

FIRST MIDWEST BANCORP INC
Form 10-Q
November 07, 2007

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended **September 30, 2007**

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 0-10967

FIRST MIDWEST BANCORP, INC.

(Exact name of Registrant as specified in its charter)

Delaware

36-3161078

(State or other jurisdiction of
incorporation or organization)

(IRS Employer Identification No.)

One Pierce Place, Suite 1500
Itasca, Illinois 60143-9768

(Address of principal executive offices) (zip code)

Registrant's telephone number, including area code: **(630) 875-7450**

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 .

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Large accelerated filer Accelerated filer Non-accelerated filer .

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

As of November 6, 2007, there were 48,586,925 shares of \$.01 par value common stock outstanding.

FIRST MIDWEST BANCORP, INC.

FORM 10-Q

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First Midwest Bancorp, Inc. is a bank holding company headquartered in the Chicago suburb of Itasca, Illinois with operations throughout the greater Chicago suburban area as well as operating centers in central and western Illinois. Our principal subsidiary is First Midwest Bank, which provides a broad range of commercial and retail banking services to consumer, commercial and industrial, and public or governmental customers. We are committed to meeting the financial needs of the people and businesses in the communities where we live and work by providing customized banking solutions, quality products, and innovative services that truly fulfill those financial needs.

AVAILABLE INFORMATION

We file annual, quarterly, and current reports, proxy statements and other information with the Securities and Exchange Commission ("SEC"), and we make this information available free of charge on or through the investor relations section of our web site at www.firstmidwest.com/aboutinvestor_overview.asp. Also posted on our web site, or available in print upon request of any stockholder to our Corporate Secretary, are our certificate of incorporation, by-laws, charters for our Audit, Compensation and Nominating, and Corporate Governance Committees, Related Person Transaction Policies and Procedures, Corporate Governance Guidelines, Code of Ethics and Standards of Conduct (the "Code"), which governs our directors, officers, and employees, and Code of Ethics for Senior Financial Officers. Within the time period required by the SEC and the Nasdaq Stock Market, we will post on our web site any amendment to the Code and any waiver applicable to any executive officer, director, or senior financial officer (as defined in the Code). In addition, our web site includes information concerning purchases and sales of our securities by our executive officers and directors, as well as any disclosure relating to certain non-GAAP financial measures (as defined in the SEC's Regulation G) that we may make public orally, telephonically, by webcast, by broadcast, or by similar means from time to time.

Our Corporate Secretary can be contacted by writing to First Midwest Bancorp, Inc., One Pierce Place, Itasca, Illinois 60143, Attn: Corporate Secretary. The Company's Investor Relations Department can be contacted by telephone at

(630) 875-7463 or by e-mail at *investor.relations@firstmidwest.com*.

CAUTIONARY STATEMENT PURSUANT TO THE PRIVATE SECURITIES
LITIGATION REFORM ACT OF 1995

We include or incorporate by reference in this Quarterly Report on Form 10-Q, and from time to time our management may make, statements that may constitute "forward-looking statements" within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are not historical facts, but instead represent only management's beliefs regarding future events, many of which, by their nature, are inherently uncertain and outside our control. Although we believe the expectations reflected in any forward-looking statements are reasonable, it is possible that our actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition indicated in such statements. In some cases, you can identify these statements by forward-looking words such as "may," "might," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential," or "continue," and the negative of these terms and other comparable terminology. We caution you not to place undue reliance on forward-looking statements, which speak only as of the date of this report, or when made.

Forward-looking statements are subject to known and unknown risks, uncertainties, and assumptions and may include projections relating to our future financial performance including our growth strategies and anticipated trends in our business. For a detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements, you should refer to our Annual Report on Form 10-K for the year ended December 31, 2006, including the sections entitled "Risk Factors" and "Management's Discussion and Analysis of Results of Operations," as well as our subsequent periodic and current reports, filed with the SEC. These risks and uncertainties are not exhaustive however. Other sections of this report describe additional factors that could adversely impact our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risks and uncertainties emerge from time to time, and it is not possible to predict all risks and uncertainties, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. We are under no duty to update any of these forward-looking statements after the date of this report to conform our prior statements to actual results or revised expectations, and we do not intend to do so.

PART 1. FINANCIAL INFORMATION (Unaudited)

ITEM 1. FINANCIAL STATEMENTS

FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(Dollar amounts and number of shares in thousands)

September 30, 2007	December 31, 2006
(Unaudited)	

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Assets

Cash and due from banks	\$ 182,495	\$ 209,825
Federal funds sold and other short-term investments	3,434	5,081
Mortgages held for sale	1,408	4,760
Trading account securities	17,431	15,878
Securities available-for-sale, at market value	1,924,357	2,442,674
Securities held-to-maturity, at amortized cost	92,913	91,380
Loans	4,931,472	5,008,944
Reserve for loan losses	<u>(61,412)</u>	<u>(62,370)</u>
Net loans	<u>4,870,060</u>	<u>4,946,574</u>
Premises, furniture, and equipment	126,322	126,677
Accrued interest receivable	54,134	54,015
Investment in corporate owned life insurance	201,418	196,598
Goodwill	262,195	262,195
Other intangible assets	27,146	30,463
Receivable for securities sold	48,731	-
Other assets	<u>72,301</u>	<u>55,406</u>
Total assets	<u>\$ 7,884,345</u>	<u>\$ 8,441,526</u>

Liabilities

Demand deposits	\$ 1,082,068	\$ 1,124,081
Savings deposits	776,844	684,599
NOW accounts	895,826	945,656
Money market deposits	860,735	854,780
Time deposits	<u>2,218,702</u>	<u>2,558,100</u>
Total deposits	5,834,175	6,167,216
Borrowed funds	998,502	1,182,268
Subordinated debt	227,948	228,674
Accrued interest payable	18,215	20,429
Other liabilities	<u>77,577</u>	<u>91,925</u>
Total liabilities	<u>7,156,417</u>	<u>7,690,512</u>

Stockholders' Equity

Preferred stock, no par value; 1,000 shares authorized, none issued	-	-
Common stock, \$.01 par value; authorized 100,000 shares; issued 61,326 shares; outstanding: September 30, 2007 - 48,735 shares		
December 31, 2006 - 50,025 shares	613	613
Additional paid-in capital	206,951	205,044
Retained earnings	865,435	823,787
Accumulated other comprehensive loss, net of tax	(36,385)	(15,288)
Treasury stock, at cost: September 30, 2007 - ----12,591 shares		
December 31, 2006 - 11,301 shares	<u>(308,686)</u>	<u>(263,142)</u>
Total stockholders' equity	<u>727,928</u>	<u>751,014</u>
Total liabilities and stockholders' equity	<u>\$ 7,884,345</u>	<u>\$ 8,441,526</u>

See notes to unaudited consolidated financial statements.

FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME

(Dollar amounts in thousands, except per share data)

(Unaudited)

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Interest Income				
Loans	\$ 93,020	\$ 93,929	\$ 277,372	\$ 258,756
Securities available-for-sale	25,651	31,142	80,545	88,239
Securities held-to-maturity	1,171	1,232	3,620	3,594
Federal funds sold and other short-term investments	248	134	813	423
Total interest income	<u>120,090</u>	<u>126,437</u>	<u>362,350</u>	<u>351,012</u>
Interest Expense				
Deposits	41,949	40,335	125,669	105,349
Borrowed funds	13,680	16,799	43,392	46,869
Subordinated debt	3,764	3,630	11,258	9,698
Total interest expense	<u>59,393</u>	<u>60,764</u>	<u>180,319</u>	<u>161,916</u>
Net interest income	60,697	65,673	182,031	189,096
Provision for loan losses				
	<u>470</u>	<u>2,715</u>	<u>5,191</u>	<u>6,364</u>
Net interest income after provision for loan losses	<u>60,227</u>	<u>62,958</u>	<u>176,840</u>	<u>182,732</u>
Noninterest Income				
Service charges on deposit accounts	11,959	10,971	33,029	29,442
Trust and investment management fees	3,934	3,736	11,640	10,603
Other service charges, commissions, and fees	5,601	5,471	16,859	14,773
Card-based fees	4,054	3,734	11,946	10,065
Corporate owned life insurance income	2,023	2,206	5,916	5,650
Security (losses) gains, net	(5,165)	509	(760)	898
Other income	989	364	4,088	2,199
Total noninterest income	<u>23,395</u>	<u>26,991</u>	<u>82,718</u>	<u>73,630</u>
Noninterest Expense				
Salaries and wages	21,381	20,473	64,840	59,179

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Retirement and other employee benefits	5,973	6,550	19,072	20,515
Net occupancy expense	5,686	5,482	16,574	15,146
Equipment expense	2,580	2,651	7,796	7,487
Technology and related costs	1,767	1,770	5,324	5,052
Professional services	2,366	2,266	6,687	6,774
Advertising and promotions	1,950	2,144	4,503	6,147
Merchant card expense	1,842	1,537	5,120	4,140
Other expenses	6,436	6,245	18,957	20,380
Total noninterest expense				
	<u>49,981</u>	<u>49,118</u>	<u>148,873</u>	<u>144,820</u>
Income before income tax expense	33,641	40,831	110,685	111,542
Income tax expense	6,404	9,616	25,108	25,824
Net income	<u>\$ 27,237</u>	<u>\$ 31,215</u>	<u>\$ 85,577</u>	<u>\$ 85,718</u>
Per Share Data				
Basic earnings per share	\$ 0.55	\$ 0.63	\$ 1.73	\$ 1.76
Diluted earnings per share	\$ 0.55	\$ 0.62	\$ 1.71	\$ 1.74
Cash dividends per share	\$ 0.295	\$ 0.275	\$ 0.885	\$ 0.825
Weighted average shares outstanding	49,134	49,940	49,554	48,802
<u>Weighted average diluted shares outstanding</u>	49,447	50,315	49,915	49,158
See notes to unaudited consolidated financial statements.				

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FIRST MIDWEST BANCORP, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Amounts in thousands, except per share data)

(Unaudited)

	<u>Common Shares Outstanding</u>	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive (Loss) Income</u>	<u>Treasury Stock</u>	<u>Total</u>
Balance at December 31, 2005	45,387	\$ 569	\$60,760	\$ 762,575	\$8,284)	\$ (271,552)	\$ 544,068
Comprehensive Income:							
Net income	-	-	-	85,718	-	-	85,718
Other comprehensive							

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income: ⁽¹⁾

Unrealized
gains on
securities

- - - - 6,400 - 6,400

Unrealized
gains on
hedging
activities

activities - - - - 210 - 210

Total
comprehensive
income

92,328

Dividends
declared
(\$0.825 per
share)

- - - (41,254) - - (41,254)

Issuance of
common
stock

4,399 44 143,579 - - - 143,623

Purchase of
treasury stock

(22) - - - (787) (787)

Share-based
compensation
expense

- - 2,213 - - - 2,213

Exercise of
stock options
and restricted
stock activity

234 - (2,987) - - 8,335 5,348

Treasury stock
issued to
benefit plans

3 - 83 - - 35 118

Other

- - 212 - - - 212

Balance at
September 30,
2006

50,001 \$ 613 ~~203,860~~ \$ 807,039 \$1,674 \$ (263,969) \$ 745,869

Balance at
December 31,
2006

50,025 \$ 613 ~~205,044~~ \$ 823,787 (\$5,288) \$ (263,142) \$ 751,014

Cumulative-effect
for change in

- - - (209) - - (209)

accounting for
purchases of
life
insurance
policies ⁽²⁾

Adjusted balance at January 1, 2007	50,025	613	205,044	823,578	(15,288)	(263,142)	750,805
Comprehensive Income:							
Net income	-	-	-	85,577	-	-	85,577
Other comprehensive loss: ⁽¹⁾							
Unrealized losses on securities	-	-	-	-	(21,084)	-	(21,084)
Other	-	-	-	-	(13)	-	(13)
Total comprehensive income	-	-	-	-	-	-	64,480
Dividends declared (\$0.885 per share)	-	-	-	(43,720)	-	-	(43,720)
Purchase of treasury stock	(1,470)	-	-	-	-	(52,199)	(52,199)
Share-based compensation expense	-	-	2,817	-	-	-	2,817
Exercise of stock options and restricted stock activity	183	-	(919)	-	-	6,751	5,832
Treasury stock (purchased for) issued to benefit plans	(3)	-	9	-	-	(96)	(87)
Balance at September 30, 2007	48,735	\$ 613	\$ 206,951	\$ 865,435	(\$6,385)	\$ (308,686)	\$ 727,928

(1) Net of taxes and reclassification adjustments.

(2) Refer to Note 2, "Recent Accounting Pronouncements," for additional details.

See notes to unaudited consolidated financial statements.

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FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollar amounts in thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2007	2006
Net cash provided by operating activities		
	<u>\$ 34,125</u>	<u>\$ 69,214</u>
Investing Activities		
Securities available-for-sale:		
Proceeds from maturities, repayments, and calls	231,469	341,943
Proceeds from sales	335,744	263,121
Purchases	(83,367)	(551,077)
Securities held-to-maturity:		
Proceeds from maturities, repayments, and calls	30,165	54,196
Purchases	(31,603)	(61,176)
Net decrease (increase) in loans	66,361	(96,156)
Proceeds from claims on corporate owned life insurance	887	718
Purchases of corporate owned life insurance	-	(15,000)
Proceeds from sales of other real estate owned	3,647	2,632
Proceeds from sales of premises, furniture, and equipment	1,034	1,046
Purchases of premises, furniture, and equipment	(9,044)	(11,781)
Acquisitions, net of cash acquired	-	(220,967)
Net cash provided by (used in) investing activities	<u>545,293</u>	<u>(292,501)</u>
Financing Activities		
Net (decrease) increase in deposit accounts	(333,041)	141,577
Net decrease in borrowed funds	(183,766)	(98,812)
Proceeds from the issuance of subordinated debt	-	99,887
Proceeds from the issuance of common stock	-	143,623
Purchases of treasury stock	(52,199)	(787)
Cash dividends paid	(44,100)	(39,987)
Exercise of stock options and restricted stock activity	4,365	4,093
Excess tax benefit related to share-based compensation	346	830
Net cash (used in) provided by financing activities	<u>(608,395)</u>	<u>250,424</u>

Net (decrease) increase in cash and cash equivalents	(28,977)	27,137
Cash and cash equivalents at beginning of period	<u>214,906</u>	<u>158,677</u>
Cash and cash equivalents at end of period		
	<u>\$ 185,929</u>	<u>\$ 185,814</u>
Supplemental Disclosures:		
Noncash transfers of loans to foreclosed real estate	\$ 4,962	\$ 2,880
Dividends declared but unpaid	14,399	13,769
Noncash transfer of loans to securities available-for-sale	-	105,976

See notes to unaudited consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated interim financial statements of First Midwest Bancorp, Inc. (the "Company"), a Delaware corporation, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission for quarterly reports on Form 10-Q and do not include certain information and footnote disclosures required by U.S. generally accepted accounting principles ("U.S. GAAP") for complete annual financial statements. Accordingly, these financial statements should be read in conjunction with the Company's 2006 Annual Report on Form 10-K ("2006 10-K").

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with U.S. GAAP and reflect all adjustments that are, in the opinion of management, necessary for the fair presentation of the financial position and results of operations for the periods presented. All such adjustments are of a normal recurring nature. The results of operations for the quarter and nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

The consolidated financial statements include the accounts and results of operations of the Company and its subsidiaries after elimination of all significant intercompany accounts and transactions. Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

U.S. GAAP requires management to make certain estimates and assumptions. Although these and other estimates and assumptions are based on the best available information, actual results could be materially different from these estimates.

2. RECENT ACCOUNTING PRONOUNCEMENTS

Accounting for Defined Benefit Pension Plan:

Effective December 31, 2006, the Company adopted Financial Accounting Standards Board ("FASB") Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* ("SFAS No. 158"), that requires companies to recognize the funded status of its defined benefit pension and postretirement plans as an asset or liability on the balance sheet rather than being disclosed in the notes to the financial statements. The over-funded or under-funded status (asset or liability) would be measured as the difference between the fair value of plan assets and the projected benefit obligation for pensions and the accumulated postretirement benefit obligation for other postretirement benefits. Actuarial gains and losses and prior service costs and credits that arise subsequent to the effective date would be recognized, net of tax, as a component of other comprehensive income and would continue to be amortized into earnings in future periods as a component of net periodic benefit cost. Any remaining unrecognized net transition asset or obligation from the initial adoption of FASB Statements No. 87 and 106, net of tax, would be recognized in other comprehensive income rather than expense, and, as such, this is the only change, if applicable, that would alter the amount of expense recognized by an entity. In addition, employers are required to set the measurement date as of the balance sheet date, rather than having the option of any date up to three months prior to the fiscal year-end. Plan assets and obligations would not be required to be remeasured for interim period reporting. The requirement to recognize the funded status in the balance sheet was effective for fiscal years ending after December 15, 2006. The requirement to measure plan assets and benefit obligations as of the balance sheet date is not effective until fiscal years ending after December 15, 2008. Since the Company already uses its December 31st fiscal year end as its measurement date, it adopted both the balance sheet recognition requirement and the measurement date requirement of SFAS No. 158 on December 31, 2006. For additional discussion regarding the adoption of SFAS No. 158 and its impact on the Company's financial position and results of operation, refer to Note 17, to the Consolidated Financial Statements on the Company's 2006 10-K.

Accounting for Uncertainty in Income Taxes:

Effective January 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, Accounting for Income Taxes* ("FIN 48"), which prescribes a comprehensive model for how companies should recognize, measure, present, and disclose in their financial statements uncertain tax positions taken or expected to be taken on a tax return. Under FIN 48, tax positions shall initially be recognized in the financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions shall initially and subsequently be measured as the largest amount of tax benefit that is more likely than not to be realized upon ultimate settlement with the tax authority assuming full knowledge of the position and all relevant facts. FIN 48 also revises disclosure requirements to include an annual tabular rollforward of unrecognized tax benefits. Differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption would be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The cumulative-effect adjustment would not apply to those items that

would not have been recognized in earnings, such as the effect of adopting FIN 48 on tax positions related to business combinations.

The adoption of FIN 48 on January 1, 2007 did not have a material impact on the Company's financial position, results of operations, or liquidity. However, FIN 48 is expected to create greater volatility in the Company's effective tax rate in future periods. At adoption on January 1, 2007, the Company had \$7.7 million in unrecognized tax benefits related to uncertain tax positions. Of this amount, \$5.3 million would favorably affect the Company's effective tax rate if recognized in future periods. Interest related to the uncertain tax positions totaled \$601,000 on January 1, 2007. The Company recognizes this accrued interest in income tax expense. There were no material changes to unrecognized tax benefits during the three-month and nine-month periods ended September 30, 2007. The Company files income tax returns in the U.S. federal jurisdiction and in Illinois, Indiana, and Iowa. The Company is no longer subject to examinations by U.S. federal, Indiana, or Iowa tax authorities for years prior to 2003 or by Illinois tax authorities for years prior to 2002.

Accounting for Servicing of Financial Assets:

Effective January 1, 2007, the Company adopted SFAS No. 156, *Accounting for Servicing of Financial Assets, an amendment of SFAS No. 140*, which requires entities to separately recognize a servicing asset or liability whenever it undertakes an obligation to service financial assets and also requires all separately recognized servicing assets or liabilities to be initially measured at fair value. In addition, this standard permits entities to choose between two alternatives, the amortization method or the fair value measurement method, for the subsequent measurement of each class of separately recognized servicing assets and liabilities. Under the amortization method, an entity shall amortize the value of servicing assets or liabilities in proportion to and over the period of estimated net servicing income or net servicing loss and assess servicing assets or liabilities for impairment or increased obligation based on fair value at each reporting date. Under the fair value measurement method, an entity shall measure servicing assets or liabilities at fair value at each reporting date and report changes in fair value in earnings in the period in which

the changes occur. Upon adoption on January 1, 2007, the Company elected fair value as the measurement method for residential real estate mortgage servicing rights. The adoption of this statement did not have a material impact on the Company's financial position, results of operation, or liquidity. Refer to Note 5, "Securitizations and Mortgage Servicing Rights," for additional information regarding the Company's servicing assets.

Accounting for Purchases of Life Insurance:

Effective January 1, 2007, the Company adopted the Emerging Issues Task Force ("EITF") Issue 06-5, *Accounting for Purchases of Life Insurance - Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4*, which explains how to determine the amount that can be realized from a life insurance contract. It also requires that if the contract provides for a greater surrender value if all individual policies in a group are surrendered at the same time, that the surrender value be determined based on the assumption that policies will be surrendered on an individual basis. In addition, the cash surrender value should not be discounted when contractual limitations on the ability to surrender a policy exist. EITF 06-5 also requires that fixed amounts that are recoverable by the policyholder in future periods over one year from the surrender of the policy be recognized at their present value. Upon adoption on January 1, 2007, the Company recorded a \$209,000 reduction to beginning retained earnings as a cumulative-effect adjustment for the change in accounting principle to record amounts recoverable beyond one year upon surrender of the policy at their present value.

Accounting for Certain Hybrid Financial Instruments:

Effective January 1, 2007, the Company adopted SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments, an amendment of SFAS Nos. 133 and 140*, which simplifies the accounting for certain derivatives embedded in other financial instruments (hybrid financial instruments) by permitting, but not requiring, these hybrid financial instruments to be carried at fair value. This statement also establishes a requirement to evaluate interests in securitized financial assets, including collateralized mortgage obligations and mortgage-backed securities, to identify embedded derivatives that would need to be accounted for separately from the financial asset.

In January 2007, the FASB issued Derivatives Implementation Group Issue No. B40 ("DIG B40") addressing application of SFAS No. 155 to collateralized mortgage obligations and mortgage-backed securities, exempting those that are pre-payable and purchased at a discount after the adoption of SFAS No. 155 from the bifurcation rules. The adoption of SFAS No. 155 and the clarifying guidance under DIG B40 on January 1, 2007 did not have a material impact on the Company's financial position, results of operation, or liquidity.

Fair Value Option

: In February 2007, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 159, *The Fair Value Option for Financial Assets and Liabilities*, that permits entities to irrevocably elect fair value to account for certain financial assets and financial liabilities, with the changes in fair value recognized in earnings as they occur. The main objectives of this statement are to (i) mitigate problems in determining reported earnings because some assets and liabilities are recorded at fair value while others are reported at cost; (ii) enable entities to reduce volatility by allowing entities that are ineligible for hedge accounting to mark the other side of the hedging transaction to market and thus create an accounting

offset; (iii) make U.S. accounting standards more consistent with international standards; and (iv) expand the use of fair value measurement, particularly for financial instruments. The impact of the initial adoption for assets and liabilities recorded before the effective date of this statement would be accounted for as a cumulative-effect adjustment to retained earnings. This statement requires entities to provide additional information that would help others understand how changes in fair values affect current-period earnings. Related fair value information is still required to be disclosed by existing accounting standards. The statement is effective for fiscal years beginning after November 15, 2007. The Company will be required to apply the new guidance beginning January 1, 2008 and currently does not expect it to have a material impact on the Company's financial position, results of operations, or liquidity.

Fair Value Measurements:

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS No. 157"), which, upon adoption, will replace various definitions of fair value in existing accounting literature with a single definition, will establish a framework for measuring fair value, and will require additional disclosures about fair value measurements. The statement clarifies that fair value is the price that would be received to sell an asset or the price paid to transfer a liability in the most advantageous market available to the entity and emphasizes that fair value is a market-based measurement and should be based on the assumptions market participants would use. The statement also creates a three-level hierarchy under which individual fair value estimates are to be ranked based on the relative reliability of the inputs used in the valuation. This hierarchy is the basis for the disclosure requirements, with fair value estimates based on the least reliable inputs requiring more extensive disclosures about the valuation method used and the gains and losses associated with those estimates. SFAS No. 157 is required to be applied whenever another financial accounting standard requires or permits an asset or liability to be measured at fair value. The statement does not expand the use of fair value to any new circumstances. The statement is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company will be required to apply the new guidance beginning January 1, 2008 and does not expect it to have a material impact on the Company's financial position, results of operations, or liquidity.

Endorsement Split-Dollar Life Insurance Arrangements:

In September 2006, the FASB ratified the EITF consensus on EITF Issue 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* ("EITF 06-4"). The EITF is limited to the recognition of a liability and related compensation costs for endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods. Therefore, the provisions of EITF 06-4 would not apply to a split-dollar life insurance arrangement that provides a specified benefit to an employee that is limited to the employee's active service period with an employer. EITF 06-4 is effective for fiscal years beginning after December 15, 2007. The effect of initially applying the guidance would be accounted for as a cumulative-effect adjustment to beginning retained earnings with the option of retrospective application. The Company will be required to adopt EITF 06-4 on January 1, 2008 and does not expect it to have a material impact on its financial position, results of operations, and liquidity.

3. SECURITIES

Securities Available-for-Sale, Held-to-Maturity, and Trading

(Dollar amounts in thousands)

	September 30, 2007			December 31, 2006				
	Amortized Cost	<u>Gross Unrealized</u> Gains	<u>Losses</u>	Market Value	Amortized Cost	<u>Gross Unrealized</u> Gains	<u>Losses</u>	Market Value
Securities Available- for-Sale								
U.S.								
Treasury	\$ 899	\$ 2	\$ -	\$ 901	\$ 3,017	\$ -	\$ (2)	\$ 3,015
U.S.								
Agency	47,795	443	-	48,238	66,796	209	(46)	66,959
Collateralized mortgage obligations	477,476	908	(4,504)	473,880	756,890	948	(12,511)	745,327
Other mortgage- backed	345,977	2,792	(5,978)	342,791	407,198	2,887	(6,313)	403,772

State and municipal	863,186	4,406	(6,018)	861,574	1,007,761	9,917	(5,562)	1,012,116
Other	234,627	44	(37,698)	196,973	212,056	779	(1,350)	211,485
Total	<u>\$ 1,969,960</u>	<u>\$ 8,595</u>	<u>\$ (54,198)</u>	<u>\$ 1,924,357</u>	<u>\$ 2,453,718</u>	<u>\$ 14,740</u>	<u>\$ (25,784)</u>	<u>\$ 2,442,674</u>

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	September 30, 2007			December 31, 2006				
	Amortized Cost	Gross Unrealized Gains	Market Losses	Market Value	Amortized Cost	Gross Unrealized Gains	Market Losses	Market Value
Securities Held-to-Maturity								
State and municipal	<u>\$ 92,913</u>	<u>\$ 238</u>	<u>\$ -</u>	<u>\$ 93,151</u>	<u>\$ 91,380</u>	<u>\$ 227</u>	<u>\$ (5)</u>	<u>\$ 91,602</u>
Trading Securities				<u>\$ 17,431</u>				<u>\$ 15,878</u>

At September 30, 2007, gross unrealized gains in the securities available-for-sale portfolio totaled \$8.6 million, and gross unrealized losses totaled \$54.2 million, resulting in a net unrealized loss of \$45.6 million. The unrealized loss on securities in an unrealized loss position for greater than 12 months totaled \$19.5 million. Management does not believe any individual unrealized loss as of September 30, 2007 represents an other-than-temporary impairment. The Company has both the intent and ability to hold the securities with unrealized losses for a period of time necessary to recover the amortized cost, or to maturity.

Trading securities held by the Company represent diversified investment securities held in a grantor trust under deferred compensation arrangements in which plan participants may direct amounts earned to be invested in securities other than Company stock. Net trading gains (losses) included in other noninterest income in the Consolidated Statements of Income totaled \$226,000 in third quarter 2007 and (\$220,000) in third quarter 2006. Trading gains (losses) totaled \$1.4 million for the nine months ended September 30, 2007 and (\$64,000) for the nine months ended September 30, 2006.

4. LOANS

Loan Portfolio

(Dollar amounts in thousands)

	September 30, 2007	December 31, 2006
Commercial and industrial	\$ 1,522,270	\$ 1,547,081
Agricultural	158,015	158,305
Real estate - commercial	1,853,088	1,852,557
Real estate - construction	621,613	583,761
Consumer	575,792	651,776
Real estate - 1-4 family	200,694	215,464
Total loans	<u>\$ 4,931,472</u>	<u>\$ 5,008,944</u>

Total loans reported are net of deferred loan fees of \$8.1 million as of September 30, 2007 and \$7.8 million as of December 31, 2006 and include overdrawn demand deposits totaling \$8.6 million as of September 30, 2007 and \$6.9 million as of December 31, 2006.

The Company primarily lends to small to mid-sized businesses and consumers in the market areas in which the Company operates. Within these areas, the Company diversifies its loan portfolio by loan type, industry, and borrower. The Company believes that such diversification reduces its exposure to economic downturns that may occur in different segments of the economy or in different industries. As of September 30, 2007 and December 31, 2006, there were no significant loan concentrations with any single borrower, industry, or geographic segment.

It is the Company's policy to review each prospective credit in order to determine the appropriateness and, when required, the adequacy of security or collateral to obtain prior to making a loan. In the event of borrower default, the Company seeks recovery in compliance with state lending laws and the Company's lending standards and credit monitoring procedures.

5. SECURITIZATIONS AND MORTGAGE SERVICING RIGHTS

In June 2006, the Company securitized \$106.0 million of real estate 1-4 family loans, converting the loans into mortgage-backed securities issued through the Federal Home Loan Mortgage Corporation. Accordingly, the securitized amounts were reclassified from loans to securities available-for-sale. The Company retained servicing responsibilities for the mortgages

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supporting these securities and collects servicing fees equal to a percentage of the outstanding principal balance of the loans being serviced. The Company also services loans from prior securitizations and services loans for which the servicing was acquired as part of a 2006 bank acquisition. Mortgage loans serviced for and owned by third parties are not included in the Consolidated Statements of Condition. The unpaid principal balance of these loans totaled \$168.9 million as of September 30, 2007

and \$193.9 million as of December 31, 2006. The Company has no recourse for credit losses on the loans securitized in 2006 or the loans previously serviced by the acquired bank but retains limited recourse, through November 30, 2011, for credit losses on \$14.6 million of loans securitized in 2004. The dollar amount of the potential recourse to the Company is capped at \$2.2 million based on a certain percentage of the initial balance of the loans for which recourse exists. The liability for the expected costs related to this recourse agreement totaled \$148,000 as of September 30, 2007 and December 31, 2006.

Changes in Fair Value of Mortgage Servicing Rights

(Dollar amounts in thousands)

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Balance at beginning of period	\$ 2,236	\$ 2,859	\$ 2,613	\$ 638
New servicing assets	-	-	-	1,424
Servicing assets of acquired bank	-	-	-	884
Changes in fair value:				
Due to changes in valuation inputs and assumptions ⁽¹⁾	(136)	-	(300)	-
Other changes in fair value ⁽²⁾	(98)	-	(311)	-
Amortization	-	(81)	-	(168)

Balance at end of period	<u>\$ 2,002</u>	<u>\$ 2,778</u>	<u>\$ 2,002</u>	<u>\$ 2,778</u>
Contractual servicing fee earned during the period	\$ 115	\$ 137	\$ 364	\$ 252

(1) Principally reflects changes in prepayment speed assumptions.

(2) Primarily represents changes in expected cash flows over time due to payoffs and paydowns.

Prior to January 1, 2007, all mortgage servicing rights retained by the Company in a sale or securitization of loans were reported at the lower of amortized cost or fair value. Mortgage servicing rights were initially capitalized based on allocating the previous carrying amount of the assets sold or securitized between the assets sold and the retained interests based on their relative fair values on the date of sale or securitization. On a quarterly basis, the Company evaluated its capitalized mortgage servicing rights for impairment based on their current fair value and determined no impairment existed.

Effective January 1, 2007, the Company adopted the provisions of SFAS No. 156 and elected to apply the fair value measurement method to account for its pre-existing mortgage servicing assets. Upon adoption, there was no cumulative-effect adjustment recognized in retained earnings, as the carrying value of mortgage servicing rights approximated its fair value. Under the fair value method, the Company initially records any mortgage servicing rights acquired after adoption of SFAS No. 156 at their estimated fair value in other assets in the Consolidated Statements of Condition. Fair value is subsequently determined by estimating the present value of the future cash flows associated with the mortgage loans serviced. Key economic assumptions used in measuring the fair value of mortgage servicing rights at September 30, 2007 include weighted-average prepayment speeds of 14.6% and weighted-average discount rates of 11.7%. The Company uses market-based data for assumptions related to the valuation of mortgage servicing rights. The net loss recognized due to the change in fair value of mortgage servicing rights totaled \$234,000 for third quarter 2007 and \$611,000 for the nine months ended September 30, 2007. Both the net impact of changes in the fair value of mortgage servicing rights and contractual servicing fees are reported in other service charges, commissions, and fees in the Company's Consolidated Statements of Income.

6. RESERVE FOR LOAN LOSSES AND IMPAIRED LOANS

Reserve for Loan Losses

(Dollar amounts in thousands)

	Quarters Ended September 30,		Nine Months Ended September 30,	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Balance at beginning of period	\$ 62,391	\$ 62,359	\$ 62,370	\$ 56,393
Loans charged-off	(2,501)	(3,206)	(8,436)	(7,877)
Recoveries of loans previously charged-off	<u>1,052</u>	<u>502</u>	<u>2,287</u>	<u>1,555</u>
Net loans charged-off	(1,449)	(2,704)	(6,149)	(6,322)
Provision for loan losses	470	2,715	5,191	6,364
Reserve of acquired bank	-	-	-	<u>5,935</u>
Balance at end of period	<u>\$ 61,412</u>	<u>\$ 62,370</u>	<u>\$ 61,412</u>	<u>\$ 62,370</u>

A portion of the Company's reserve for loan losses is allocated to loans deemed impaired. All impaired loans are included in nonperforming assets.

Impaired, Nonaccrual, and Past Due Loans

(Dollar amounts in thousands)

	September 30, 2007	December 31, 2006
	March 31, 2006	December 31, 2005
Nonaccrual loans:		
Impaired loans with valuation reserve required ⁽¹⁾	\$ 3,650	\$ 5,103
Impaired loans with no valuation reserve required	6,553	7,601
Total impaired loans	10,203	12,704
Other nonaccrual loans ⁽²⁾	2,568	3,505
Total nonaccrual loans	<u>\$ 12,771</u>	<u>\$ 16,209</u>
Loans past due 90 days and still accruing interest	\$ 21,421	\$ 12,810
Valuation reserve related to impaired loans	1,937	3,594

(1) These impaired loans require a valuation reserve because the value of the loans is less than the recorded investment in the loans.

(2) These loans are not considered for impairment since they are part of a small balance, homogeneous portfolio.

The average recorded investment in impaired loans was \$12.1 million for the nine months ended September 30, 2007 and \$12.9 million for the nine months ended September 30, 2006. Interest income recognized on impaired loans was \$312,000 for the nine months ended September 30, 2007 and \$40,000 for the nine months ended September 30, 2006. Interest income recognized on impaired loans is recorded using the cash basis of accounting. As of September 30, 2007, the Company had \$16,000 of additional funds committed to be advanced in connection with impaired loans.

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7. EARNINGS PER COMMON SHARE

Basic and Diluted Earnings per Share

(Amounts in thousands, except per share data)

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net income	\$ 27,237	\$ 31,215	\$ 85,577	\$ 85,718
Weighted-average common shares outstanding:				

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Weighted-average common shares outstanding (basic)	49,134	49,940	49,554	48,802
Dilutive effect of stock options	267	371	327	355
Dilutive effect of non-vested restricted stock awards	<u>46</u>	<u>4</u>	<u>34</u>	<u>1</u>
Diluted weighted-average common shares outstanding	<u>49,447</u>	<u>50,315</u>	<u>49,915</u>	<u>49,158</u>
Basic earnings per share	\$ 0.55	\$ 0.63	\$ 1.73	\$ 1.76
Diluted earnings per share	0.55	0.62	1.71	1.74

8. PENSION PLAN

Net Periodic Benefit Pension Expense

(Dollar amounts in thousands)

	Quarters Ended September 30,		Nine Months Ended September 30,	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Components of net periodic benefit cost:				
Service cost	\$ 802	\$ 1,237	\$ 2,770	\$ 3,712
Interest cost	633	671	2,187	2,013
Expected return on plan assets	(792)	(861)	(2,735)	(2,584)
Recognized net actuarial loss	181	276	625	829
Amortization of prior service cost	<u>1</u>	<u>1</u>	<u>3</u>	<u>3</u>
Net periodic cost	<u>\$ 825</u>	<u>\$ 1,324</u>	<u>\$ 2,850</u>	<u>\$ 3,973</u>

The Company previously disclosed in Note 17 to the Consolidated Financial Statements on its 2006 10-K that it did not expect to contribute to its pension plan in 2007. Based on the current actuarial assumptions, the Company contributed \$5.0 million to its pension plan during third quarter 2007. The Company does not anticipate any additional contributions to its Pension Plan during the remainder of 2007.

9. COMMITMENTS, GUARANTEES, AND CONTINGENT LIABILITIES

Credit Extension Commitments and Guarantees

In the normal course of business, the Company enters into a variety of financial instruments with off-balance sheet risk to meet the financing needs of its customers, to reduce its exposure to fluctuations in interest rates, and to conduct lending activities. These instruments principally include commitments to extend credit, standby letters of credit, and commercial letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the Consolidated Statements of Condition.

Contractual or Notional Amounts of Financial Instruments

(Dollar amounts in thousands)

	September 30, 2007	December 31, 2006
Commitments to extend credit:		
Home equity lines	\$ 282,164	\$ 314,714
All other commitments	1,109,713	1,135,237
Letters of credit:		
Standby	138,519	170,740
Commercial	310	2,281
Recourse on assets securitized	14,583	17,771

Standby and commercial letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Standby letters of credit generally are contingent upon the failure of the customer to perform according to the terms of the underlying contract with the third party and are most often issued in favor of a municipality where construction is taking place to ensure the borrower adequately completes the construction. Commercial letters of credit are issued specifically to facilitate commerce and typically result in the commitment being drawn on when the underlying transaction is consummated between the customer and the third party. This type of letter of credit is issued through a correspondent bank on behalf of a customer who is involved in an international business activity such as the importing of goods.

The maximum potential future payments guaranteed by the Company under standby letters of credit arrangements are equal to the contractual amount of the commitment. The carrying value of the Company's standby letters of credit, which is included in other liabilities in the Consolidated Statements of Condition, totaled \$691,000 as of September 30, 2007 and \$837,000 as of December 31, 2006. As of September 30, 2007, standby letters of credit had a remaining weighted-average term of approximately 12.1 months, with remaining actual lives ranging from less than 1 year to 7.8 years. If a commitment is funded, the Company may seek recourse through the liquidation of the underlying collateral provided including real estate, physical plant and property, marketable securities, or cash.

For a discussion on recourse on assets securitized, refer to Note 5, "Securitized and Mortgage Servicing Rights."

Legal Proceedings

At September 30, 2007, there were certain legal proceedings pending against the Company and its subsidiaries in the ordinary course of business. The Company does not believe that liabilities, individually or in the aggregate, arising from these proceedings, if any, would have a material adverse effect on the consolidated financial condition of the Company as of September 30, 2007.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The discussion presented below provides an analysis of our results of operations and financial condition for the quarter and nine months ended September 30, 2007 and 2006. When we use the terms "First Midwest," the "Company," "we," "us," and "our," we mean First Midwest Bancorp, Inc., a Delaware Corporation, and its consolidated subsidiaries. When we use the term the "Bank," we are referring to our wholly-owned banking facility, First Midwest Bank. Management's discussion and analysis should be read in conjunction with the consolidated financial statements and accompanying notes presented elsewhere in this report, as well as in our 2006 Annual Report on Form 10-K ("2006 10-K"). Results of operations for the quarter and nine months ended September 30, 2007 are not necessarily indicative of results to be expected for the year ending December 31, 2007. Unless otherwise stated, all earnings per share data included in this section and throughout the remainder of this discussion are presented on a diluted basis.

ACQUISITION ACTIVITY

On March 31, 2006, we completed the acquisition of Bank Calumet, Inc. ("Bank Calumet"), a single bank holding company in a cash transaction valued at approximately \$307.0 million. Bank Calumet provided retail and commercial banking services to customers through 30 full service locations predominantly in Lake County, Indiana, and the contiguous Illinois counties of Cook and Will. As a part of the acquisition, we acquired \$676.4 million in loans and \$940.0 million in deposits.

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The results of operations of Bank Calumet are included in our Consolidated Statements of Income effective with second quarter 2006.

PERFORMANCE OVERVIEW

Net income for the quarter ended September 30, 2007 was \$27.2 million, or \$0.55 per share, compared to \$31.2 million, or \$0.62 per share, for third quarter 2006. During third quarter 2007, the turmoil in the capital markets resulted in premiums being charged in some sectors for access to funding. Responding to this condition, we sold \$187.9 million of agency-guaranteed securities with an average yield of 3.9% for a loss of \$5.2 million. We used the proceeds to reduce our overnight and other short-dated borrowings, which were at rates of 5.25% and higher. Partially offsetting this transaction was the recognition of after-tax benefits associated with state income tax loss carryforwards of \$1.4 million. The net effect of these two items reduced after-tax income by \$0.04 per share. Third quarter 2007 performance resulted in an annualized return on average assets of 1.35% compared to 1.44% for third quarter 2006, and an annualized return on average equity of 14.6% compared to 17.1% for third quarter 2006.

Net income for the nine-month period ended September 30, 2007 was \$85.6 million, or \$1.71 per share, compared to \$85.7 million, or \$1.74 per share, for the same period in 2006. Annualized return on average assets was 1.40% for each of the nine-month periods ended September 30, 2007 and 2006. Annualized return on average equity for the nine-month periods ended September 30, 2007 and 2006 was 15.2% and 17.1%, respectively.

Net interest income for the quarter and nine-month periods ended September 30, 2007 declined \$5.0 million and \$7.1 million, respectively, from the same periods in 2006 due primarily to a decline in credit spreads on loans as a result of increased competition and a lag in repricing of interest-earning assets compared to our funding sources. Net interest margin for the quarter and nine-month periods ended September 30, 2007 declined 6 basis points and 12 basis points, respectively, from the same periods in 2006. The principal factors partially mitigating the impact of the decline in margin on net income during the quarter and nine-month periods ended September 30, 2007 were solid and consistent credit quality, growth in fee-based revenues, and well-controlled noninterest expense.

While net interest margin for the nine-month period ended September 20, 2007 declined 12 basis points to 3.59% compared to the same period in 2006, the quarterly net interest margin has trended upward from 3.53% for the quarter ended March 31, 2007 to 3.63% for the quarter ended September 30, 2007.

Charge-offs as a percentage of average loans for the quarter ended September 30, 2007 were 12 basis points, the lowest level in 2 years. Our charge-offs as a percentage of average loans for the nine-month period ended September 30, 2007 were 17 basis points compared to 18 basis points for the same period of 2006. We believe these results reflect our consistent, conservative underwriting philosophy at a time of tremendous competition for loans and in an environment where many competitors have experienced significant credit issues.

Fee-based revenues grew 6.8% for third quarter 2007 and 13.2% for the nine-month period ended September 30, 2007 compared to the same periods in 2006. While increases occurred in most fee categories, the growth for these periods in 2007 was primarily due to increases in service charges on deposits, card-based fees, and trust services.

Noninterest expense growth was well controlled. Noninterest expense grew 1.8% for third quarter 2007 and 2.8% for the nine-month period ended September 30, 2007 compared to the same periods in 2006.

Business Outlook

We expect that fourth quarter 2007 operating results should track the operating trends demonstrated in third quarter 2007. Specifically, net interest margin should approximate 3.60%. Loan growth, which appears to have gained momentum, should continue. Asset quality should remain solid, and the efficiency ratio should remain near the third quarter 2007 level. The results will be influenced by, among other factors, the timing and magnitude of federal funds rate movements, the return of the capital markets to more normal pricing levels, changes in deposit mix, and asset generation. In the longer term, we believe the strength and diversity of the Chicago marketplace will continue to provide us with opportunities for growth.

EARNINGS PERFORMANCE

Net Interest Income

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Net interest income represents the difference between interest income plus fees earned on interest-earning assets and interest expense incurred on interest-bearing liabilities. The level of interest rates and the volume and mix of interest-earning assets and interest-bearing liabilities impact net interest income. Net interest margin represents net interest income as a percentage of total average interest-earning assets. The accounting policies underlying the recognition of interest income on loans, securities, and other interest-earning assets are included in the Notes to Consolidated Financial Statements contained in our 2006 10-K.

Our accounting and reporting policies conform to U.S. generally accepted accounting principles ("U.S. GAAP") and general practice within the banking industry. For purposes of this discussion, both net interest income and net interest margin have been adjusted to a fully tax-equivalent basis to more appropriately compare the returns on certain tax-exempt loans and securities to those on taxable interest-earning assets. Although we believe that these non-GAAP financial measures enhance investors' understanding of our business and performance, these non-GAAP financial measures should not be considered an alternative to GAAP. The effect of such adjustment is presented in the following table.

Table 1
Effect of Tax-Equivalent Adjustment

(Dollar amounts in thousands)

	Quarters Ended September 30,		%	Nine Months Ended September 30,		%
	2007	2006		2007	2006	
Net interest income (GAAP)	\$ 60,697	\$ 65,673	(7.6)	\$ 182,031	\$ 189,096	(3.7)
Tax-equivalent adjustment	4,988	6,132	(18.7)	15,670	17,669	(11.3)
	\$ 65,685	\$ 71,805	(8.5)	\$ 197,701	\$ 206,765	(4.4)

Tax-equivalent net
interest income

Tax-equivalent net interest income for the quarter and nine-month periods ended September 30, 2007 declined \$6.1 million and \$9.1 million, respectively, compared to the same periods in 2006.

Table 2 summarizes the changes in our average interest-earning assets and interest-bearing liabilities as well as the average rates earned and paid on these assets and liabilities, respectively, for the quarters ended September 30, 2007 and 2006. This table also details increases and decreases in income and expense for each of the major categories of interest-earning assets and interest-bearing liabilities and analyzes the extent to which such variances are attributable to volume and rate changes. Interest income and yields are presented on a tax-equivalent basis assuming a federal income tax rate of 35%, which includes the tax-equivalent adjustment as presented in Table 1 above.

As shown in Table 2, third quarter 2007 tax-equivalent interest income declined \$7.5 million compared to third quarter 2006. The decline in interest-earning assets reduced interest income by \$8.1 million, while an increase in the average rate earned on interest-earning assets improved interest income by \$572,000. Third quarter 2007 interest expense decreased \$1.4 million compared to third quarter 2006. The decline in interest-bearing liabilities reduced interest expense by \$9.2 million and was partially offset by a \$7.8 million increase attributable to higher interest rates paid on interest-bearing liabilities.

Table 3 summarizes the same information as Table 2 but for the nine-month periods ended September 30, 2007 and September 30, 2006.

We continue to use multiple interest rate scenarios to rigorously assess the direction and magnitude of changes in interest rates and their impact on net interest income. A description and analysis of our market risk and interest rate sensitivity profile and management policies is included in Item 3, "Quantitative and Qualitative Disclosures About Market Risk," of this Form 10-Q.

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Table 2
Net Interest Income and Margin Analysis

(Dollar amounts in thousands)

	Quarters Ended											
	September 30, 2007 and 2006											
	Average Balances		Average Interest Rates Earned/Paid			Interest Income/Expense			Increase/(Decrease) in Interest Income/Expense Due to:			
	2007	2006	Increase (Decrease)	2007	2006	Basis Points Inc/(Dec)	2007	2006	Increase (Decrease)	Volume	Rate	Total
Federal funds sold	\$ 10,424	\$ 4,360	\$ 6,064	5.86%	6.64%	(78)	\$ 154	\$ 73	\$ 81	\$ 89	\$ (8)	\$ 1

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and other short-term investments												
Mortgages held for sale	1,885	4,192	(2,307)	6.52%	5.77%	75	31	61	(30)	(39)	930	
Trading account securities	17,489	-	17,489	1.44%	0.00%	144	63	-	63	63	-	63
Securities available for sale	1,170,944	2,606,332	(431,388)	5.48%	5.61%	(13)	29,808	36,560	(6,752)	(5,929)	(8,675)	(8,675)
Securities held-to-maturity	97,713	106,301	(8,588)	6.65%	6.53%	12	1,624	1,736	(112)	(144)	312	312
Loans:												
Commercial and industrial	1,535,062	1,565,427	(30,365)	7.70%	7.54%	16	29,805	29,759	46	(450)	496	46
Agricultural	152,781	141,536	11,245	7.15%	7.16%	(1)	2,754	2,553	201	203	(201)	201
Real estate - commercial	816,456	1,868,071	(51,615)	7.39%	7.18%	21	33,855	33,807	48	(590)	638	48
Real estate - construction	606,309	545,465	60,844	8.24%	8.45%	(21)	12,585	11,624	961	1,253	(292)	961
Consumer	581,573	699,972	(118,399)	7.67%	7.44%	23	11,247	13,121	(1,874)	(2,306)	(438)	741
Real estate - 1-4 family	203,619	217,103	(13,484)	6.14%	5.98%	16	3,152	3,275	(123)	(213)	90	23
Total loans	4,895,800	5,037,574	(141,774)	7.57%	7.41%	16	93,398	94,139	(741)	(2,103)	1,367	741
Total interest-earning assets	\$ 7,198,255	\$ 7,758,759	\$ (560,504)	6.91%	6.79%	12	\$ 125,078	\$ 132,569	\$ (7,491)	\$ (8,063)	\$ 67,491	\$ 67,491
Savings deposits	\$ 774,133	\$ 674,039	\$ 100,094	1.76%	0.78%	98	\$ 3,442	\$ 1,318	\$ 2,124	\$ 222	\$ 1,902	\$ 184
NOW accounts	941,488	992,916	(51,428)	1.79%	1.43%	36	4,237	3,570	667	(173)	840	667
	864,001	919,889	(55,888)	3.43%	3.26%	17	7,467	7,562	(95)	(614)	519	95

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Money
market
deposits

Time
deposits

2,208,876	2,536,742	(327,866)	4.81%	4.36%	45	26,803	27,885	(1,082)	(5,508)	4,412,082
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Borrowed

funds 1,093,068	1,343,671	(250,603)	4.97%	4.96%	1	13,680	16,799	(3,119)	(3,136)	(3,719)
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Subordinated

debt 226,180	226,187	(7)	6.60%	6.37%	23	3,764	3,630	134	-	134,134
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Total

interest-bearing

liabilities 1,07,746	\$ 6,693,444	\$ (585,698)	3.86%	3.60%	26	\$ 59,393	\$ 60,764	\$ (1,371)	\$ (9,209)	\$ 7,838,711
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Net

interest

margin

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income

			3.63%	3.69%	(6)	\$ 65,685	\$ 71,805	\$ (6,120)	\$ 1,146	\$ (7,266,211)
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