378    | \$ 769      | \$ 10,545  |
| Loans acquired with<br>deteriorated<br>credit quality | \$ -                                     | \$ -   | \$ -                       | \$ -      | \$ -        | \$ -       |
| <b>Loans:</b>   |  |  |                            |           |             |            |
| Ending balance  | \$ 505,693                               | \$ 130,595                                   | \$ 185,151                 | \$ 16,270 | \$ 22,365   | \$ 860,074 |
| <b>Ending balance:</b>                                |  |  |                            |           |             |            |

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|   |            |            |            |          |          |           |
|---|------------|------------|------------|----------|----------|-----------|
| Individually evaluated for impairment           | \$ 4,719   | \$ 1,149   | \$ -       | \$-      | \$-      | \$5,868   |
| Collectively evaluated for impairment           | \$ 500,974 | \$ 129,446 | \$ 185,151 | \$16,270 | \$22,365 | \$854,206 |
| Loans acquired with deteriorated credit quality | \$ -       | \$ -       | \$ -       | \$-      | \$-      | \$-       |

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| 2010  | Commercial/<br>Commercial<br>Real Estate | Agricultural/<br>Agricultural<br>Real Estate | Residential Real<br>Estate | Consumer  | Unallocated | Total      |
|---|--|--|----------------------------|-----------|-------------|------------|
| Allowance for loan losses:                            |  |  |                            |           |             |            |
| Balance, beginning of year                            | \$ 7,428                                 | \$ 315                                       | \$ 488                     | \$ 410    | \$ 821      | \$ 9,462   |
| Provision charged to<br>expense                       | 3,473                                    | 89   | (118 )                     | 264       | 29          | 3,737      |
| Losses charged off                                    | (2,770 )                                 | (3 )   | (65 )                      | (284 )    | -           | (3,122 )   |
| Recoveries  | 176                                      | 3  | 135                        | 2         | -           | 316        |
| Balance, end of year                                  | \$ 8,307                                 | \$ 404                                       | \$ 440                     | \$ 392    | \$ 850      | \$ 10,393  |
| Ending balance:                                       |  |  |                            |           |             |            |
| Individually evaluated for<br>impairment              | \$ 1,086                                 | \$ -   | \$ -                       | \$ -      | \$ -        | \$ 1,086   |
| Collectively evaluated for<br>impairment              | \$ 7,221                                 | \$ 404                                       | \$ 440                     | \$ 392    | \$ 850      | \$ 9,307   |
| Loans acquired with<br>deteriorated<br>credit quality |  |  |                            |           |             |            |
|   | \$ -                                     | \$ -   | \$ -                       | \$ -      | \$ -        | \$ -       |
| Loans:  |  |  |                            |           |             |            |
| Ending balance  | \$ 465,390                               | \$ 118,973                                   | \$ 183,000                 | \$ 20,486 | \$ 16,732   | \$ 804,581 |
| Ending balance:                                       |  |  |                            |           |             |            |
| Individually evaluated for<br>impairment              | \$ 7,332                                 | \$ 1,152                                     | \$ -                       | \$ -      | \$ -        | \$ 8,484   |
| Collectively evaluated for<br>impairment              | \$ 458,058                               | \$ 117,821                                   | \$ 183,000                 | \$ 20,486 | \$ 16,732   | \$ 796,097 |
| Loans acquired with<br>deteriorated<br>credit quality |  |  |                            |           |             |            |
|   | \$ -                                     | \$ -   | \$ -                       | \$ -      | \$ -        | \$ -       |
| 2009  |  |  |                            |           |             |            |
| Allowance for loan losses:                            |  |  |                            |           |             |            |
| Balance, beginning of year                            | \$ 5,345                                 | \$ 223                                       | \$ 510                     | \$ 436    | \$ 1,073    | \$ 7,587   |
| Provision charged to expense                          | 3,315                                    | 89   | 202                        | 240       | (252 )      | 3,594      |
| Losses charged off                                    | (1,256 )                                 | -  | (352 )                     | (271 )    | -           | (1,879 )   |
| Recoveries  | 24                                       | 3  | 128                        | 5         | -           | 160        |
| Balance, end of year                                  | \$ 7,428                                 | \$ 315                                       | \$ 488                     | \$ 410    | \$ 821      | \$ 9,462   |
| Ending balance:                                       |  |  |                            |           |             |            |
| Individually evaluated for<br>impairment              | \$ 563                                   | \$ -   | \$ -                       | \$ -      | \$ -        | \$ 563     |
| Collectively evaluated for<br>impairment              | \$ 6,865                                 | \$ 315                                       | \$ 488                     | \$ 410    | \$ 821      | \$ 8,899   |
| Loans acquired with<br>deteriorated<br>credit quality |  |  |                            |           |             |            |
|   | \$ -                                     | \$ -   | \$ -                       | \$ -      | \$ -        | \$ -       |
| Loans:  |  |  |                            |           |             |            |

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|   |           |           |           |          |          |           |
|---|-----------|-----------|-----------|----------|----------|-----------|
| Ending balance                                  | \$376,170 | \$111,845 | \$180,404 | \$21,518 | \$10,813 | \$700,750 |
| Ending balance:                                 |           |           |           |          |          |           |
| Individually evaluated for impairment           | \$9,509   | \$1,356   | \$-       | \$-      | \$-      | \$10,865  |
| Collectively evaluated for impairment           | \$366,661 | \$110,489 | \$180,404 | \$21,518 | \$10,813 | \$689,885 |
| Loans acquired with deteriorated credit quality |           |           |           |          |          |           |
|   | \$-       | \$-       | \$-       | \$-      | \$-      | \$-       |

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Consistent with regulatory guidance, charge-offs on all loan segments are taken when specific loans, or portions thereof, are considered uncollectible. The Company's policy is to promptly charge these loans off in the period the uncollectible loss is reasonably determined.

For all loan portfolio segments except 1-4 family residential properties and consumer, the Company promptly charges-off loans, or portions thereof, when available information confirms that specific loans are uncollectible based on information that includes, but is not limited to, (1) the deteriorating financial condition of the borrower, (2) declining collateral values, and/or (3) legal action, including bankruptcy, that impairs the borrower's ability to adequately meet its obligations. For impaired loans that are considered to be solely collateral dependent, a partial charge-off is recorded when a loss has been confirmed by an updated appraisal or other appropriate valuation of the collateral.

The Company charges-off 1-4 family residential and consumer loans, or portions thereof, when the Company reasonably determines the amount of the loss. The Company adheres to timeframes established by applicable regulatory guidance which provides for the charge-down of 1-4 family first and junior lien mortgages to the net realizable value less costs to sell when the loan is 180 days past due, charge-off of unsecured open-end loans when the loan is 180 days past due, and charge down to the net realizable value when other secured loans are 120 days past due. Loans at these respective delinquency thresholds for which the Company can clearly document that the loan is both well-secured and in the process of collection, such that collection will occur regardless of delinquency status, need not be charged off.

#### Credit Quality

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, collateral support, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes loans with an outstanding balance greater than \$100,000 and non-homogenous loans, such as commercial and commercial real estate loans. This analysis is performed on a continuous basis. The Company uses the following definitions for risk ratings:

**Watch.** Loans classified as watch have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

**Substandard.** Loans classified as substandard are inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

**Doubtful.** Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing factors, conditions and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered pass rated loans. The following tables present the credit risk profile of the Company's loan portfolio by loan class based on rating category and payment activity as of December 31, 2011 and 2010 (in thousands):

Construction &

Farm Loans

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|             | Land Development |          |          |          | 1-4 Family Residential Properties |           | Multifamily Residential Properties |          |
|-------------|------------------|----------|----------|----------|-----------------------------------|-----------|------------------------------------|----------|
|             | 2011             | 2010     | 2011     | 2010     | 2011                              | 2010      | 2011                               | 2010     |
| Pass        | \$19,708         | \$15,778 | \$67,637 | \$58,751 | \$180,247                         | \$174,782 | \$19,638                           | \$10,381 |
| Watch       | 2,168            | 2,219    | 2,496    | 4,710    | 497                               | 267       | -                                  | 6,204    |
| Substandard | 1,260            | 1,494    | 2,452    | 1,531    | 1,105                             | 4,478     | 208                                | 5,561    |
| Doubtful    | -                | 888      | -        | -        | -                                 | -         | -                                  | -        |
| Total       | \$23,136         | \$20,379 | \$72,585 | \$64,992 | \$181,849                         | \$179,527 | \$19,846                           | \$22,146 |

|             | Commercial Real Estate (Nonfarm/Nonresidential) |           | Agricultural Loans |          | Commercial & Industrial Loans |           | Consumer Loans |          |
|-------------|---|-----------|--------------------|----------|-------------------------------|-----------|----------------|----------|
|             | 2011  | 2010      | 2011               | 2010     | 2011                          | 2010      | 2011           | 2010     |
| Pass        | \$288,539                                       | \$276,174 | \$58,133           | \$53,293 | \$147,591                     | \$120,284 | \$16,271       | \$19,655 |
| Watch       | 24,664  | 14,598    | 1,840              | 3,269    | 280                           | 2,519     | -              | -        |
| Substandard | 7,798   | 10,053    | 3,284              | 1,745    | 2,845                         | 3,516     | -              | -        |
| Doubtful    | -   | -         | -                  | -        | -                             | -         | -              | -        |
| Total       | \$321,001                                       | \$300,825 | \$63,257           | \$58,307 | \$150,716                     | \$126,319 | \$16,271       | \$19,655 |

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|             | All Other Loans |          | Total Loans |           |
|-------------|-----------------|----------|-------------|-----------|
|             | 2011            | 2010     | 2011        | 2010      |
| Pass        | \$11,413        | \$12,431 | \$809,177   | \$741,529 |
| Watch       | -               | -        | 31,945      | 33,786    |
| Substandard | -               | -        | 18,952      | 28,378    |
| Doubtful    | -               | -        | -           | 888       |
| Total       | \$11,413        | \$12,431 | \$860,074   | \$804,581 |

The following table presents the Company's loan portfolio by loan class aging analysis as of December 31, 2011 and 2010 (in thousands):

|                                       | 30-59<br>days<br>Due | 60-89<br>days<br>Due | 90 Days<br>Past<br>Due | Total<br>Past<br>Due | Total<br>Current | Total<br>Loans<br>Receivable | Total<br>Loans ><br>90 days &<br>Accruing |
|---------------------------------------|----------------------|----------------------|------------------------|----------------------|------------------|------------------------------|---|
|                                       |                      |                      |                        |                      |                  |                              |   |
| December 31, 2011                     |                      |                      |                        |                      |                  |                              |   |
| Construction and land development     | \$ -                 | \$ -                 | \$ -                   | \$ -                 | \$23,136         | \$23,136                     | \$ -                                      |
| Farm loans                            | 377                  | 111                  | 737                    | 1,225                | 71,360           | 72,585                       | -   |
| 1-4 Family residential properties (1) | 1,079                | 200                  | 1,033                  | 2,312                | 179,537          | 181,849                      | -   |
| Multifamily residential properties    | -                    | -                    | -                      | -                    | 19,846           | 19,846                       | -   |
| Commercial real estate                | 399                  | 101                  | 228                    | 728                  | 320,273          | 321,001                      | -   |
| Loans secured by real estate          | 1,855                | 412                  | 1,998                  | 4,265                | 614,152          | 618,417                      | -   |
| Agricultural loans                    | -                    | -                    | 673                    | 673                  | 62,584           | 63,257                       | -   |
| Commercial and industrial loans       | 950                  | 73                   | 585                    | 1,608                | 149,108          | 150,716                      | -   |
| Consumer loans                        | 94                   | 36                   | 7                      | 137                  | 16,134           | 16,271                       | -   |
| All other loans                       | -                    | -                    | -                      | -                    | 11,413           | 11,413                       | -   |
| Total loans                           | \$2,899              | \$521                | \$3,263                | \$6,683              | \$853,391        | \$860,074                    | \$ -                                      |
| December 31, 2010                     |                      |                      |                        |                      |                  |                              |   |
| Construction and land development     | \$ 5                 | \$ -                 | \$ 150                 | \$ 155               | \$20,224         | \$20,379                     | \$ -                                      |
| Farm loans                            | 5                    | 0                    | 761                    | 766                  | 64,226           | 64,992                       | -   |
| 1-4 Family residential properties (1) | 819                  | 201                  | 1,624                  | 2,644                | 176,883          | 179,527                      | -   |
| Multifamily residential properties    | -                    | 573                  | -                      | 573                  | 21,573           | 22,146                       | -   |
| Commercial real estate                | 1,535                | 1,075                | 727                    | 3,337                | 297,488          | 300,825                      | -   |
| Loans secured by real estate          | 2,364                | 1,849                | 3,262                  | 7,475                | 580,394          | 587,869                      | -   |
| Agricultural loans                    | 125                  | -                    | 828                    | 953                  | 57,354           | 58,307                       | -   |
| Commercial and industrial loans       | 473                  | 64                   | 259                    | 796                  | 125,523          | 126,319                      | -   |
| Consumer loans                        | 177                  | 32                   | 15                     | 224                  | 19,431           | 19,655                       | -   |
| All other loans                       | -                    | -                    | -                      | -                    | 12,431           | 12,431                       | -   |
| Total loans                           | \$3,139              | \$1,945              | \$4,364                | \$9,448              | \$795,133        | \$804,581                    | \$ -                                      |

(1) includes loans held for sale

#### Impaired Loans

Within all loan portfolio segments, loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. The entire balance of a loan is considered delinquent if the minimum payment contractually required to be made is not received by the specified due date. Impaired loans, excluding certain troubled debt restructured loans, are placed on nonaccrual status. Impaired loans include nonaccrual loans and loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection. It is the Company's policy to have any restructured loans which are on nonaccrual status prior to being modified remain on nonaccrual status until, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collection of interest or principal. If the restructured loan is on accrual status prior to being modified, the loan is reviewed to determine if the modified loan should remain on accrual status.

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The Company's policy is to discontinue the accrual of interest income on all loans for which principal or interest is ninety days past due. The accrual of interest is discontinued earlier when, in the opinion of management, there is reasonable doubt as to the timely collection of interest or principal. Once interest accruals are discontinued, accrued but uncollected interest is charged against current year income. Subsequent receipts on non-accrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured. Interest on loans determined to be troubled debt restructurings is recognized on an accrual basis in accordance with the restructured terms if the loan is in compliance with the modified terms. Nonaccrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collection of interest or principal. . The Company requires a period of satisfactory performance of not less than six months before returning a nonaccrual loan to accrual status.

The following tables present impaired loans by loan class for the years ended December 31, 2011 and 2010 (in thousands):

|                                     | December 31, 2011   |                                |                       | December 31, 2010   |                                |                       |
|-------------------------------------|---------------------|--------------------------------|-----------------------|---------------------|--------------------------------|-----------------------|
|                                     | Recorded<br>Balance | Unpaid<br>Principal<br>Balance | Specific<br>Allowance | Recorded<br>Balance | Unpaid<br>Principal<br>Balance | Specific<br>Allowance |
| Loans with a specific allowance:    |                     |                                |                       |                     |                                |                       |
| Construction and land development   | \$833               | \$1,070                        | \$295                 | \$1,804             | \$1,804                        | \$478                 |
| Farm loans                          | -                   | -                              | -                     | -                   | -                              | -                     |
| 1-4 Family residential properties   | 71                  | 71                             | 27                    | 917                 | 917                            | 273                   |
| Multifamily residential properties  | -                   | -                              | -                     | 573                 | 669                            | 69                    |
| Commercial real estate              | 1,414               | 1,693                          | 183                   | 1,120               | 1,120                          | 79                    |
| Loans secured by real estate        | 2,318               | 2,834                          | 505                   | 4,414               | 4,510                          | 899                   |
| Agricultural loans                  | -                   | -                              | -                     | -                   | -                              | -                     |
| Commercial and industrial loans     | 382                 | 382                            | 70                    | 231                 | 231                            | 187                   |
| Consumer loans                      | -                   | -                              | -                     | -                   | -                              | -                     |
| All other loans                     | -                   | -                              | -                     | -                   | -                              | -                     |
| Total loans                         | \$2,700             | \$3,216                        | \$575                 | \$4,645             | \$4,741                        | \$1,086               |
| Loans without a specific allowance: |                     |                                |                       |                     |                                |                       |
| Construction and land development   | \$-                 | \$-                            | \$-                   | \$151               | \$151                          | \$-                   |
| Farm loans                          | 532                 | 532                            | -                     | 540                 | 540                            | -                     |
| 1-4 Family residential properties   | 1,641               | 1,818                          | -                     | 1,648               | 1,678                          | -                     |
| Multifamily residential properties  | -                   | -                              | -                     | -                   | -                              | -                     |
| Commercial real estate              | 1,226               | 1,256                          | -                     | 1,916               | 3,095                          | -                     |
| Loans secured by real estate        | 3,399               | 3,606                          | -                     | 4,255               | 5,464                          | -                     |
| Agricultural loans                  | 673                 | 673                            | -                     | 828                 | 828                            | -                     |
| Commercial and industrial loans     | 660                 | 1,255                          | -                     | 692                 | 804                            | -                     |
| Consumer loans                      | 8                   | 20                             | -                     | 14                  | 14                             | -                     |
| All other loans                     | -                   | -                              | -                     | 0                   | -                              | -                     |

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|                                    |         |         |       |          |          |         |
|------------------------------------|---------|---------|-------|----------|----------|---------|
| Total loans                        | \$4,740 | \$5,554 | \$-   | \$5,789  | \$7,110  | \$-     |
| Total loans:                       |         |         |       |          |          |         |
| Construction and land development  | \$833   | \$1,070 | \$295 | \$1,955  | \$1,955  | \$478   |
| Farm loans                         | 532     | 532     | -     | 540      | 540      | -       |
| 1-4 Family residential properties  | 1,712   | 1,889   | 27    | 2,565    | 2,595    | 273     |
| Multifamily residential properties | -       | -       | -     | 573      | 669      | 69      |
| Commercial real estate             | 2,640   | 2,949   | 183   | 3,036    | 4,215    | 79      |
| Loans secured by real estate       | 5,717   | 6,440   | 505   | 8,669    | 9,974    | 899     |
| Agricultural loans                 | 673     | 673     | -     | 828      | 828      | -       |
| Commercial and industrial loans    | 1,042   | 1,637   | 70    | 923      | 1,035    | 187     |
| Consumer loans                     | 8       | 20      | -     | 14       | 14       | -       |
| All other loans                    | -       | -       | -     | -        | -        | -       |
| Total loans                        | \$7,440 | \$8,770 | \$575 | \$10,434 | \$11,851 | \$1,086 |

The following table presents average recorded investment and interest income recognized on impaired loans for the years ended December 31, 2011 and 2010 (in thousands):

|                                    | December 31, 2011                    |                            | December 31, 2010                    |                            |
|------------------------------------|--------------------------------------|----------------------------|--------------------------------------|----------------------------|
|                                    | Average Investment in Impaired Loans | Interest Income Recognized | Average Investment in Impaired Loans | Interest Income Recognized |
| Construction and land development  | \$841                                | \$ -                       | \$1,975                              | \$ -                       |
| Farm loans                         | 532                                  | -                          | 1,317                                | -                          |
| 1-4 Family residential properties  | 1,755                                | -                          | 2,720                                | -                          |
| Multifamily residential properties | -                                    | -                          | 670                                  | -                          |
| Commercial real estate             | 2,688                                | 22                         | 4,425                                | 56                         |
| Loans secured by real estate       | 5,816                                | 22                         | 11,107                               | 56                         |
| Agricultural loans                 | 673                                  | -                          | 993                                  | -                          |
| Commercial and industrial loans    | 1,199                                | 14                         | 1,165                                | 19                         |
| Consumer loans                     | 10                                   | -                          | 17                                   | -                          |
| All other loans                    | -                                    | -                          | -                                    | -                          |
| Total loans                        | \$7,698                              | \$ 36                      | \$13,282                             | \$ 75                      |

For the twelve months ended December 31, 2011 and 2010, the amount of interest income recognized by the Company within the period that the loans were impaired was due to loans modified in a troubled debt restructuring that remained on accrual status. The balance of loans modified in a troubled debt restructuring included in the impaired loans stated above that were still accruing was \$395,000 of commercial real estate and \$322,000 of commercial and industrial at December 31, 2011 and \$887,000 of commercial real estate and \$215,000 of commercial and industrial at December 31, 2010. For the twelve months ended December 31, 2011 and 2010, the amount of interest income recognized using a cash-basis method of accounting during the period that the loans were impaired was not material.

#### Non Accrual Loans

The following table presents the Company's nonaccrual loans at December 31, 2011 and 2010 (in thousands). This table excludes purchased impaired loans and performing troubled debt restructurings.

|                                    | 2011    | 2010    |
|------------------------------------|---------|---------|
| Construction and land development  | \$833   | \$1,955 |
| Farm loans                         | 532     | 540     |
| 1-4 Family residential properties  | 1,712   | 2,565   |
| Multifamily residential properties | -       | 573     |
| Commercial real estate             | 2,245   | 2,149   |
| Loans secured by real estate       | 5,322   | 7,782   |
| Agricultural loans                 | 673     | 828     |
| Commercial and industrial loans    | 720     | 708     |
| Consumer loans                     | 8       | 14      |
| All other loans                    | -       | -       |
| Total loans                        | \$6,723 | \$9,332 |

The aggregate principal balances of nonaccrual, past due ninety days or more loans were \$6,723,000 and \$9,332,000 at December 31, 2011 and 2010, respectively. Interest income which would have been recorded under the original terms of such nonaccrual loans totaled \$239,000, \$428,000 and \$672,000 in 2011, 2010 and 2009, respectively.

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### Troubled Debt Restructuring

The balance of troubled debt restructurings at December 31, 2011 and 2010 was \$1,834,000 and \$1,102,000, respectively. Approximately \$140,000 and \$250,000 in specific reserves have been established with respect to these loans as of December 31, 2011 and 2010, respectively. During the year ended December 31, 2011, the terms of two commercial loans and three commercial real estate loans were modified in troubled debt restructurings. As troubled debt restructurings, these loans are included in nonperforming loans and are classified as impaired which requires that they be individually measured for impairment. The modification of the terms of these loans included one or a combination of the following: a reduction of stated interest rate of the loan; an extension of the maturity date and change in payment terms; or a permanent reduction of the recorded investment in the loan.

The modification of one commercial real estate loan involved charging down the loan to a level which is expected to be serviced by the on-going operations of the property at a market interest rate and amortization period. The loan was in non-accrual status at the time of the modification and will remain so until sustained performance occurs under the modified terms. Modification of the second commercial real estate loan also involved charging down the loan and the combining of several past due notes which lowered the monthly payment of the notes.

The third modification involved a commercial real estate loan and a commercial loan of a single borrower. These notes were restructured to lower the monthly payments by re-amortizing the debt. The interest rates and maturity dates remained unchanged, however the balloon payments were increased.

The second commercial loan was modified to interest-only payments for a six-month period with the maturity date extended for eighteen months. The interest rate remained unchanged. The loan is 75% guaranteed by the Small Business Administration.

The following table presents the Company's recorded balance of troubled debt restructurings at of December 31, 2011 (in thousands):

|  | December<br>31,<br>2011 |
|--|-------------------------|
| Troubled debt restructurings:            |                         |
| Construction and land development        | \$-                     |
| Farm loans                               | -                       |
| 1-4 Family residential properties        | 393                     |
| Multifamily residential properties       | -                       |
| Commercial real estate                   | 557                     |
| Loans secured by real estate             | 951                     |
| Agricultural loans                       | -                       |
| Commercial and industrial loans          | 167                     |
| Consumer loans                           | -                       |
| All other loans                          | -                       |
| Total                                    | \$1,117                 |
| Performing troubled debt restructurings: |                         |
| Construction and land development        | \$-                     |
| Farm loans                               | -                       |
| 1-4 Family residential properties        | -                       |
| Multifamily residential properties       | -                       |

|                                 |       |
|---------------------------------|-------|
| Commercial real estate          | 395   |
| Loans secured by real estate    | 395   |
| Agricultural loans              | -     |
| Commercial and industrial loans | 322   |
| Consumer loans                  | -     |
| All other loans                 | -     |
| Total                           | \$717 |

The troubled debt restructurings described above increased the allowance for loan losses by \$140,000 through the allocation of a specific reserve, and resulted in charge offs of \$555,219 during the year ended December 31, 2011.

A loan is considered to be in payment default once it is 90 days past due under the modified terms. There were two loans totaling \$215,000 identified as troubled debt restructurings during the prior twelve months that experienced defaults during the year ended December 31, 2011.

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## Note 6 – Premises and Equipment, Net

Premises and equipment at December 31, 2011 and 2010 consisted of:

|   | 2011     | 2010     |
|---|----------|----------|
| Land                                      | \$5,966  | \$5,533  |
| Buildings and improvements                | 28,499   | 26,174   |
| Furniture and equipment                   | 15,407   | 14,707   |
| Leasehold improvements                    | 3,083    | 3,005    |
| Construction in progress                  | 584      | 10       |
| Subtotal                                  | 53,539   | 49,429   |
| Accumulated depreciation and amortization | 22,822   | 20,885   |
| Total                                     | \$30,717 | \$28,544 |

Depreciation and amortization expense was \$2,452,000, \$1,829,000 and \$1,538,000 for the years ended December 31, 2011, 2010 and 2009, respectively.

## Note 7 – Goodwill and Intangible Assets

The Company has goodwill from business combinations, intangible assets from branch acquisitions, identifiable intangible assets assigned to core deposit relationships and customer lists of insurance agencies acquired. The following table presents gross carrying amount and accumulated amortization by major intangible asset class as of December 31, 2011 and 2010:

|                                      | 2011                       |                             | 2010                       |                             |
|--------------------------------------|----------------------------|-----------------------------|----------------------------|-----------------------------|
|                                      | Gross<br>Carrying<br>Value | Accumulated<br>Amortization | Gross<br>Carrying<br>Value | Accumulated<br>Amortization |
| Goodwill not subject to amortization | \$29,513                   | \$ 3,760                    | \$29,513                   | \$ 3,760                    |
| Intangibles from branch acquisition  | 3,015                      | 2,965                       | 3,015                      | 2,764                       |
| Core deposit intangibles             | 8,986                      | 5,119                       | 8,986                      | 4,376                       |
| Customer list intangibles            | 1,904                      | 1,887                       | 1,904                      | 1,697                       |
|                                      | \$43,418                   | \$ 13,731                   | \$43,418                   | \$ 12,597                   |

Goodwill of \$8.4 million was recorded for the acquisition of ten branches from First Bank, a Missouri state chartered bank, during the third quarter of 2010. All of the goodwill was assigned to the banking segment of the Company. The Company expects this goodwill to be fully deductible for tax purposes.

The following table provides a reconciliation of the purchase price paid for the First Bank branches and the amount of goodwill recorded (in thousands):

|                                       |          |
|---------------------------------------|----------|
| Purchase price                        | \$15,610 |
| Less purchase accounting adjustments: |          |
| Fair value of loans                   | \$2,102  |
| Fair value of premises and equipment  | (7,685 ) |
| Fair value of time deposits           | 1,413    |
| Core deposit intangible               | (3,050 ) |
|                                       | (7,220 ) |

Resulting goodwill from acquisition \$8,390

Total amortization expense for the years ended December 31, 2011, 2010 and 2009 was as follows:

|                                      | 2011    | 2010  | 2009  |
|--------------------------------------|---------|-------|-------|
| Intangibles from branch acquisitions | \$201   | \$201 | \$201 |
| Core deposit intangibles             | 743     | 423   | 339   |
| Customer list intangibles            | 190     | 190   | 190   |
|                                      | \$1,134 | \$814 | \$730 |

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Estimated amortization expense for each of the five succeeding years is shown in the table below:

|                                 |       |
|---------------------------------|-------|
| Estimated amortization expense: |       |
| For period ended 12/31/12       | \$773 |
| For period ended 12/31/13       | \$673 |
| For period ended 12/31/14       | \$643 |
| For period ended 12/31/15       | \$616 |
| For period ended 12/31/16       | \$381 |

In accordance with the provisions of SFAS 142, "Goodwill and Other Intangible Assets," codified in ASC 350, the Company performed testing of goodwill for impairment as of September 30, 2011 and 2010, and determined, as of each of these dates, that goodwill was not impaired. Management also concluded that the remaining amounts and amortization periods were appropriate for all intangible assets.

#### Note 8 – Deposits

As of December 31, 2011 and 2010, deposits consisted of the following:

|                      | 2011        | 2010        |
|----------------------|-------------|-------------|
| Demand deposits:     |             |             |
| Non-interest bearing | \$198,962   | \$183,932   |
| Interest-bearing     | 213,920     | 209,203     |
| Savings              | 259,968     | 215,178     |
| Money market         | 268,129     | 287,382     |
| Time deposits        | 234,755     | 317,015     |
| Total deposits       | \$1,170,734 | \$1,212,710 |

Total interest expense on deposits for the years ended December 31, 2011, 2010 and 2009 was as follows:

|                         | 2011    | 2010    | 2009     |
|-------------------------|---------|---------|----------|
| Interest-bearing demand | \$332   | \$500   | \$539    |
| Savings                 | 1,481   | 1,279   | 882      |
| Money market            | 1,993   | 2,690   | 2,304    |
| Time deposits           | 2,919   | 4,002   | 9,245    |
| Total                   | \$6,725 | \$8,471 | \$12,970 |

As of December 31, 2011, 2010 and 2009, the aggregate amount of time deposits in denominations of more than \$100,000 and the total interest expense on such deposits was as follows:

|                               | 2011     | 2010     | 2009     |
|-------------------------------|----------|----------|----------|
| Outstanding                   | \$67,854 | \$88,928 | \$81,692 |
| Interest expense for the year | 1,204    | 1,719    | 3,857    |

The following table shows the amount of maturities for all time deposits as of December 31, 2011:

|                    |            |
|--------------------|------------|
| Less than 1 year   | \$ 171,266 |
| 1 year to 2 years  | 27,360     |
| 2 years to 3 years | 12,545     |
| 3 years to 4 years | 10,991     |
| 4 years to 5 years | 12,265     |
| Over 5 years       | 328        |
| Total              | \$ 234,755 |

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In 2011 the Company maintained account relationships with various public entities throughout its market areas. Four public entities had total balances of \$28.7 million in various checking accounts and time deposits as of December 31, 2011. These balances are subject to change depending upon the cash flow needs of the public entity.

#### Note 9 – Borrowings

As of December 31, 2011 and 2010 borrowings consisted of the following:

|  | 2011      | 2010      |
|--|-----------|-----------|
| Securities sold under agreements to repurchase | \$132,380 | \$94,057  |
| Federal Home Loan Bank advances:               |           |           |
| Fixed-term advances                            | 19,750    | 22,750    |
| Subordinated debentures                        | 20,620    | 20,620    |
| Other borrowings:                              |           |           |
| Due in one year or less                        | 8,250     | -         |
| Total  | \$181,000 | \$137,427 |

Aggregate annual maturities of long-term borrowings at December 31, 2011 are:

|            |          |
|------------|----------|
| 2012       | \$14,750 |
| 2013       | -        |
| 2014       | -        |
| 2015       | -        |
| 2016       | -        |
| Thereafter | 25,620   |
|            | \$40,370 |

FHLB advances represent borrowings by First Mid Bank to economically fund loan demand. The fixed term advances totaling \$19.75 million are as follows:

- \$5 million advance at 4.82% with a 5-year maturity, due January 19, 2012, two year lockout, callable quarterly
- \$5 million advance at 4.69% with a 5-year maturity, due February 23, 2012, two year lockout, callable quarterly
  - \$4.75 million advance at 1.60% with a 5-year maturity, due December 24, 2012
- \$5 million advance at 4.58% with a 10-year maturity, due July 14, 2016, one year lockout, callable quarterly

Securities sold under agreements to repurchase have overnight maturities and a weighted average rate of .16%. First Mid Bank has collateral pledge agreements whereby it has agreed to keep on hand at all times, free of all other pledges, liens, and encumbrances, whole first mortgages on improved residential property with unpaid principal balances aggregating no less than 133% of the outstanding advances and letters of credit (\$0 on December 31, 2011) from the FHLB. The securities underlying the repurchase agreements are under the Company's control.

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|   | 2011       | 2010      | 2009      |
|---|------------|-----------|-----------|
| Securities sold under agreements to repurchase: |            |           |           |
| Maximum outstanding at any month-end            | \$ 132,380 | \$ 94,530 | \$ 83,826 |
| Average amount outstanding for the year         | 108,240    | 76,758    | 72,589    |

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At December 31, 2011 and 2010, there was no outstanding loan balance on a revolving credit agreement with The Northern Trust Company. This loan was renewed on April 22, 2011. The revolving credit agreement has a maximum available balance of \$20 million with a term of one year from the date of closing. The interest rate (2.375% at December 31, 2011) is floating at 2.25% over the federal funds rate. The loan is unsecured and subject to a borrowing agreement containing requirements for the Company and First Mid Bank to maintain various operating and capital ratios. The Company and First Mid Bank were in compliance with all the existing covenants at December 31, 2011 and 2010.

As described under Note 1 — “Preferred Stock” above, the Remaining Investors have not yet been issued their shares of Series C Preferred Stock because of unanticipated delays in applying for and obtaining the approval of the Federal Reserve Board, which the these investors must secure to be issued their shares of Series C Preferred Stock. The Company has previously accepted from the Remaining Investors subscriptions for \$8,250,000 of the Series C Preferred Stock pursuant to their respective subscription agreements. In November 2011, the disinterested members of the Board of Directors of the Company approved and authorized, and the Remaining Investors agreed to, certain amendments to the Series C Preferred Stock subscription agreements resulting in the release to the Company of the funds escrowed by the Remaining Investors for their subscribed shares of the Series C Preferred Stock and the issuance by the Company of short-term unsecured promissory notes, which are dated November 21, 2011, to the Remaining Investors. The Notes collectively have an aggregate principal amount of \$8,250,000 and each have an 8% annual interest rate. The notes have a maturity date of January 20, 2012 and were subsequently renewed on that date for an additional 60 days. Each Note also contains a prepayment provision applicable when approval from the Federal Reserve Board is received to allow the Remaining Investors to purchase the shares of Series C Preferred Stock originally subscribed. Additionally, if the Company experiences an Event of Default as defined in the Note, such as becoming insolvent or generally failing to pay its debts as they become due, then a Remaining Investor may, at his, her or its option, declare the entire unpaid amount of the Note immediately due and payable, without presentment, demand, portents or notice of any kind, and the Remaining Investor shall be entitled to recover from the Company all costs and expenses, including reasonable attorneys' fees and disbursements and court costs, incurred in enforcing the Remaining Investor's rights under the Note.

On February 27, 2004, the Company completed the issuance and sale of \$10 million of floating rate trust preferred securities through Trust I, a statutory business trust and wholly-owned unconsolidated subsidiary of the Company, as part of a pooled offering. The Company established Trust I for the purpose of issuing the trust preferred securities. The \$10 million in proceeds from the trust preferred issuance and an additional \$310,000 for the Company's investment in common equity of the Trust, a total of \$10,310 000, was invested in junior subordinated debentures of the Company. The underlying junior subordinated debentures issued by the Company to Trust I mature in 2034, bear interest at three-month London Interbank Offered Rate (“LIBOR”) plus 280 basis points, reset quarterly, and are callable, at the option of the Company, at par on or after April 7, 2009. At December 31, 2011 and 2010 the rate was 3.10% and 3.15%, respectively. The Company used the proceeds of the offering for general corporate purposes.

On April 26, 2006, the Company completed the issuance and sale of \$10 million of fixed/floating rate trust preferred securities through Trust II, a statutory business trust and wholly-owned unconsolidated subsidiary of the Company, as part of a pooled offering. The Company established Trust II for the purpose of issuing the trust preferred securities. The \$10 million in proceeds from the trust preferred issuance and an additional \$310,000 for the Company's investment in common equity of Trust II, a total of \$10,310 000, was invested in junior subordinated debentures of the Company. The underlying junior subordinated debentures issued by the Company to Trust II mature in 2036, bore interest at a fixed rate of 6.98% paid quarterly until June 15, 2011 and then converted to floating rate (LIBOR plus 160 basis points) after June 15, 2011 (1.95% at December 31, 2011). The net proceeds to the Company were used for general corporate purposes, including the Company's acquisition of Mansfield.

The trust preferred securities issued by Trust I and Trust II are included as Tier 1 capital of the Company for regulatory capital purposes. On March 1, 2005, the Federal Reserve Board adopted a final rule that allows the continued limited inclusion of trust preferred securities in the calculation of Tier 1 capital for regulatory purposes. The final rule provided a five-year transition period, ending September 30, 2010, for application of the revised quantitative limits. On March 17, 2009, the Federal Reserve Board adopted an additional final rule that delayed the effective date of the new limits on inclusion of trust preferred securities in the calculation of Tier 1 capital until September 30, 2011. The Company does not expect the application of the revised quantitative limits to have a significant impact on its calculation of Tier 1 capital for regulatory purposes or its classification as well-capitalized. The Dodd-Frank Act, signed into law July 21, 2010, removes trust preferred securities as a permitted component of a holding company's Tier 1 capital after a three-year phase-in period beginning January 1, 2013 for larger holding companies. For holding companies with less than \$15 billion in consolidated assets, existing issues of trust preferred securities are grandfathered and not subject to this new restriction. Therefore, the existing trust preferred securities issued by Trust I and Trust II will continue to count as Tier I capital. New issuances of trust preferred securities, however would not count as Tier 1 regulatory capital.

#### Note 10 – Regulatory Capital

The Company is subject to various regulatory capital requirements administered by the federal banking agencies. Bank holding companies follow minimum regulatory requirements established by the Federal Reserve Board. First Mid Bank follows similar minimum regulatory requirements established for national banks by the OCC. Failure to meet minimum capital requirements can result in the initiation of certain mandatory and possibly additional discretionary action by regulators that, if undertaken, could have a direct material effect on the Company's financial statements.

Quantitative measures established by each regulatory agency to ensure capital adequacy require the reporting institutions to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2011 and 2010, that all capital adequacy requirements have been met.

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As of December 31, 2011 and 2010, the most recent notification from the primary regulators categorized First Mid Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios must be maintained as set forth in the table. At December 31, 2011, there are no conditions or events since the most recent notification that management believes have changed this categorization.

|  | Actual     |       |   | For Capital Adequacy Purposes |         | To Be Well Capitalized Under Prompt Corrective Action Provisions |          |
|--|------------|-------|---|-------------------------------|---------|--|----------|
|  | Amount     | Ratio |   | Amount                        | Ratio   | Amount   | Ratio    |
| <b>December 31, 2011</b>                 |            |       |   |                               |         |  |          |
| Total Capital (to risk-weighted assets)  |            |       |   |                               |         |  |          |
| Company                                  | \$ 145,006 | 14.48 | % | \$ 80,093                     | > 8.00% | N/A  | N/A      |
| First Mid Bank                           | 127,386    | 12.83 |   | 79,434                        | > 8.00  | \$ 99,292  | > 10.00% |
| Tier 1 Capital (to risk-weighted assets) |            |       |   |                               |         |  |          |
| Company                                  | 133,886    | 13.37 |   | 40,046                        | > 4.00  | N/A  | N/A      |
| First Mid Bank                           | 116,266    | 11.71 |   | 39,717                        | > 4.00  | 59,575   | > 6.00   |
| Tier 1 Capital (to average assets)       |            |       |   |                               |         |  |          |
| Company                                  | 133,886    | 8.99  |   | 59,574                        | > 4.00  | N/A  | N/A      |
| First Mid Bank                           | 116,266    | 7.85  |   | 59,228                        | > 4.00  | 74,035   | > 5.00   |
| <b>December 31, 2010</b>                 |            |       |   |                               |         |  |          |
| Total Capital (to risk-weighted assets)  |            |       |   |                               |         |  |          |
| Company                                  | \$ 118,622 | 12.84 | % | \$ 73,914                     | > 8.00% | N/A  | N/A      |
| First Mid Bank                           | 113,143    | 12.32 |   | 73,491                        | > 8.00  | \$ 91,864  | > 10.00% |
| Tier 1 Capital (to risk-weighted assets) |            |       |   |                               |         |  |          |
| Company                                  | 108,229    | 11.71 |   | 36,957                        | > 4.00  | N/A  | N/A      |
| First Mid Bank                           | 102,748    | 11.19 |   | 36,745                        | > 4.00  | 55,118   | > 6.00   |
| Tier 1 Capital (to average assets)       |            |       |   |                               |         |  |          |
| Company                                  | 108,229    | 7.42  |   | 58,369                        | > 4.00  | N/A  | N/A      |
| First Mid Bank                           | 102,748    | 7.07  |   | 58,141                        | > 4.00  | 72,676   | > 5.00   |

#### Note 11 – Disclosure of Fair Values of Financial Instruments

ACS Topic 820, “Fair Value Measurements,” defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Topic 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. In accordance with Topic 820, the Company groups its financial assets and financial liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 Valuations for assets and liabilities traded in active exchange markets, such as the New York Stock Exchange. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third party pricing services for identical or comparable assets or liabilities which use observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Following is a description of the inputs and valuation methodologies used for assets measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

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Available-for-Sale Securities. The fair value of available-for-sale securities are determined by various valuation methodologies. Where quoted market prices are available in an active market, securities are classified within Level 1. Level 1 securities include exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models or quoted prices of securities with similar characteristics. Level 2 securities include U.S. Treasury securities, obligations of U.S. government corporations and agencies, obligations of states and political subdivisions, mortgage-backed securities, collateralized mortgage obligations and corporate bonds. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy and include subordinated tranches of collateralized mortgage obligations and investments in trust preferred securities.

The trust preferred securities are collateralized debt obligation securities that are backed by trust preferred securities issued by banks, thrifts, and insurance companies. The market for these securities at December 31, 2011 is not active and markets for similar securities are also not active. The inactivity was evidenced first by a significant widening of the bid-ask spread in the brokered markets in which trust preferred securities trade and then by a significant decrease in the volume of trades relative to historical levels. The new issue market is also inactive as no new trust preferred securities have been issued since 2007. There are currently very few market participants who are willing and or able to transact for these securities. The market values for these securities (and any securities other than those issued or guaranteed by the US Treasury) are very depressed relative to historical levels.

Given conditions in the debt markets today and the absence of observable transactions in the secondary and new issue markets, we determined:

- The few observable transactions and market quotations that are available are not reliable for purposes of determining fair value at December 31, 2011,
- An income valuation approach technique (present value technique) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs will be equally or more representative of fair value than the market approach valuation technique used at prior measurement dates , and
- The Company's trust preferred securities will be classified within Level 3 of the fair value hierarchy because we determined that significant adjustments are required to determine fair value at the measurement date.

The following table presents the Company's assets that are measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall as of December 31, 2011 and 2010 (in thousands):

|   | Fair Value | Fair Value Measurements Using                                  |   |   |
|---|------------|--|---|---|
|   |            | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| December 31, 2011   |            |  |   |   |
| Available-for-sale securities:  |            |  |   |   |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | \$ 166,066 | \$-  | \$ 166,066                                    | \$ -                                      |
| Obligations of states and political subdivisions                                      | 41,202     | -  | 41,202  | -   |

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|   |           |      |            |        |
|---|-----------|------|------------|--------|
| Mortgage-backed securities: GSE residential | 261,833   | -    | 261,755    | 58     |
| Trust preferred securities                  | 719       | -    | -          | 719    |
| Other securities                            | 9,096     | 29   | 9,067      | -      |
| Total available-for-sale securities         | \$478,916 | \$29 | \$ 478,110 | \$ 777 |

December 31, 2010

Available-for-sale securities:

|   |           |      |           |       |
|---|-----------|------|-----------|-------|
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | \$152,381 | \$-  | \$152,381 | \$-   |
| Obligations of states and political subdivisions                                      | 26,914    | -    | 26,914    | -     |
| Mortgage-backed securities: GSE residential   | 160,931   | -    | 160,863   | 68    |
| Trust preferred securities  | 581       | -    | -         | 581   |
| Other securities  | 2,009     | 31   | 1,978     | -     |
| Total available-for-sale securities   | \$342,816 | \$31 | \$342,136 | \$649 |

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The change in fair value of assets measured on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2011 and 2010 is summarized as follows (in thousands):

| December 31, 2011   | Available-for-Sale Securities<br>Trust |                         |          |
|---|--|-------------------------|----------|
|   | Mortgaged-backed<br>Securities         | Preferred<br>Securities | Total    |
| Beginning balance   | \$68                                   | \$581                   | \$649    |
| Transfers into Level 3  | -                                      | -                       | -        |
| Transfers out of Level 3  | -                                      | -                       | -        |
| Total gains or losses   |  |                         |          |
| Included in net income  | -                                      | (886 )                  | (886 )   |
| Included in other comprehensive income (loss)   | -                                      | 1,108                   | 1,108    |
| Purchases, issuances, sales and settlements   |  |                         |          |
| Purchases   | -                                      | -                       | -        |
| Issuances   | -                                      | -                       | -        |
| Sales   | -                                      | -                       | -        |
| Settlements   | (10 )                                  | (84 )                   | (94 )    |
| Ending balance  | \$58                                   | \$719                   | \$777    |
| Total gains or losses for the period included in net income attributable to the change in unrealized gains or losses related to assets and liabilities still held at the reporting date | \$-                                    | \$(886 )                | \$(886 ) |

| December 31, 2010   | Available-for-Sale Securities<br>Trust |                         |            |
|---|--|-------------------------|------------|
|   | Mortgaged-backed<br>Securities         | Preferred<br>Securities | Total      |
| Beginning balance   | \$75                                   | \$3,155                 | \$3,230    |
| Transfers into Level 3  | -                                      | -                       | -          |
| Transfers out of Level 3  | -                                      | -                       | -          |
| Total gains or losses   |  |                         |            |
| Included in net income  | -                                      | (1,418 )                | (1,418 )   |
| Included in other comprehensive income (loss)   | 1                                      | (1,411 )                | (1,410 )   |
| Purchases, issuances, sales and settlements   |  |                         |            |
| Purchases   | -                                      | -                       | -          |
| Issuances   | -                                      | -                       | -          |
| Sales   | -                                      | -                       | -          |
| Settlements   | (8 )                                   | 255                     | 247        |
| Ending balance  | \$68                                   | \$581                   | \$649      |
| Total gains or losses for the period included in net income attributable to the change in unrealized gains or losses related to assets and liabilities still held at the reporting date | \$-                                    | \$(1,418 )              | \$(1,418 ) |

Following is a description of the valuation methodologies used for assets measured at fair value on a nonrecurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy.

Impaired Loans (Collateral Dependent). Loans for which it is probable that the Company will not collect all principal and interest due according to contractual terms are measured for impairment. Allowable methods for determining the amount of impairment and estimating fair value include using the fair value of the collateral for collateral dependent loans. If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment is utilized. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value. Impaired loans that are collateral dependent are classified within Level 3 of the fair value hierarchy when impairment is determined using the fair value method.

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Management establishes a specific reserve for loans that have an estimated fair value that is below the carrying value. The total carrying amount of loans for which a specific reserve has been established as of December 31, 2011 was \$2,562,000 and a fair value of \$2,282,000 resulting in specific loss exposures of \$280,000. At December 31, 2010, the total carrying amount of loans for which a specific reserve had been established was \$4,809,000. These loans had a fair value of \$3,854,000 which resulted in specific loss exposures of \$955,000.

When there is little prospect of collecting either principal or interest, loans, or portions of loans, may be charged-off to the allowance for loan losses. Losses are recognized in the period an obligation becomes uncollectible. The recognition of a loss does not mean that the loan has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off the loan even though partial recovery may be effected in the future.

Foreclosed Assets Held For Sale. Other real estate owned acquired through loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. The adjustment at the time of foreclosure is recorded through the allowance for loan losses. Due to the subjective nature of establishing the fair value when the asset is acquired, the actual fair value of the other real estate owned or foreclosed asset could differ from the original estimate. If it is determined that fair value declines subsequent to foreclosure, a valuation allowance is recorded through noninterest expense. Operating costs associated with the assets after acquisition are also recorded as noninterest expense. Gains and losses on the disposition of other real estate owned and foreclosed assets are netted and posted to other noninterest expense. The total carrying amount of other real estate owned as of December 31, 2011 was \$4,606,000. Other real estate owned measured at fair value on a nonrecurring basis during the period amounted to \$2,336,000. The total carrying amount of other real estate owned as of December 31, 2010 was \$6,127,000. Other real estate owned measured at fair value on a nonrecurring basis during the period amounted to \$940,000.

The following table presents the fair value measurement of assets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2011 and 2010 (in thousands):

|                                       | Fair Value | Fair Value Measurements Using   |   |  |
|---------------------------------------|------------|---|---|--|
|                                       |            | Quoted<br>Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs (Level<br>2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| December 31, 2011                     |            |   |   |  |
| Impaired loans (collateral dependent) | \$2,282    | \$-   | \$ -  | \$ 2,282   |
| Foreclosed assets held for sale       | 2,336      | -   | -   | 2,336  |
| December 31, 2010                     |            |   |   |  |
| Impaired loans (collateral dependent) | \$3,854    | \$-   | \$-   | \$3,854  |
| Foreclosed assets held for sale       | 940        | -   | -   | 940  |

Other

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying balance sheets at amounts other than fair value.

#### Cash and Cash Equivalents and Federal Reserve and Federal Home Loan Bank Stock

The carrying amount approximates fair value.

#### Certificates of Deposit Investments

The fair value of certificates of deposit investments is estimated using a discounted cash flow calculation that applies the rates currently offered for deposits of similar remaining maturities.

#### Held-to-maturity Securities

Fair value is based on quoted market prices, if available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

#### Loans

For loans with floating interest rates, it is assumed that the estimated fair values generally approximate the carrying amount balances. Fixed rate loans have been valued using a discounted present value of projected cash flow. The discount rate used in these calculations is the current rate at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. The carrying amount of accrued interest approximates its fair value.

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## Deposits

Deposits include demand deposits, savings accounts, NOW accounts and certain money market deposits. The carrying amount of these deposits approximates fair value. The fair value of fixed-maturity time deposits is estimated using a discounted cash flow calculation that applies the rates currently offered for deposits of similar remaining maturities.

## Securities Sold Under Agreements to Repurchase

The fair value of securities sold under agreements to repurchased is estimated using a discounted cash flow calculation that applies the rates currently offered for deposits of similar remaining maturities.

## Short-term Borrowings and Interest Payable

The carrying amount approximates fair value.

## Long-term Debt and Federal Home Loan Bank Advances

Rates currently available to the Company for debt with similar terms and remaining maturities are used to estimate the fair value of existing debt.

The following table presents estimated fair values of the Company's financial instruments in accordance with FAS 107-1 and APB 28-1, codified with ASC 805.

|  | December 31, 2011  |               | December 31, 2010  |               |
|--|--------------------|---------------|--------------------|---------------|
|  | Carrying<br>Amount | Fair<br>Value | Carrying<br>Amount | Fair<br>Value |
| <b>Financial Assets</b>                        |                    |               |                    |               |
| Cash and due from banks                        | \$52,105           | \$52,105      | \$151,493          | \$151,493     |
| Federal funds sold                             | 20,997             | 20,997        | 80,000             | 80,000        |
| Certificates of deposit investments            | 13,231             | 13,225        | 10,000             | 9,996         |
| Available-for-sale securities                  | 478,916            | 478,916       | 342,816            | 342,816       |
| Held-to-maturity securities                    | 51                 | 51            | 50                 | 53            |
| Loans held for sale                            | 1,046              | 1,046         | 114                | 114           |
| Loans net of allowance for loan losses         | 847,908            | 850,308       | 794,074            | 799,039       |
| Interest receivable                            | 7,052              | 7,052         | 6,390              | 6,390         |
| Federal Reserve Bank stock                     | 1,520              | 1,520         | 1,520              | 1,520         |
| Federal Home Loan Bank stock                   | 3,727              | 3,727         | 3,727              | 3,727         |
| <b>Financial Liabilities</b>                   |                    |               |                    |               |
| Deposits                                       | \$1,170,734        | \$1,172,069   | \$1,212,710        | \$1,214,025   |
| Securities sold under agreements to repurchase | 132,380            | 132,383       | 94,057             | 94,058        |
| Interest payable                               | 510                | 510           | 701                | 701           |
| Federal Home Loan Bank borrowings              | 19,750             | 20,619        | 22,750             | 23,953        |
| Other borrowings                               | 8,250              | 8,250         | -                  | -             |
| Junior subordinated debentures                 | 20,620             | 11,969        | 20,620             | 11,438        |

## Note 12—Deferred Compensation Plan

The Company follows the provisions of ASC 710, for purposes of the First Mid-Illinois Bancshares, Inc. Deferred Compensation Plan (“DCP”). At December 31, 2011, the Company classified the cost basis of its common stock issued and held in trust in connection with the DCP of approximately \$2,904,000 as treasury stock. The Company also classified the cost basis of its related deferred compensation obligation of approximately \$2,904,000 as an equity instrument (deferred compensation).

The DCP was effective as of June 1984. The purpose of the DCP is to enable directors, advisory directors, and key employees the opportunity to defer a portion of the fees and cash compensation paid by the Company as a means of maximizing the effectiveness and flexibility of compensation arrangements. The Company invests all participants’ deferrals in shares of common stock. Dividends paid on the shares are credited to participants’ DCP accounts and invested in additional shares. During 2011 and 2010 the Company issued 5,920 common shares and 4,766 common shares, respectively, pursuant to the DCP.

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## Note 13 – Stock Incentive Plan

At the Annual Meeting of Stockholders held May 23, 2007, the stockholders approved the First Mid-Illinois Bancshares, Inc. 2007 Stock Incentive Plan (“SI Plan”). The SI Plan was implemented to succeed the Company’s 1997 Stock Incentive Plan, which had a ten-year term that expired October 21, 2007, under which there are still options outstanding. The SI Plan is intended to provide a means whereby directors, employees, consultants and advisors of the Company and its subsidiaries may sustain a sense of proprietorship and personal involvement in the continued development and financial success of the Company and its subsidiaries, thereby advancing the interests of the Company and its stockholders. Accordingly, directors and selected employees, consultants and advisors may be provided the opportunity to acquire shares of Common Stock of the Company on the terms and conditions established in the SI Plan.

On September 27, 2011, the Board of Directors passed a resolution authorizing and approving the Executive Long-Term Incentive Plan (“LTIP”). The LTIP was implemented to provide methodology for granting Stock Awards and Stock Unit Awards under the SI Plan to select senior executives of the Company or any subsidiary.

A maximum of 300,000 shares are authorized under the SI Plan. This amount reflects the Company’s stock split which occurred on June 29, 2007. Options to acquire shares are awarded at an exercise price equal to the fair market value of the shares on the date of grant and have a 10-year term. Options granted to employees vest over a four-year period and options granted to directors vest at the time they are issued. As of December 31, 2010, the Company had awarded 59,500 shares as stock options under the SI Plan.

During the third quarter of 2011, the Company awarded 17,409 shares as 50% Stock Awards and 50% Stock Unit Awards under the LTIP of the SI Plan. There were no shares awarded as stock options during 2011.

The fair value of options granted is estimated on the grant date using the Black-Scholes option-pricing model. Expected volatility is based on historical volatility of the Company’s stock and other factors. The Company uses historical data to estimate option exercise and employee termination within the valuation model; separate groups of employees who have similar historical exercise behavior are considered separately for valuation purposes. The expected term of options granted is derived from the output of the option valuation model and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. There were no options granted during 2011, 2010 or 2009.

The following table summarizes the compensation cost, net of forfeitures, related to stock-based compensation:

|  | For the Years Ended December 31, |      |      |
|--|----------------------------------|------|------|
|  | 2011                             | 2010 | 2009 |
| <b>Stock and stock unit awards</b>                       |                                  |      |      |
| Pre-tax compensation expense                             | \$92                             | \$-  | \$-  |
| Income tax benefit                                       | (32 )                            | -    | -    |
| Stock and stock unit awards expense, net of income taxes | \$60                             | \$-  | \$-  |
| <b>Stock options</b>                                     |                                  |      |      |
| Pre-tax compensation expense                             | \$52                             | \$52 | \$53 |
| Income tax benefit                                       | (1 )                             | (1 ) | (2 ) |
| Stock options expense, net of income taxes               | \$51                             | \$51 | \$51 |

|   |        |       |       |
|---|--------|-------|-------|
| <b>Total share-based compensation</b>                       |        |       |       |
| Pre-tax compensation expense                                | \$ 144 | \$ 52 | \$ 53 |
| Income tax benefit  | (33 )  | (1 )  | (2 )  |
| Total share-based compensation expense, net of income taxes | \$ 111 | \$ 51 | \$ 52 |

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A summary of option activity under the SI Plan and the 1997 Stock Incentive Plan as of December 31, 2011, 2010 and 2009, and changes during the years then ended is presented below:

|                                | Shares    | Weighted-Average<br>Exercise Price | 2011   |                                 |
|--------------------------------|-----------|------------------------------------|--|---------------------------------|
|                                |           |                                    | Weighted-Average<br>Remaining<br>Contractual<br>Term | Aggregate<br>Intrinsic<br>Value |
| Outstanding, beginning of year | 239,532   | \$ 22.50                           |  |                                 |
| Granted                        | -         | -                                  |  |                                 |
| Exercised                      | (11,392 ) | 10.67                              |  |                                 |
| Forfeited or expired           | -         | -                                  |  |                                 |
| Outstanding, end of year       | 228,140   | \$ 23.09                           | 3.32   | \$159,552                       |
| Exercisable, end of year       | 207,265   | \$ 22.98                           | 2.99   | \$159,552                       |

Stock options for 202,970 and 182,095 shares of common stock were not considered in computing the aggregate intrinsic value of outstanding shares and exercisable shares, respectively, for 2011 because they were anti-dilutive.

|                                | Shares    | Weighted-Average<br>Exercise Price | 2010   |                                 |
|--------------------------------|-----------|------------------------------------|--|---------------------------------|
|                                |           |                                    | Weighted-Average<br>Remaining<br>Contractual<br>Term | Aggregate<br>Intrinsic<br>Value |
| Outstanding, beginning of year | 289,033   | \$ 20.54                           |  |                                 |
| Granted                        | -         | -                                  |  |                                 |
| Exercised                      | (49,500 ) | 11.05                              |  |                                 |
| Forfeited or expired           | (1 )      | 8.37                               |  |                                 |
| Outstanding, end of year       | 239,532   | \$ 22.50                           | 4.16   | \$204,345                       |
| Exercisable, end of year       | 204,407   | \$ 22.18                           | 3.58   | \$204,345                       |

Stock options for 202,970 and 167,845 shares of common stock were not considered in computing the aggregate intrinsic value of outstanding shares and exercisable shares, respectively, for 2010 because they were anti-dilutive.

|                                | Shares    | Weighted-Average<br>Exercise Price | 2009   |                                 |
|--------------------------------|-----------|------------------------------------|--|---------------------------------|
|                                |           |                                    | Weighted-Average<br>Remaining<br>Contractual<br>Term | Aggregate<br>Intrinsic<br>Value |
| Outstanding, beginning of year | 352,425   | \$ 19.73                           |  |                                 |
| Granted                        | -         | -                                  |  |                                 |
| Exercised                      | (37,267 ) | 10.42                              |  |                                 |
| Forfeited or expired           | (26,125 ) | 24.08                              |  |                                 |

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|                          |         |          |      |           |
|--------------------------|---------|----------|------|-----------|
| Outstanding, end of year | 289,033 | \$ 20.54 | 4.67 | \$533,000 |
| Exercisable, end of year | 239,658 | \$ 19.73 | 3.88 | \$533,000 |

Stock options for 202,970 and 153,595 shares of common stock were not considered in computing the aggregate intrinsic value of outstanding shares and exercisable shares, respectively, for 2009 because they were anti-dilutive.

The total intrinsic value of options exercised during the years ended December 31, 2011, 2010 and 2009, was \$90,000, \$365,000, and \$308,000, respectively.

A summary of the status of the Company's shares subject to unvested options under the SI Plan and the 1997 Stock Incentive Plan as of December 31, 2011, 2010 and 2009, and changes during the years then ended, is presented below:

|                             | 2011      |  | 2010      |  | 2009      |  |
|-----------------------------|-----------|--|-----------|--|-----------|--|
|                             | Shares    | Weighted-Average Grant-Date Fair Value | Shares    | Weighted-Average Grant-Date Fair Value | Shares    | Weighted-Average Grant-Date Fair Value |
| Unvested, beginning of year | 35,125    | \$ 3.29                                | 49,375    | \$ 3.34                                | 75,953    | \$ 3.90                                |
| Granted                     | -         | -                                      | -         | -                                      | -         | -                                      |
| Vested                      | (14,250 ) | 3.47                                   | (14,250 ) | 3.47                                   | (24,453 ) | 5.29                                   |
| Forfeited                   | -         | -                                      | -         | -                                      | (2,125 )  | 3.70                                   |
| Unvested, end of year       | 20,875    | \$ 3.16                                | 35,125    | \$ 3.29                                | 49,375    | \$ 3.34                                |

As of December 31, 2011 and 2010, there was \$17,000 and \$69,000, respectively, of total unrecognized compensation cost related to unvested options granted under the SI Plan and the 1997 Stock Incentive Plan. That cost is expected to be recognized over a period of one year. The total fair value of shares subject to options that vested during the years ended December 31, 2011, 2010, and 2009, was \$49,000, \$49,000, and \$129,000, respectively.

The following table summarizes information about stock options under the SI Plan outstanding at December 31, 2011:

| Range of Exercise Prices | Options Outstanding |   |                                 | Options Exercisable |                                 |
|--------------------------|---------------------|---|---------------------------------|---------------------|---------------------------------|
|                          | Number Outstanding  | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Number Exercisable  | Weighted-Average Exercise Price |
| Below \$17.50            | 25,171              | 0.96  | \$ 12.11                        | 25,170              | \$ 12.11                        |
| \$17.50 to \$25.00       | 91,469              | 3.41  | \$ 21.34                        | 78,220              | \$ 21.06                        |
| Above \$25.00            | 111,500             | 3.78  | \$ 27.00                        | 103,875             | \$ 27.06                        |
|                          | 228,140             | 3.32  | \$ 23.09                        | 207,265             | \$ 22.98                        |

In September 2011, as part of the LTIP approval, the Board approved a form of Stock Award/Stock Unit Award Agreement and a form of Stock Unit Award Agreement. These forms set forth the terms and conditions of the Stock Awards and Stock Units granted to participants in the Plan as part of their Annual Performance Award and Cumulative Performance Award. Each of the Annual Performance Award and Cumulative Performance Award consists of Stock Awards (50%) and Stock Units (50%), except that Awards to retirement-eligible employees are made 100% in Stock Units. The target number of shares subject to the Stock Awards and/or Stock Units is adjusted by the Board at the end of each applicable performance period based on the actual level of attainment of performance goals previously set by the Board. The Annual Performance Award has a one-year performance period and vest over four years. The Cumulative Performance Award has a three-year performance period and vest at the end of the three-year period. Stock Awards are settled in shares while Stock Units are settled in cash (although Stock Units held

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by retirement-eligible employees are settled half in shares and half in cash). The following table summarizes non-vested stock and stock unit activity for the year ended December 31, 2011:

|                              | Shares   | 2011<br>Weighted-avg<br>Grant-date<br>Fair Value |
|------------------------------|----------|--|
| Nonvested, beginning of year | -        | \$ -   |
| Granted                      | 17,409   | 18.70  |
| Vested                       | (2,313 ) | 18.70  |
| Forfeited                    | -        | -  |
| Nonvested, end of year       | 15,096   | \$ 18.70   |
| Fair value of shares vested  |          | \$ 42,675  |

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The fair value of the awards is amortized to compensation expense over the vesting periods of the awards (four years for annual awards and three years for cumulative awards) and is based on the market price of the Company's common stock at the date of grant multiplied by the number of shares granted that are expected to vest. As of December 31, 2011, there was \$216,000, of total unrecognized compensation cost related to unvested stock and stock unit awards under the SI. That cost is expected to be recognized over a period of three years.

#### Note 14 – Retirement Plans

The Company has a defined contribution retirement plan which covers substantially all employees and which provides for a Company contribution equal to 4% of each participant's compensation and a Company matching contribution of up to 50% of the first 4% of pre-tax contributions made by each participant. Employee contributions are limited to the 402(g) limit of compensation. The total expense for the plan amounted to \$930,000, \$803,000 and \$757,000 in 2011, 2010 and 2009, respectively. The Company also has two agreements in place to pay \$50,000 annually for 20 years from the retirement date to the surviving spouse of a deceased former senior officer of the Company and to one current senior officer. Total expense under these two agreements amounted to \$55,000, \$60,000 and \$90,000 in 2011, 2010 and 2009, respectively. The current liability recorded for these two agreements was \$918,000 and \$913,000, as of December 31, 2011 and 2010, respectively.

#### Note 15 – Income Taxes

The components of federal and state income tax expense (benefit) for the years ended December 31, 2011, 2010 and 2009 were as follows:

|                 | 2011           | 2010           | 2009           |
|-----------------|----------------|----------------|----------------|
| <b>Current</b>  |                |                |                |
| Federal         | \$5,558        | \$4,167        | \$4,761        |
| State           | 1,641          | 790            | 761            |
| Total Current   | 7,199          | 4,957          | 5,522          |
| <b>Deferred</b> |                |                |                |
| Federal         | (435 )         | (286 )         | (1,201 )       |
| State           | (235 )         | (149 )         | (314 )         |
| Total Deferred  | (670 )         | (435 )         | (1,515 )       |
| <b>Total</b>    | <b>\$6,529</b> | <b>\$4,522</b> | <b>\$4,007</b> |

Recorded income tax expense differs from the expected tax expense (computed by applying the applicable statutory U.S. federal tax rate of 35% to income before income taxes). During 2011, 2010 and 2009, the Company was in a graduated tax rate position. The principal reasons for the difference are as follows:

|                                   | 2011    | 2010    | 2009    |
|-----------------------------------|---------|---------|---------|
| Expected income taxes             | \$6,265 | \$4,649 | \$4,277 |
| Effects of:                       |         |         |         |
| Tax-exempt income                 | (618 )  | (511 )  | (483 )  |
| Nondeductible interest expense    | 16      | 20      | 31      |
| State taxes, net of federal taxes | 914     | 417     | 291     |
| Other items                       | 52      | 47      | (9 )    |

|                             |         |         |         |
|-----------------------------|---------|---------|---------|
| Effect of marginal tax rate | (100 )  | (100 )  | (100 )  |
| Total                       | \$6,529 | \$4,522 | \$4,007 |

In 2011, the State of Illinois increased the corporate income tax rate from 7.3% to 9.5%. Tax expense recorded by the Company during 2011, 2010 and 2009 did not include any interest or penalties. Tax returns filed with the Internal Revenue Service and Illinois Department of Revenue are subject to review by law under a three-year statute of limitations. The Company is no longer subject to U.S. federal or state income tax examinations by tax authorities for years before 2008.

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The tax effects of the temporary differences that gave rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2011 and 2010 are presented below:

|   | 2011    | 2010    |
|---|---------|---------|
| Deferred tax assets:                                    |         |         |
| Allowance for loan losses                               | \$4,489 | \$4,059 |
| Available-for-sale investment securities                | -       | 1,319   |
| Deferred compensation                                   | 984     | 951     |
| Supplemental retirement                                 | 370     | 357     |
| Core deposit premium amortization                       | 120     | 26      |
| Interest on non-accrual loans                           | 155     | 229     |
| Other-than-temporary impairment on securities           | 1,662   | 1,261   |
| Expense from other real estate properties held for sale | 492     | 49      |
| Other   | 148     | 211     |
| Total gross deferred tax assets                         | \$8,420 | \$8,462 |
| Deferred tax liabilities:                               |         |         |
| Deferred loan costs                                     | \$82    | \$92    |
| Goodwill  | 2,069   | 1,620   |
| Prepaid expenses  | 187     | 135     |
| FHLB stock dividend                                     | 334     | 322     |
| Depreciation  | 790     | 373     |
| Purchase accounting                                     | 274     | 587     |
| Accumulated accretion                                   | 59      | 59      |
| Available-for-sale investment securities                | 2,012   | -       |
| Total gross deferred tax liabilities                    | \$5,807 | \$3,188 |
| Net deferred tax assets                                 | \$2,613 | \$5,274 |

Net deferred tax assets are recorded in other assets on the consolidated balance sheets. No valuation allowance related to deferred tax assets was recorded at December 31, 2011 and 2010 as management believes it is more likely than not that the deferred tax assets will be fully realized.

#### Note 16 – Dividend Restrictions

The National Bank Act imposes limitations on the amount of dividends that may be paid by a national bank, such as First Mid Bank. Generally, a national bank may pay dividends out of its undivided profits, in such amounts and at such times as the bank's board of directors deems prudent. Without prior OCC approval, however, a national bank may not pay dividends in any calendar year which, in the aggregate, exceed the bank's year-to-date net income plus the bank's adjusted retained net income for the two preceding years. Factors that could adversely affect First Mid Bank's net income include other-than-temporary impairment on investment securities that result in credit losses and economic conditions in industries where there are concentrations of loans outstanding that result in impairment of these loans and, consequently loan charges and the need for increased allowances for losses. See "Item 1A. Risk Factors," Note 4 – "Investment Securities" and Note 5 – "Loans" for a more detailed discussion of the factors.

The payment of dividends by any financial institution or its holding company is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, First Mid Bank exceeded its minimum capital requirements under applicable guidelines as of December 31, 2011. As of December 31, 2011, approximately \$24.3 million was available to be paid

as dividends to the Company by First Mid Bank. Notwithstanding the availability of funds for dividends, however, the OCC may prohibit the payment of any dividends by First Mid Bank if the OCC determines that such payment would constitute an unsafe or unsound practice.

Note 17 – Commitments and Contingent Liabilities

First Mid Bank enters into financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include lines of credit, letters of credit and other commitments to extend credit. Each of these instruments involves, to varying degrees, elements of credit, and interest rate and liquidity risk in excess of the amounts recognized in the consolidated balance sheets. The Company uses the same credit policies and requires similar collateral in approving lines of credit and commitments and issuing letters of credit as it does in making loans. The exposure to credit losses on financial instruments is represented by the contractual amount of these instruments. However, the Company does not anticipate any losses from these instruments.

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The off-balance sheet financial instruments whose contract amounts represent credit risk at December 31, 2011 and 2010 are as follows:

|   | 2011      | 2010      |
|---|-----------|-----------|
| Unused commitments including lines of credit: |           |           |
| Commercial real estate                        | \$33,970  | \$15,882  |
| Commercial operating                          | 119,102   | 87,068    |
| Home Equity                                   | 24,804    | 25,421    |
| Other   | 44,433    | 34,556    |
| Total   | \$222,309 | \$162,927 |
| Standby letters of credit                     | \$6,267   | \$6,349   |

Commitments to originate credit represent approved commercial, residential real estate and home equity loans that generally are expected to be funded within ninety days. Lines of credit are agreements by which the Company agrees to provide a borrowing accommodation up to a stated amount as long as there is no violation of any condition established in the loan agreement. Both commitments to originate credit and lines of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the liens and some commitments are expected to expire without being drawn upon, the total amounts do not necessarily represent future cash requirements.

Standby letters of credit are conditional commitments issued by the Company to guarantee the financial performance of customers to third parties. Standby letters of credit are primarily issued to facilitate trade or support borrowing arrangements and generally expire in one year or less. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending credit facilities to customers. The maximum amount of credit that would be extended under letters of credit is equal to the total off-balance sheet contract amount of such instrument at December 31, 2011 and 2010. The Company's deferred revenue under standby letters of credit agreements was nominal.

#### Note 18—Related Party Transactions

Certain officers, directors and principal stockholders of the Company and its subsidiaries, their immediate families or their affiliated companies ("related parties") have loans with one or more of the subsidiaries. These loans are made in the ordinary course of business on substantially the same terms, including interest and collateral, as those prevailing for comparable transactions with others. Loans to related parties totaled approximately \$20,787,000 and \$21,271,000 at December 31, 2011 and 2010, respectively. Activity during 2011 and 2010 was as follows:

|                   | 2011     | 2010     |
|-------------------|----------|----------|
| Beginning balance | \$21,271 | \$23,221 |
| New loans         | 4,935    | 4,067    |
| Loan repayments   | (4,986 ) | (6,017 ) |
| Ending balance    | \$21,220 | \$21,271 |

Deposits from related parties held by First Mid Bank at December 31, 2011 and 2010 totaled \$35,095,000 and \$38,569,000, respectively.

See Note 1-“Preferred Stock” regarding the Series C Preferred Stock, the Remaining Investors and the Notes.

#### Note 19 – Business Combination

On September 10, 2010, First Mid Bank completed its acquisition of 10 Illinois bank branches (the “Branches”) from First Bank, a Missouri state chartered bank, located in Bartonville, Bloomington, Galesburg, Knoxville, Peoria and Quincy, Illinois. The acquisition was consistent with the Company’s strategy to expand its overall service area and bring added convenience to its customers by offering banking capabilities in 25 Illinois communities. In accordance with the Branch Purchase and Assumption Agreement, dated as of May 7, 2010, by and between First Mid Bank and First Bank, First Mid Bank acquired approximately \$336 million of deposits, approximately \$135 million of performing loans and the bank facilities and certain other assets of the Branches. First Mid Bank paid First Bank (a) the principal amount of the loans acquired, (b) the net book value, or approximately \$5.3 million, for the bank facilities and certain assets located at the Branches, (c) a deposit premium of 4.77% on the core deposits acquired, which equated to approximately \$15.6 million, and (d) approximately \$1.8 million for the cash on hand at the Branches, with proration of certain periodic expenses. The acquisition settled by First Bank paying cash of \$178.3 million to First Mid Bank for the difference between these amounts and the total deposits assumed. The purchase was accounted for under the acquisition method in accordance with ASC 805, “Business Combinations,” and accordingly the assets and liabilities were recorded at their fair values on the date of acquisition.

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The following table summarizes the estimated fair values of assets acquired and liabilities assumed at the date of acquisition (in thousands).

|  | Acquired<br>Book Value | Fair Value<br>Adjustments | As<br>Recorded<br>by<br>First Mid<br>Bank |
|--|------------------------|---------------------------|---|
| <b>Assets</b>                                  |                        |                           |   |
| Cash   | \$180,074              | \$ -                      | \$180,074                                 |
| Loans  | 135,219                | (2,102 )                  | 133,117                                   |
| Premises and equipment                         | 5,266                  | 7,685                     | 12,951                                    |
| Goodwill                                       | -                      | 8,390                     | 8,390                                     |
| Core deposit intangible                        | -                      | 3,050                     | 3,050                                     |
| Other assets                                   | 488                    | -                         | 488                                       |
| Total assets acquired                          | \$321,047              | \$ 17,023                 | \$338,070                                 |
| <b>Liabilities</b>                             |                        |                           |   |
| Deposits                                       | \$336,016              | \$ 1,413                  | \$337,429                                 |
| Securities sold under agreements to repurchase | 126                    |                           | 126                                       |
| Other liabilities                              | 515                    |                           | 515                                       |
| Total liabilities assumed                      | \$336,657              | \$ 1,413                  | \$338,070                                 |

The Company recognized \$1,154,000 of costs related to completion of the acquisition during 2010. These acquisition costs were included in other expense. The difference between the fair value and acquired value of the purchased loans of \$2,102,000 is being accreted to interest income over the remaining term of the loans. The difference between the fair value and acquired value of the assumed time deposits of \$1,413,000 is being amortized to interest expense over the remaining term of the time deposits. The core deposit intangible asset, with a fair value of \$3,050,000, is being amortized on an accelerated basis over its estimated life of ten years.

The following unaudited pro forma condensed combined financial information presents the results of operations of the Company, including the effects of the purchase accounting adjustments and acquisition expenses, had the acquisition taken place at the beginning of 2010 (in thousands). The actual results of operations of the Company include all of the effects of the purchase accounting adjustments and acquisition expenses and, accordingly, no pro forma information is provided.

|                            | For the year<br>ended<br>December<br>31, 2010 |
|----------------------------|---|
| Net interest income        | \$46,425                                      |
| Provision for loan losses  | 4,737   |
| Non-interest income        | 14,686  |
| Non-interest expense       | 41,614  |
| Income before income taxes | 14,760  |
| Income tax expense         | 4,527   |

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|   |           |
|---|-----------|
| Net income                                  | \$10,233  |
| Dividends on preferred shares               | 2,240     |
| Net income available to common stockholders | \$7,993   |
| Earnings per share                          |           |
| Basic                                       | \$1.31    |
| Diluted                                     | \$1.31    |
| Basic weighted average shares outstanding   |           |
|   | 6,092,670 |
| Diluted weighted average shares outstanding |           |
|   | 6,116,727 |

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The unaudited pro forma condensed combined financial statements do not reflect any anticipated cost savings and revenue enhancements. Accordingly, the pro forma results of operations of the Company as of and after the business combination may not be indicative of the results that actually would have occurred if the combination had been in effect during the periods presented or of the results that may be attained in the future.

#### Note 20 – Leases

The Company has several noncancellable operating leases, primarily for property rental of banking buildings that expire over the next ten years. These leases generally contain renewal options for periods ranging from one to five years. Rental expense for these leases was \$1,331,000, \$884,000 and \$543,000 for the years ended December 31, 2010, 2009 and 2008, respectively. Future minimum lease payments under operating leases are:

|                              | Operating<br>Leases |
|------------------------------|---------------------|
| 2012                         | \$1,141             |
| 2013                         | 1,002               |
| 2014                         | 1,002               |
| 2015                         | 352                 |
| 2016                         | 352                 |
| Thereafter                   | 880                 |
| Total minimum lease payments | \$4,729             |

#### Note 21– Parent Company Only Financial Statements

Presented below are condensed balance sheets, statements of income and cash flows for the Company:

##### First Mid-Illinois Bancshares, Inc. (Parent Company)

##### Balance Sheets

| December 31,                                      | 2011             | 2010             |
|---|------------------|------------------|
| <b>Assets</b>                                     |                  |                  |
| Cash  | \$20,538         | \$2,381          |
| Premises and equipment, net                       | 3,112            | 481              |
| Investment in subsidiaries                        | 147,225          | 130,179          |
| Other assets                                      | 2,495            | 2,800            |
| <b>Total Assets</b>                               | <b>\$173,370</b> | <b>\$135,841</b> |
| <b>Liabilities and Stockholders' equity</b>       |                  |                  |
| <b>Liabilities</b>                                |                  |                  |
| Dividends payable                                 | \$2,200          | \$1,706          |
| Debt  | 28,870           | 20,620           |
| Other liabilities                                 | 1,333            | 1,250            |
| <b>Total Liabilities</b>                          | <b>32,403</b>    | <b>23,576</b>    |
| Stockholders' equity                              | 140,967          | 112,265          |
| <b>Total Liabilities and Stockholders' equity</b> | <b>\$173,370</b> | <b>\$135,841</b> |





## First Mid-Illinois Bancshares, Inc. (Parent Company)

## Statements of Income

| Years ended December 31,  | 2011     | 2010    | 2009     |
|---|----------|---------|----------|
| <b>Income:</b>  |          |         |          |
| Dividends from subsidiaries   | \$938    | \$6,744 | \$-      |
| Other income  | 40       | 8       | 29       |
| Total income  | 978      | 6,752   | 29       |
| Operating expenses  | 2,414    | 2,728   | 2,958    |
| Income (loss) before income taxes and equity<br>in undistributed earnings of subsidiaries | (1,436 ) | 4,024   | (2,929 ) |
| Income tax benefit  | 1,005    | 1,062   | 1,148    |
| Income (loss) before equity in undistributed<br>earnings of subsidiaries                  | (431 )   | 5,086   | (1,781 ) |
| Equity in undistributed earnings of subsidiaries  | 11,803   | 3,675   | 9,995    |
| Net income  | \$11,372 | \$8,761 | \$8,214  |

## First Mid-Illinois Bancshares, Inc. (Parent Company)

## Statements of Cash Flows

| Years ended December 31,   | 2011      | 2010     | 2009      |
|--|-----------|----------|-----------|
| <b>Cash flows from operating activities:</b>   |           |          |           |
| Net income   | \$11,372  | \$8,761  | \$8,214   |
| <b>Adjustments to reconcile net income to net<br/>cash provided by operating activities:</b> |           |          |           |
| Depreciation, amortization, accretion, net   | 71        | 47       | 47        |
| Dividends received from subsidiary   | 938       | 6,744    | -         |
| Equity in undistributed earnings of subsidiaries   | (11,803 ) | (3,675 ) | (9,995 )  |
| (Increase) decrease in other assets  | (3,283 )  | (9,966 ) | (447 )    |
| Increase (decrease) in other liabilities   | 128       | (12 )    | (126 )    |
| Net cash provided by (used in) operating activities  | (2,577 )  | 1,899    | (2,307 )  |
| <b>Cash flows from financing activities:</b>   |           |          |           |
| Repayment of long-term debt  | -         | -        | (13,000 ) |
| Proceeds from short-term debt  | 8,250     | -        | -         |
| Proceeds from issuance of preferred stock  | 19,150    | -        | 24,635    |
| Proceeds from issuance of common stock   | 406       | 971      | 894       |
| Purchase of treasury stock   | (2,385 )  | (2,499 ) | (3,122 )  |
| Dividends paid on preferred stock  | (2,990 )  | (2,136 ) | (1,242 )  |
| Dividends paid on common stock   | (1,697 )  | (1,714 ) | (1,521 )  |
| Net cash provided by (used in) financing activities  | 20,734    | (5,378 ) | 6,644     |
| Increase (decrease) in cash  | 18,157    | (3,479 ) | 4,337     |
| Cash at beginning of year  | 2,381     | 5,860    | 1,523     |
| Cash at end of year  | \$20,538  | \$2,381  | \$5,860   |

## Note 22 – Quarterly Financial Data – Unaudited

The following table presents summarized quarterly data for each of the two years ended December 31:

|   | Quarters ended in 2011 |           |              |             |
|---|------------------------|-----------|--------------|-------------|
|   | March 31               | June 30   | September 30 | December 31 |
| <b>Selected operations data:</b>                    |                        |           |              |             |
| Interest income                                     | \$ 14,029              | \$ 14,122 | \$ 14,168    | \$ 14,453   |
| Interest expense                                    | 2,324                  | 2,243     | 2,026        | 1,911       |
| Net interest income                                 | 11,705                 | 11,879    | 12,142       | 12,542      |
| Provision for loan losses                           | 940                    | 916       | 728          | 517         |
| Net interest income after provision for loan losses | 10,765                 | 10,963    | 11,414       | 12,025      |
| Other income  | 4,005                  | 4,059     | 3,700        | 4,023       |
| Other expense                                       | 10,292                 | 11,011    | 10,864       | 10,886      |
| Income before income taxes                          | 4,478                  | 4,011     | 4,250        | 5,162       |
| Income taxes  | 1,633                  | 1,433     | 1,571        | 1,892       |
| Net income  | 2,845                  | 2,578     | 2,679        | 3,270       |
| Dividends on preferred shares                       | 707                    | 1,011     | 919          | 939         |
| Net income available to common stockholders         | \$ 2,138               | \$ 1,567  | \$ 1,760     | \$ 2,331    |
| Basic earnings per common share                     | \$ 0.35                | \$ 0.26   | \$ 0.29      | \$ 0.39     |
| Diluted earnings per common share                   | \$ 0.35                | \$ 0.26   | \$ 0.29      | \$ 0.39     |
|   |                        |           |              |             |
|   | Quarters ended in 2010 |           |              |             |
|   | March 31               | June 30   | September 30 | December 31 |
| <b>Selected operations data:</b>                    |                        |           |              |             |
| Interest income                                     | \$ 12,210              | \$ 12,071 | \$ 12,464    | \$ 14,138   |
| Interest expense                                    | 2,819                  | 2,661     | 2,686        | 2,590       |
| Net interest income                                 | 9,391                  | 9,410     | 9,778        | 11,548      |
| Provision for loan losses                           | 760                    | 1,083     | 884          | 1,010       |
| Net interest income after provision for loan losses | 8,631                  | 8,327     | 8,894        | 10,538      |
| Other income  | 3,068                  | 3,043     | 3,652        | 4,057       |
| Other expense                                       | 7,790                  | 8,708     | 9,536        | 10,893      |
| Income before income taxes                          | 3,909                  | 2,662     | 3,010        | 3,702       |
| Income taxes  | 1,361                  | 880       | 998          | 1,283       |
| Net income  | 2,548                  | 1,782     | 2,012        | 2,419       |
| Dividends on preferred shares                       | 577                    | 554       | 554          | 555         |
| Net income available to common stockholders         | \$ 1,971               | \$ 1,228  | \$ 1,458     | \$ 1,864    |
| Basic earnings per common share                     | \$ 0.32                | \$ 0.20   | \$ 0.24      | \$ 0.31     |
| Diluted earnings per common share                   | \$ 0.32                | \$ 0.20   | \$ 0.24      | \$ 0.31     |

Report of Independent Registered Public Accounting Firm

Audit Committee, Board of Directors and Stockholders  
First Mid-Illinois Bancshares, Inc.  
Mattoon, Illinois

We have audited the accompanying consolidated balance sheets of First Mid-Illinois Bancshares, Inc. as of December 31, 2011 and 2010 and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2011. The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Our audits included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of First Mid-Illinois Bancshares, Inc. as of December 31, 2011 and 2010, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), First Mid-Illinois Bancshares, Inc.'s internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 6, 2012 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/BKD, LLP

Decatur, Illinois  
March 6, 2012

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company's management carried out an evaluation, under the supervision and with the participation of the chief executive officer and the chief financial officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of December 31, 2011. Based upon that evaluation, the chief executive officer along with the chief financial officer concluded that the Company's disclosure controls and procedures as of December 31, 2011, were effective.

Management's Annual Report on Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. The Company's internal control over financial reporting is a process designed under the supervision of the Company's chief executive officer and chief financial officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2011 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in "Internal Control—Integrated Framework." Based on the assessment, management determined that, as of December 31, 2011, the Company's internal control over financial reporting is effective, based on those criteria. Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2011 has been audited by BKD, LLP, an independent registered public accounting firm, as stated in their report following.

March 6, 2012

/s/ William S. Rowland

William S. Rowland  
President and Chief Executive Officer

/s/ Michael L. Taylor

Michael L. Taylor  
Chief Financial Officer

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting that occurred during the Company's fourth fiscal quarter of 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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Report of Independent Registered Public Accounting Firm

Audit Committee, Board of Directors and Stockholders  
First Mid-Illinois Bancshares, Inc.  
Mattoon, Illinois

We have audited First Mid-Illinois Bancshares, Inc.'s internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's report. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, First Mid-Illinois Bancshares, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of First Mid-Illinois Bancshares, Inc. and our report dated March 6, 2012 expressed an unqualified opinion thereon.

/s/ BKD, LLP  
Decatur, Illinois

March 6, 2012

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## ITEM 9B. OTHER INFORMATION

None.

## PART III

### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information called for by Item 10 with respect to directors and director nominees is incorporated by reference to the Company's Proxy Statement for the 2012 Annual Meeting of the Company's shareholders under the captions "Proposal 1 – Election of Directors," "Corporate Governance Matters" and "Section 16 – Beneficial Ownership Reporting Compliance."

The information called for by Item 10 with respect to executive officers is incorporated by reference to Part I hereof under the caption "Supplemental Item – Executive Officers of the Company" and to the Company's Proxy Statement for the 2012 Annual Meeting of the Company's shareholders under the caption "Section 16 – Beneficial Ownership Reporting Compliance."

The information called for by Item 10 with respect to audit committee financial expert is incorporated by reference to the Company's Proxy Statement for the 2012 Annual Meeting of the Company's shareholders under the captions "Audit Committee" and "Report of the Audit Committee to the Board of Directors."

The information called for by Item 10 with respect to corporate governance is incorporated by reference to the Company's Proxy Statement for the 2012 Annual Meeting of the Company's shareholders under the caption "Corporate Governance Matters."

The Company has adopted a code of ethics for senior financial management applicable to the Chief Executive Officer and Chief Financial Officer of the Company. This code of ethics is posted on the Company's website. In the event that the Company amends or waives any provisions of this code of ethics, the Company intends to disclose the same on its website at [www.firstmid.com](http://www.firstmid.com).

### ITEM 11. EXECUTIVE COMPENSATION

The information called for by Item 11 is incorporated by reference to the Company's Proxy Statement for the 2012 Annual Meeting of the Company's shareholders under the captions "Executive Compensation," "Non-qualified Deferred Compensation," "Potential Payments Upon Termination or Change in Control of the Company," "Director Compensation," "Corporate Governance Matters – Compensation Committee Interlocks and Insider Participation," and "Compensation Committee Report."

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information called for by Item 12 with respect to equity compensation plans is provided in the table below.

| Plan category | Equity Compensation Plan Information |
|---------------|--------------------------------------|
|---------------|--------------------------------------|



|  | Number of securities to be issued upon exercise of outstanding options (a) | Weighted-average exercise price of outstanding options (b) | Number of securities remaining available for future issuance under equity compensation plans (c) |
|--|--|--|--|
| <b>Equity compensation plans approved by security holders:</b> |  |  |  |
| (A) Deferred Compensation Plan                                 | -  | -  | 398,454 (1)  |
| (B) Stock Incentive Plan                                       | 228,140 (2)  | \$ 23.09 (3)   | 225,591 (4)  |
| Equity compensation plans not approved by security holders (5) | -  | -  | -  |
| Total  | 228,140  | \$ 23.09   | 624,045  |

(1) Consists of shares issuable with respect to participant deferral contributions invested in common stock.

(2) Consists of stock options.

(3) Represents the weighted-average exercise price of outstanding stock options.

(4) Consists of stock option and/or restricted stock.

(5) The Company does not maintain any equity compensation plans not approved by stockholders.

The Company's equity compensation plans approved by security holders consist of the Deferred Compensation Plan and the Stock Incentive Plan. Additional information regarding each plan is available in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Stock Plans" and Note 13 – "Stock Incentive herein.

The information called for by Item 12 with respect to security ownership is incorporated by reference to the Company's Proxy Statement for the 2012 Annual Meeting of the Company's shareholders under the caption "Voting Securities and Principal Holders Thereof."

#### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information called for by Item 13 is incorporated by reference to the Company's Proxy Statement for the 2012 Annual Meeting of the Company's shareholders under the captions "Certain Relationships and Related Transactions" and "Corporate Governance Matters – Board of Directors."

#### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information called for by Item 14 is incorporated by reference to the Company's Proxy Statement for the 2012 Annual Meeting of the Company's shareholders under the caption "Fees of Independent Auditors."

### PART IV

#### ITEM 15. EXHIBIT AND FINANCIAL STATEMENT SCHEDULES

(a)(1) and (2) -- Financial Statements and Financial Statement Schedules

The following consolidated financial statements and financial statement schedules of the Company are filed as part of this document under Item 8.

Financial Statements and Supplementary Data:

- Consolidated Balance Sheets -- December 31, 2011 and 2010
- Consolidated Statements of Income -- For the Years Ended December 31, 2011, 2010 and 2009
- Consolidated Statements of Changes in Stockholders' Equity -- For the Years Ended December 31, 2011, 2010 and 2009
- Consolidated Statements of Cash Flows -- For the Years Ended December 31, 2011, 2010 and 2009.

(a)(3) – Exhibits

The exhibits required by Item 601 of Regulation S-K and filed herewith are listed in the Exhibit Index that follows the Signature Page and immediately precedes the exhibits filed.

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SIGNATURES

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FIRST MID-ILLINOIS BANCSHARES, INC.

(Company)

Dated: March 6, 2012

By: /s/ William S. Rowland

William S. Rowland  
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on the 6th day of March 2012, by the following persons on behalf of the Company and in the capacities listed.

Signature and Title

/s/ William S. Rowland  
William S. Rowland, Chairman of the Board,  
President and Chief Executive Officer and Director  
(Principal Executive Officer)

/s/ Michael L. Taylor

Michael L. Taylor, Executive Vice President and Chief Financial Officer  
(Principal Financial Officer and Principal Accounting Officer)

/s/ Joseph R. Dively  
Joseph R. Dively, Senior Executive Vice President and Director

/s/ Charles A. Adams

Charles A. Adams, Director

/s/ Steven L. Grissom

Steven L. Grissom, Director

/s/ Benjamin I. Lumpkin

Benjamin I. Lumpkin, Director

/s/ Gary W. Melvin  
Gary W. Melvin, Director

/s/ Sara Jane Preston

Sara Jane Preston, Director

/s/ Ray A. Sparks

Ray A. Sparks, Director

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| Exhibit Number | Exhibit Index to Annual Report on Form 10-K Description and Filing or Incorporation Reference  |
|----------------|--|
| 2.1            | Branch Purchase and Assumption Agreement between First Mid-Illinois Bank & Trust, N.A. and First Bank dated May 7, 2010<br>Incorporated by reference to Exhibit 10.1 to First Mid-Illinois Bancshares, Inc.'s 8-K filed with the SEC on May 7, 2010.   |
| 3.1            | Restated Certificate of Incorporation and Amendment to Restated Certificate of Incorporation of First Mid-Illinois Bancshares, Inc. Incorporated by reference to Exhibit 3(a) to First Mid-Illinois Bancshares, Inc.'s Annual Report on Form 10-K for the year ended December 31, 1987.                            |
| 3.2            | Amended and Restated Bylaws of First Mid-Illinois Bancshares, Inc.<br>Incorporated by reference to Exhibit 3.2 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed with the SEC on November 14, 2007.  |
| 3.3            | Certificate of Designation, Preferences and Rights of Series B 9% Non-Cumulative Perpetual Convertible Preferred Stock of the Company<br>Incorporated by reference to Exhibit 4.1 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed with the SEC on February 11, 2009.                     |
| 3.4            | Certificate of Designation, Preferences and Rights of Series C 8% Non-Cumulative Perpetual Convertible Preferred Stock of the Company<br>Incorporated by reference to Exhibit 4.1 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed with the SEC on February 11, 2011.                     |
| 4.1            | Rights Agreement, dated as of September 22, 2009, between First Mid-Illinois Bancshares, Inc. and Harris Trust and Savings Bank, as Rights Agent<br>Incorporated by reference to Exhibit 4.1 to First Mid-Illinois Bancshares, Inc.'s Registration Statement on Form 8-A filed with the SEC on September 24, 2009. |
| 4.2            | Form of Registration Rights Agreement<br>Incorporated by reference to Exhibit 4.2 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed with the SEC on February 11, 2009.   |
| 4.3            | Form of Registration Rights Agreement<br>Incorporated by reference to Exhibit 4.2 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed with the SEC on February 11, 2011.   |
| 4.4            | Form of Promissory Note<br>Incorporated by reference to Exhibit 4.1 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed with the SEC on November 21, 2011.   |
| 10.1           | Employment Agreement between the Company and William S. Rowland<br>Incorporated by reference to Exhibit 10.1 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed with the SEC on December 16, 2010.  |

- 10.2 Employment Agreement between the Company and Joseph R. Dively  
Incorporated by reference to Exhibit 10.1 to First Mid-Illinois Bancshares, Inc.'s Report on Form 8-K filed with the SEC on April 27, 2011.
- 10.3 Employment Agreement between the Company and John W. Hedges  
Incorporated by reference to Exhibit 10.2 to First Mid-Illinois Bancshares, Inc.'s Report on Form 8-K filed with the SEC on April 27, 2011.
- 10.4 Employment Agreement between the Company and Michael L. Taylor  
Incorporated by reference to Exhibit 10.1 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed with the SEC on May 3, 2010.
- 10.5 Employment Agreement between the Company and Laurel G. Allenbaugh  
Incorporated by reference to Exhibit 10.2 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed with the SEC on May 3, 2010.
- 10.6 Employment Agreement between the Company and Charles A. LeFebvre  
Incorporated by reference to Exhibit 10.3 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed with the SEC on May 3, 2010.
- 10.9 Employment Agreement between the Company and Eric S. McRae  
Incorporated by reference to Exhibit 10.1 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed with the SEC on February 24, 2009.
- 10.10 Amended and Restated Deferred Compensation Plan  
Incorporated by reference to Exhibit 10.4 to First Mid-Illinois Bancshares, Inc.'s Annual Report on Form 10-K for the for the year ended December 31, 2005.
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| Exhibit Number | Exhibit Index to Annual Report on Form 10-K<br>Description and Filing or Incorporation Reference   |
|----------------|--|
| 10.11          | 2007 Stock Incentive Plan<br>Incorporated by reference to Exhibit 10.1 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed with the SEC on May 23, 2007.   |
| 10.12          | First Amendment to 2007 Stock Incentive Plan<br>Incorporated by reference to Exhibit 10.12 to First Mid-Illinois Bancshares, Inc.'s Annual Report on Form 10-K for the for the year ended December 31, 2009.   |
| 10.13          | 1997 Stock Incentive Plan<br>Incorporated by reference to Exhibit 10.5 to First Mid-Illinois Bancshares, Inc.'s Annual Report on Form 10-K for the for the year ended December 31, 1998.   |
| 10.14          | Form of 2007 Stock Incentive Plan Stock Option Agreement<br>Incorporated by reference to Exhibit 10.1 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed with the SEC on December 12, 2007.   |
| 10.15          | Form of Stock Award/Stock Unit Award Agreement<br>Incorporated by reference to Exhibit 10.1 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed with the SEC on September 27, 2011.  |
| 10.16          | Form of Stock Unit Award Agreement<br>Incorporated by reference to Exhibit 10.1 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed with the SEC on September 27, 2011.  |
| 10.17          | Supplemental Executive Retirement Plan<br>Incorporated by reference to Exhibit 10.8 to First Mid-Illinois Bancshares, Inc.'s Annual Report on Form 10-K for the for the year ended December 31, 2005.  |
| 10.18          | First Amendment to Supplemental Executive Retirement Plan<br>Incorporated by reference to Exhibit 10.9 to First Mid-Illinois Bancshares, Inc.'s Annual Report on Form 10-K for the for the year ended December 31, 2005.   |
| 10.19          | Participation Agreement (as Amended and Restated) to Supplemental Executive Retirement Plan between the Company and William S. Rowland<br>Incorporated by reference to Exhibit 10.10 to First Mid-Illinois Bancshares, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2005. |
| 10.20          | Description of Incentive Compensation Plan<br>Incorporated by reference to Exhibit 10.16 to First Mid-Illinois Bancshares, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2008.   |



11.1 Statement re: Computation of Earnings Per Share (Filed herewith)

21.1 Subsidiaries of the Company (Filed herewith)

23.1 Consent of BKD LLP (Filed herewith)

31.1 Certification of Chief Executive Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002  
(Filed herewith)

31.2 Certification of Chief Financial Officer pursuant to section 302 of the Sarbanes-Oxley Act of 2002  
(Filed herewith)

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002  
(Filed herewith)

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002  
(Filed herewith)