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Other income

18,310

15,787

13,820

13,455

15,264

Other expense

42,838

43,053

36,927

33,212

31,460

Income before income taxes

22,435

17,901

13,283

12,221

15,967

Income tax expense

8,410

6,529

4,522

4,007

5,443

Net income

14,025

11,372

8,761

8,214

10,524

Dividends on preferred shares

4,252

3,576

2,240

1,821

—

Net income available to common stockholders

$
9,773

$
7,796

$
6,521

$
6,393

$
10,524

Per Common Share Data

Basic earnings per share

$
1.62

$
1.29

$
1.07

$

1.04

$
1.69

Diluted earnings per share

1.62

1.29

1.07

1.04

1.67

Dividends declared per share

0.42

0.40

0.38

0.38

0.38

Book value per common share

17.53

16.18

14.46

14.23

13.50

Capital Ratios

Total capital to risk-weighted assets

15.65
%

14.48
%

12.84
%

15.76
%

11.99
%
Tier 1 capital to risk-weighted assets

14.51
%

13.37
%

11.71
%

14.57
%

11.02
%

Tier 1 capital to average assets

9.66
%

8.99
%

7.42
%

10.63
%

8.41
%
Financial Ratios

Net interest margin

3.44
%

3.45
%

3.51
%

3.40
%

3.73
%
Return on average assets

0.91

%

0.76
%

0.72
%

0.74
%

1.03
%
Return on average common equity

9.53
%

8.36
%

7.20
%

9.56
%

12.87
%
Dividend on common shares payout ratio

25.93
%

31.01
%

35.51
%

36.54
%

22.49
%
Average equity to average assets

9.76
%

8.88

%

9.44
%

9.59
%

8.00
%
Allowance for loan losses as a percent of total loans

1.29
%

1.29
%

1.29
%

1.35
%

1.02
%
Year End Balances

Total assets

$
1,578,032

$
1,500,956

$
1,468,245

$
1,095,155

$
1,049,700

Net loans, including loans held for sale

899,289

848,954

794,188

691,288

734,351

Total deposits

1,274,065

1,170,734

1,212,710

840,410

806,354

Total equity

156,687

140,967

112,265

111,221

82,778

Average Balances

Total assets

$
1,543,453

$
1,502,794

$
1,219,353

$
1,108,669

$
1,022,734

Net loans, including loans held for sale

866,912

796,520

708,367

692,961

733,681

Total deposits

1,236,598

1,212,206

972,811

744,043

795,786

Total equity

150,578

133,444

115,151

106,295

81,793

18

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 years ended December 31, 2012, 2011 and 2010. 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 1955. 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, 2012, 2011 and 2010

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 $14.02 million, $11.37 million, and $8.76 million and diluted earnings per share were $1.62, $1.29, and $1.07 for the years ended December 31, 2012, 2011 and 2010, respectively. The increases in net income and earnings per share in 2012 was primarily the result of an increase in net interest income due to an increase in the size of the balance sheet and lower rates paid on deposit balances resulting in less interest expense for the year, no impairment charges recorded for investment securities, an increase in mortgage banking income and a reduction of other real estate owned expenses. The following table shows the Company's annualized performance ratios for the years ended December 31, 2012, 2011 and 2010:

	2012		2011		2010	
Return on average assets	0.91	%	0.76	%	0.72	%
Return on average common equity	9.53	%	8.36	%	7.20	%
Average common equity to average assets	9.76	%	8.88	%	9.44	%

Total assets at December 31, 2012, 2011 and 2010 were $1.58 billion, $1.50 billion, and $1.47 billion, respectively. Net loan balances increased to $899.3 million at December 31, 2012, from $849 million at December 31, 2011 from $794.2 million at December 31, 2010. Of the increase in 2012, $46.9 million or 93% was due to increases in loans secured by real estate. Of the increase in 2011, $53.8 million or 98% was due to increases in loans secured by real estate and commercial and industrial loans.

Total deposit balances increased to $1.27 billion at December 31, 2012 from $1.17 billion at December 31, 2011 and from $1.21 billion at December 31, 2010. The increase in 2012 was due to a decline in increases in non-interest bearing and savings account balances offset by higher rate CDs that matured and were not replaced. The decrease in 2011 was due to a decline in money market balances and higher rate CDs that matured and were not replaced.

Net interest margin, defined as net interest income divided by average interest-earning assets, was 3.44% for 2012, 3.45% for 2011 and 3.51% for 2010. The decrease during 2012 was the result of a greater decline in asset yields for loans and and investments than deposit rates due to the continued historically low level of interest rates. 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.

Net interest income increased to $49.6 million in 2012 from $48.3 million in 2011 and $40.1 million in 2010. 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.

Non-interest income increased to $18.3 million in 2012 compared to $15.8 million in 2011 and $13.8 million in 2010. The primary reason for the increase of $2.5 million or 16% from 2011 to 2012 was increases in trust revenue and mortgage banking revenue and no other-than-temporary impairment charges on investment securities. The primary reason for the increase of $2 million or 14.2% from 2010 to 2011 was increases in ATM and debit fees, an increase in trust revenues and less other-than-temporary impairment charges on investment securities.

Non-interest expenses decreased $215,000, to $42.8 million in 2012 compared to $43.1 million in 2011, and $36.9 million in 2010. The decrease during 2012 was primarily due to a decline in expenses from other real estate owned offset by an increase in salaries and benefits expenses. 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.

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

	2012 vs 2011	2011 vs 2010
Net interest income	$1,342	$8,141
Provision for loan losses	454	636
Other income, including securities transactions	2,523	1,967
Other expenses	215	(6,126)
Income taxes	(1,881)	(2,007)
Increase in net income	$2,653	$2,611

Credit quality is an area of importance to the Company. Year-end total nonperforming loans were $7.6 million at December 31, 2012 compared to $7.4 million at December 31, 2011 and $10.4 million at December 31, 2010. The increase in 2012 was primarily the result of additional loans becoming past-due and put on non-accrual. 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 $1.2 million at December 31, 2012 compared to $4.6 million at December 31, 2011 and $6.1 million at December 31, 2010. The Company’s provision for loan losses was $2.6 million for 2012 compared to $3.1 million for 2011 and $3.7 million for 2010. At December 31, 2012, the composition of the loan portfolio remained similar to year-end 2011. Loans secured by both commercial and residential real estate comprised of 72% of the loan portfolio for both December 31, 2012 and 2011.

The Company also held investments in three trust preferred securities with a fair value of $585,000 and unrealized losses of $4.4 million at December 31, 2012 compared to four trust preferred securities with a fair value of $719,000 and unrealized losses of $4.9 million at December 31, 2011. On July 3, 2012, the company's holding in PreTSL VI was redeemed in full. The payment received was sufficient to pay-off the book value of the security of $123,000, reverse the recorded OTTI impairment of $127,000 and recover previously unrecorded interest of $11,500. During 2012, the Company recorded no other-than-temporary impairment charges for the credit portion of the unrealized losses of these securities compared to $886,000 during 2011 and $1.4 million during 2010. The charges during 2011 and 2010 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, 2012, 2011, and 2010 was 14.51%, 13.37%, and 11.71%, respectively. The Company’s total capital to risk weighted assets ratio at December 31, 2012, 2011, and 2010 was 15.65% ,14.48%, and 12.84%, respectively. The increase in

2012 was primarily the result of an increase in retained earnings due to the Company's net income and the issuance of $8,250,000 of Series C Preferred Stock. (See "Preferred Stock" in Note 1 to consolidated financial statements for more detailed information.) 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 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, 2012, 2011 and 2010 were $234.9 million, $228.6 million, and $169.3 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.

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 2012 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.

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.

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 December 31, 2012			Year Ended December 31, 2011			Year Ended December 31, 2010		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS									
Interest-bearing deposits	$16,559	$40	0.24 %	$83,877	$213	0.25 %	$75,558	$186	0.25 %
Federal funds sold	41,484	37	0.09 %	78,227	69	0.09 %	65,644	85	0.13 %
Certificates of deposit investments	10,714	57	0.53 %	11,651	78	0.67 %	9,473	110	1.16 %
Investment securities									
Taxable	458,158	9,970	2.18 %	388,108	9,819	2.53 %	249,636	7,746	3.10 %
Tax-exempt (1)	49,198	1,714	3.48 %	30,971	1,194	3.86 %	23,251	953	4.10 %
Loans (2) (3)	866,912	43,949	5.07 %	807,463	45,399	5.62 %	718,669	41,803	5.82 %
Total earning assets	1,443,025	55,767	3.85 %	1,400,297	56,772	4.05 %	1,142,231	50,883	4.45 %
Cash and due from banks	35,125			31,554			21,378		
Premises and equipment	30,234			29,374			19,454		
Other assets	46,646			52,512			46,592		
Allowance for loan losses	(11,577)			(10,943)			(10,302)		
Total assets	$1,543,453			$1,502,794			$1,219,353		
LIABILITIES AND STOCKHOLDERS’ EQUITY									
Deposits:									
Demand deposits, interest-bearing	$511,199	1,443	0.28 %	$499,184	2,325	0.47 %	$421,743	3,190	0.76 %
Savings deposits	281,831	1,186	0.42 %	251,268	1,481	0.59 %	165,337	1,279	0.77 %
Time deposits	224,350	2,214	0.99 %	264,508	2,919	1.10 %	243,606	4,002	1.64 %
Securities sold under agreements									
to repurchase	113,443	117	0.10 %	108,240	172	0.16 %	76,758	133	0.17 %
FHLB advances	10,619	308	2.90 %	20,238	765	3.78 %	26,092	1,090	4.18 %
Federal funds purchased	59	—	0.68 %	14	—	0.55 %	8	—	0.47 %
Subordinated debentures	20,620	563	2.73 %	20,620	770	3.73 %	20,620	1,053	4.39 %
Other debt	4,035	326	8.00 %	927	72	8.00 %	642	9	2.76 %
Total interest-bearing liabilities	1,166,156	6,157	0.53 %	1,164,999	8,504	0.73 %	954,806	10,756	1.13 %
Demand deposits	219,218			197,246			142,125		
Other liabilities	7,501			7,105			7,271		
Stockholders’ equity	150,578			133,444			115,151		
Total liabilities & equity	$1,543,453			$1,502,794			$1,219,353		
Net interest income		$49,610			$48,268			$40,127	

Net interest spread	3.32	%	3.32	%	3.32	%
Impact of non-interest bearing funds	0.12	%	0.13	%	0.19	%
Net yield on interest-earning assets	3.44	%	3.45	%	3.51	%

(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):

	2012 Compared to 2011 Increase – (Decrease)			2011 Compared to 2010 Increase – (Decrease)		
	Total Change	Volume (1)	Rate (1)	Total Change	Volume (1)	Rate (1)
Earning Assets:						
Interest-bearing deposits	$(173)	$(165)	$(8)	$27	$27	$—
Federal funds sold	(32)	(32)	—	(16)	14	(30)
Certificates of deposit investments	(21)	(6)	(15)	(32)	21	(53)
Investment securities:						
Taxable	151	1,623	(1,472)	2,073	3,694	(1,621)
Tax-exempt (2)	520	645	(125)	241	301	(60)
Loans (3)	(1,450)	3,191	(4,641)	3,596	5,062	(1,466)
Total interest income	(1,005)	5,256	(6,261)	5,889	9,119	(3,230)
Interest-Bearing Liabilities:						
Deposits:						
Demand deposits, interest-bearing	(882)	57	(939)	(865)	514	(1,379)
Savings deposits	(295)	166	(461)	202	550	(348)
Time deposits	(705)	(425)	(280)	(1,083)	320	(1,403)
Securities sold under agreements to repurchase	(55)	8	(63)	39	48	(9)
FHLB advances	(457)	(307)	(150)	(325)	(228)	(97)
Federal funds purchased	—	—	—	—	—	—
Subordinated debentures	(207)	—	(207)	(283)	—	(283)
Other debt	254	254	—	63	5	58
Total interest expense	(2,347)	(247)	(2,100)	(2,252)	1,209	(3,461)
Net interest income	$1,342	$5,503	$(4,161)	$8,141	$7,910	$231

(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 $1.3 million or 2.8% in 2012 compared to an increase of $8.1 million or 20.3% in 2011. The increase in net interest income in 2012 was primarily due to a greater increase in investment and loan balances offset by declines in interest-bearing asset rates compared to declines in rates of interest-bearing liabilities during the same period. The increase in net interest income in 2011 was primarily due to an increase in earning assets.

In 2012, average earning assets increased by $42.7 million or 3% and average interest-bearing liabilities increased $1.2 million or .1% compared with 2011. In 2011, average earning assets increased by $258.1 million, or 22.6%, and average interest-bearing liabilities increased $210.2 million or 22% compared with 2010. Changes in average balances are shown below:

- Average interest-bearing deposits held by the Company decreased $67.3 million or 80.2% in 2012 compared to 2011. In 2011, average interest-bearing deposits held by the Company increased $8.3 million or 11% compared to 2010.

- Average federal funds sold decreased $36.7 million or 46.9% in 2012 compared to 2011. In 2011, average federal funds sold increased $12.6 million or 19.2% compared to 2010.

- Average certificates of deposit investments decreased $.9 million or 7.7% in 2012 compared to 2011. In 2011, average certificates of deposit investments increased $2.2 million or 23.2% compared to 2010.

- Average loans increased by $59.4 million or 7.4% in 2012 compared to 2011. In 2011, average loans increased by $88.8 million or 12.4% compared to 2010.

- Average securities increased by $88.3 million or 21.1% in 2012 compared to 2011. In 2011, average securities increased by $146.2 million or 53.6% compared to 2010.

- Average deposits increased by $2.4 million or .2% in 2012 compared to 2011. In 2011, average deposits increased by $184.3 million or 22.2% compared to 2010.

- Average securities sold under agreements to repurchase increased by $5.2 million or 4.8% in 2012 compared to 2011. In 2011, average securities sold under agreements to repurchase increased by $31.5 million or 41% compared to 2010.

- Average borrowings and other debt decreased by $6.5 million or 15.6% in 2012 compared to 2011. In 2011, average borrowings and other debt decreased by $5.6 million or 11.8% compared to 2010.

- The federal funds rate remained at a range of 0% to .30% at December 31, 2012, 2011 and 2010.

- Net interest margin decreased to 3.44% compared to 3.45% in 2011 and 3.51% in 2010. Asset yields decreased by 20 basis points in 2012, and interest-bearing liabilities decreased by 20 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 2012, 2011 and 2010 were $1,038,000, $615,000, and $491,000, respectively. The net yield on interest-earning assets on a tax equivalent basis was 3.51% in 2012, 3.51% in 2011 and 3.57% in 2010.

Provision for Loan Losses

The provision for loan losses in in 2012 was $2,647,000 in 2012 compared to $3,101,000 in 2011 and $3,737,000 in 2010. Nonperforming loans increased to $7,593,000 at December 31, 2012 from $7,440,000 at December 31, 2011 and compared to $10,434,000 at December 31, 2010. The increase in 2012 was primarily due to additional loans becoming past due and being put on non-accrual. The decrease in 2011 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 $1,991,000 during 2012, $2,374,000 during 2011 and $2,806,000 during 2010. 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	
	2012	2011	2010	2012	2011
Trust	$3,330	$3,030	$2,601	$300	$429
Brokerage	688	650	536	38	114

Insurance commissions	1,813	1,786	1,779	27	7
Service charges	4,808	4,817	4,662	(9)	155
Securities gains	934	486	543	448	(57)
Impairment recoveries (losses) on securities	127	(886)	(1,418)	1,013	532
Mortgage banking	1,509	788	776	721	12
ATM / debit card revenue	3,554	3,483	2,869	71	614
Other	1,547	1,633	1,472	(86)	161
Total other income	$18,310	$15,787	$13,820	$2,523	$1,967

Total non-interest income increased to $18.3 million in 2012 compared to $15.8 million in 2011 and $13.8 million in 2010. The primary reasons for the more significant year-to-year changes in other income components are as follows:

- Trust revenues increased $300,000 or 9.9% in 2012 to $3,330,000 from $3,030,000 in 2011 compared to $2,601,000 in 2010. The increase from 2011 to 2012 in trust revenues was due to an increase in revenues from Personal Trust and Agency accounts and retirement services accounts during the year. Trust assets were $633.8 million at December 31, 2012 compared to $546.7 million at December 31, 2011 and $507.5 million at December 31, 2010.

- Revenue from brokerage annuity sales increased $38,000 or 5.8% to $688,000 in 2012 from $650,000 in 2011 compared to $536,000 in 2010. The increase from 2011 to 2012 was due an increase in commissions received from the sale of annuities.

- Insurance commissions increased $27,000 or 1.5% to $1,813,000 in 2012 from $1,786,000 in 2011 compared to $1,779,000 in 2010. The increase from 2011 to 2012 was due to an increase in property and casualty insurance commissions during 2012 compared to 2011.

- Fees from service charges decreased $9,000 or .2% to $4,808,000 in 2012 from $4,817,000 in 2011 compared to $4,662,000 in 2010. The decrease from 2011 to 2012 was due to lower transaction account fees. The 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 in 2012 were $934,000 up $448,000 or 92% from $486,000 in 2011 and $543,000 in 2010. Several securities in the investment portfolio were sold to improve the overall portfolio mix and the margin in 2012 and 2011.

- During 2012, the Company received payment for the redemption of one of its investments in trust preferred securities that resulted in the reversal of $127,000 of previous other-than-temporary impairment charges. 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. See Note 4 - Investment Securities in the notes to the financial statements for a more detailed description of these charges.

- Mortgage banking income increased $721,000 or 91.5% to $1,509,000 in 2012 from $788,000 in 2011 compared to $776,000 in 2010. The increase from 2011 to 2012 was due to an increase in the volume of loans originated and sold by First Mid Bank due to lower interest rates on various loan types. Loans sold balances are as follows:

$101 million (representing 796 loans) in 2012
$60 million (representing 500 loans) in 2011
$64 million (representing 570 loans) in 2010

FIrst Mid Bank generally releases the servicing rights on loans sold into the secondary market.

- Revenue from ATMs and debit cards increased $71,000 or 2% to $3,554,000 in 2012 from $3,483,000 in 2011 compared to $2,869,000 in 2010. The increase from 2011 to 2012 was due to an increase in the number of transactions processed offset by lower fees received for processing these transactions. The increase from 2010 to 2011 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 decreased $86,000 or 5.3% in 2012 to $1,547,000 from $1,633,000 in 2011 compared to $1,472,000 in 2010. The decrease from 2011 to 2012 was primarily due to non-recurring income received in 2011 for distribution of an investment in other assets and decreases in various other expenses. The increase from 2011 to 2010 was primarily due to the non-recurring income received for distribution of an investment in other assets and an increase in rental income from buildings acquired in the Branch acquisition 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 Year	
	2012	2011	2010	2012	2011
Salaries and benefits	$23,433	$22,247	$18,649	$1,186	$3,598
Occupancy and equipment	8,088	7,960	5,851	128	2,109
Other real estate owned, net	390	1,471	1,076	(1,081)	395
FDIC insurance assessment expense	875	1,167	1,508	(292)	(341)
Amortization of other intangibles	773	1,134	814	(361)	320
Stationery and supplies	609	581	610	28	(29)
Legal and professional fees	2,093	2,070	2,361	23	(291)
Marketing and promotion	1,014	1,050	940	(36)	110
Other	5,563	5,373	5,118	190	255
Total other expense	$42,838	$43,053	$36,927	$(215)	$6,126

Total non-interest expense decreased to $42.8 million in 2012 from $43.1 million in 2011 and $36.9 million in 2010. 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 $1,186,000 or 5.3% to $23,433,000 from $22,247,000 in 2011, compared to $18,649,000 in 2010. The increase in 2012 was as primarily due to an increase in incentive compensation expense as a result of achieving desired objectives in 2012 compared to 2011 and merit raises for continuing employees. The increase in 2011 was 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 2010 and merit raises for continuing employees. There were 400 full-time equivalent employees at December 31, 2012, compared to 402 at December 31, 2011, and 419 at December 31, 2010.

- Occupancy and equipment expense increased $128,000 or 1.6% to $8,088,000 in 2012 from $7,960,000 in 2011, compared to $5,851,000 in 2010. The increase in 2012 was primarily due to increases in building depreciation expense and other expenses associated with the Company's purchase of a building in Mattoon, Illinois in 2011. 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 decreased $1,081,000 or 73.5% to $390,000 from $1,471,000 in 2011, compared to $1,076,000 in 2010. The decrease in 2012 was due to less expenses for maintenance, insurance and property taxes resulting from less properties owned and fewer losses on properties sold compared to 2011. 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 2010.

- FDIC insurance expense decreased $292,000 or 25% to $875,000 from $1,167,000 in 2011, compared to $1,508,000 in 2010. The decrease in 2012 was due to a full year of assessments calculated under the new rules implemented during the second quarter of 2011 and lower assessment rates during 2012 compared to 2011. The decrease in 2011 was due to a decrease in expense resulting from a change in the calculation of the insurance assessment during the second quarter of 2011.

- Amortization of other intangibles expense decreased $361,000 or 31.8% to $773,000 from $1,134,000 in 2011, compared to $814,000 in 2010 . The decrease in 2012 was due to the customer list intangibles becoming fully amortized during the first quarter of 2012 and less amortization expense for core deposit intangibles. 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 $190,000 or 3.5% to $5,563,000 from $5,373,000 in 2011, compared to $5,118,000 in 2010. In 2012, the increase was due to increases in various expenses. 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 increased $15,000 or .4% to $3,716,000 from $3,701,000 in 2011, compared to $3,911,000 in 2010. The decrease in 2011 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 $8,410,000 in 2012 compared to $6,529,000 in 2011, and $4,522,000 in 2010. Effective tax rates were 37.5%, 36.5%, and 34.0%, respectively, for 2012, 2011 and 2010. 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 increase in the Company's effective tax rate in 2012 was primarily due to a decline in the amount of tax-exempt securities held by the Company.

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 amortized cost of the available-for-sale and held-to-maturity securities for the last three years (dollars in thousands):

	December 31, 2012			2011			2010		
	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	$180,851	1.75	%	$164,812	1.99	%	$152,086	1.90	%
Obligations of states and political subdivisions	53,064	3.62	%	38,879	3.92	%	26,599	4.05	%
Mortgage-backed securities: GSE residential	252,310	2.81	%	254,930	3.17	%	158,936	3.72	%
Trust preferred securities	4,974	3.50	%	5,625	4.05	%	6,595	3.74	%
Other securities	9,663	1.92	%	9,561	1.92	%	2,035	2.48	%
Total securities	$500,862	2.53	%	$473,807	2.81	%	346,251	2.94	%

At December 31, 2012, the Company's investment portfolio increased by $27.1 million from December 31, 2011 due to the purchase of various 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, 2012 for certain investment securities (in thousands):

			Average Credit Rating of Fair Value at December 31, 2012 (1)					
	Amortized Cost	Estimated Fair Value	AAA	AA +/-	A +/-	BBB +/-	< BBB -	Not rated
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$180,851	$182,169	$182,169	$—	$—	$—	$—	$—
Obligations of state and political subdivisions	53,064	56,207	3,254	41,406	6,964	1,384	—	3,199
Mortgage-backed securities (2)	252,310	259,460	—	—	—	—	—	259,460
Trust preferred securities	4,974	585	—	—	—	—	585	—

Other securities	9,663	9,888	—	—	7,930	1,898	—	60
Total investments	$500,862	$508,309	$185,423	$41,406	$14,894	$3,282	$585	$262,719

(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 three trust preferred pooled securities issued by FTN Financial Securities Corp. ("FTN"). The following table contains information regarding these securities as of December 31, 2012:

Deal name	PreTSL I	PreTSL II	PreTSL XXVIII
Class	Mezzanine	Mezzanine	Mezzanine C-1
Book value	$513,000	$809,000	$3,652,000
Fair value	$297,000	$219,000	$69,000
Unrealized gains/(losses)	$(216,000)	$(590,000)	$(3,583,000)
Other-than-temporary impairment recorded in earnings	$691,000	$2,187,000	$1,111,000
Lowest credit rating assigned	Ca	Ca	C
Number of performing banks	12	14	27
Number of issuers in default	4	4	9
Number of issuers in deferral	1	5	9
Original collateral	$303,112,000	$334,170,000	$360,850,000
Actual defaults & deferrals as a % of original collateral	22.8%	26.0%	25.2%
Remaining collateral	$177,000,000	$183,200,000	$353,616,000
Actual defaults & deferrals as a % of remaining collateral	39.0%	47.5%	2,570.0%
Expected defaults & deferrals as a % of remaining collateral	36.6%	45.7%	34.3%
Performing collateral	$108,000,000	$96,200,000	$262,616,000
Current balance of class	$90,533,716	$122,047,807	$37,111,400
Subordination	$131,121,879	$185,063,249	$301,063,079
Excess subordination	$(23,121,879)	$(88,863,249)	$(30,420,834)
Excess subordination as a % of remaining performing collateral	(21.4)%	(92.4)%	(11.9)%
Discount rate (1)	9.74%	9.68%	1.60%-4.95%
Expected defaults & deferrals as a % of remaining collateral (2)	2% / .36	2% / .36	2% / .36
Recovery assumption (3)	10%	10%	10%
Prepayment assumption (4)	1%	1%	1%

(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) Additional assumptions regarding prepayments:
Banks with more than $15 billion in total assets as of 12/31/2009:
(a) For fixed rate TruPS, all securities will be called in one year
(b) For floating rate TruPS, (1) all securities with spreads greater than 250 bps will be called in one year (2) all securities with spreads between 150 bps and 250 bps will be called at a rate of 5% annually (3) all securities with spreads less than 150 bps will be called at a rate of 1% annually
Banks with less than $15 billion in total assets as of 12/31/2009:
(a) For fixed rate TruPS, (1) all securities with coupons greater than 8% that were issued by healthy banks with the capacity to prepay will be called in one year (2) All remaining fixed rate securities will be called at a rate of 1% annually
(b) For floating rate TruPs, all securities will be called at a rate of 1% annually

The trust preferred pooled securities are Collateralized Debt Obligations ("CDOs") 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 and all classes senior to the specified class. Excess subordination is the amount that the performing collateral balance exceeds the current outstanding balance of the specific 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.

During the year ended December 31, 2011 the Company was receiving "payment in kind" ("PIK") in lieu of cash interest on all of its trust preferred securities investments as and to the extent described below. During 2012, the Company began receiving its full interest payments on PreTSL I and partial interest payments on PreTSL II. Also during 2012, the company's holding in PreTSL VI was redeemed in full. The payment received was sufficient to pay-off the book value of the security of $123,000, reverse the recorded OTTI impairment of $127,000 and recover previously unrecorded interest of approximately $11,500.

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 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 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, 2012 and 2011.

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.

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 OTTI, related to other factors, is recognized in other comprehensive earnings, net of applicable taxes.

The term "other-than-temporary" is not intended to indicate that the decline is permanent, but 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 in the notes to the financial statements for a discussion of the Company's evaluation and, when applicable, charges for OTTI.

Loans

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

	2012	% Outstanding Loans		2011	2010	2009	2008
Construction and land development	$31,341	3.4	%	$23,136	$20,379	$28,041	$40,362
Farm loans	86,271	9.5	%	72,585	64,992	62,330	65,647
1-4 Family residential properties	186,498	20.5	%	181,849	179,527	180,415	200,204
Multifamily residential properties	44,863	4.9	%	19,846	22,146	19,467	23,833
Commercial real estate	316,322	34.7	%	321,001	300,825	226,400	217,307

Loans secured by real estate	665,295	73.0 %	618,417	587,869	516,653	547,353
Agricultural loans	61,014	6.7 %	63,257	58,307	54,144	54,098
Commercial and industrial loans	160,299	17.6 %	150,716	126,319	105,351	109,324
Consumer loans	16,264	1.8 %	16,271	19,655	20,815	25,806
All other loans	8,193	0.9 %	11,413	12,431	3,787	5,357
Total loans	$911,065	100.0 %	$860,074	$804,581	$700,750	$741,938

Loan balances increased by $51 million or 5.9% from December 31, 2011 to December 31, 2012 primarily due to originations of loans secured by real estate and commercial and industrial loans. 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. The balances of loans sold into the secondary market were $101 million in 2012 compared to $60 million in 2011. The balance of real estate loans held for sale, included in the balances shown above, amounted to $212,000 and $1,046,000 as of December 31, 2012 and 2011, respectively.

All of the loans acquired in the acquisition of the Branches during 2010 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, 2012 and 2011 is $503,000 and $906,000, respectively.

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.

The following table summarizes the loan portfolio geographically by branch region as of December 31, 2012 and 2011 (dollars in thousands):

	December 31, 2012			December 31, 2011		
	Principal balance	% Outstanding Loans		Principal balance	% Outstanding loans	
Mattoon region	$183,657	20.2	%	$163,446	19.0	%
Charleston region	51,179	5.6	%	48,716	5.7	%
Sullivan region	128,650	14.1	%	120,369	14.0	%
Effingham region	63,910	7.0	%	75,750	8.8	%
Decatur region	218,318	24.0	%	197,063	22.9	%
Peoria region	156,370	17.2	%	143,955	16.7	%
Highland region	108,981	11.9	%	110,775	12.9	%
Total all regions	$911,065	100.0	%	$860,074	100.0	%

Loans are geographically dispersed among these regions located in central and southwestern Illinois. While these regions have experienced some economic stress during 2012 and 2011, 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 some 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, 2012 and 2011, the Company did have industry loan concentrations in excess of 25% of total risk-based capital in the following industries (dollars in thousands):

	December 31, 2012			December 31, 2011		
	Principal balance	% Outstanding Loans		Principal balance	% Outstanding Loans	
Other grain farming	$124,367	13.65	%	$120,061	13.17	%
Lessors of non-residential buildings	89,940	9.87	%	82,557	9.50	%
Lessors of residential buildings & dwellings	59,848	6.57	%	44,009	5.06	%
Hotels and motels	45,783	5.03	%	46,842	5.64	%

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

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The following table presents the balance of loans outstanding as of December 31, 2012, by contractual maturities (in thousands):

	Maturity (1) One year or less(2)	Over 1 through 5 years	Over 5 years	Total
Construction and land development	$17,866	$6,649	$6,826	$31,341
Farm loans	11,904	39,859	34,508	86,271
1-4 Family residential properties	24,646	84,463	77,389	186,498
Multifamily residential properties	888	17,893	26,082	44,863
Commercial real estate	47,509	178,914	89,899	316,322
Loans secured by real estate	102,813	327,778	234,704	665,295
Agricultural loans	45,144	14,814	1,056	61,014
Commercial and industrial loans	110,283	42,117	7,899	160,299
Consumer loans	3,546	12,367	351	16,264
All other loans	805	1,840	5,548	8,193
Total loans	$262,591	$398,916	$249,558	$911,065

(1) Based upon remaining contractual maturity.
(2) Includes demand loans, past due loans and overdrafts.

As of December 31, 2012, loans with maturities over one year consisted of approximately $580.7 million in fixed rate loans and approximately $67.8 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 Nonperforming Other 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 “troubled debt restructurings”. 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 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. 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,									
	2012		2011		2010		2009		2008	
Nonaccrual loans	$7,573		$6,723		$9,332		$12,720		$7,285	
Restructured loans which are performing in accordance with revised terms	20		717		1,102		—		—	
Total nonperforming loans	7,593		7,440		10,434		12,720		7,285	
Repossessed assets	1,229		4,606		6,199		2,896		2,400	
Total nonperforming loans and repossessed assets	$8,822		$12,046		$16,633		$15,616		$9,685	
Nonperforming loans to loans, before allowance for loan losses	0.83	%	0.87	%	1.30	%	1.82	%	0.98	%
Nonperforming loans and repossessed assets to loans, before allowance for loan losses	0.98	%	1.40	%	2.07	%	2.23	%	1.31	%

The $850,000 increase in nonaccrual loans during 2012 resulted from the net of $4,403,000 of loans put on nonaccrual status, offset by $331,000 of loans transferred to other real estate owned, $632,000 of loans charged off and $2,590,000 of loans becoming current or paid-off. The following table summarizes the composition of nonaccrual loans (in thousands):

	December 30, 2012			December 31, 2011		
	Balance	% of Total		Balance	% of Total	
Construction and land development	$1,522	20.1	%	$833	12.4	%
Farm loans	418	5.5	%	532	7.9	%
1-4 Family residential properties	1,899	25.1	%	1,712	25.5	%
Commercial real estate	2,063	27.2	%	2,245	33.4	%
Loans secured by real estate	5,902	77.9	%	5,322	79.2	%
Agricultural loans	930	12.3	%	673	10.0	%
Commercial and industrial loans	704	9.3	%	720	10.7	%
Consumer loans	37	0.5	%	8	0.1	%
Total loans	$7,573	100.0	%	$6,723	100.0	%

Interest income that would have been reported if nonaccrual and restructured loans had been performing totaled $173,000, $239,000 and $428,000 for the years ended December 31, 2012, 2011 and 2010, respectively.

The $3,377,000 decrease in repossessed assets during 2012 resulted from the net of $780,000 of additional assets repossessed, $3,791,000 of repossessed assets sold and $366,000 of further write-downs of repossessed assets to current market value. The following table summarizes the composition of repossessed assets (in thousands):

	December 31, 2012			December 31, 2011		
	Balance	% of Total		Balance	% of Total	
Construction and land development	$278	22.6	%	$694	15.1	%
1-4 family residential properties	539	43.9	%	571	12.4	%
Multi-family residential properties	30	2.4	%	43	0.9	%
Commercial real estate	340	27.7	%	3,298	71.6	%
Total real estate	1,187	96.6	%	4,606	100.0	%
Consumer Loans	42	3.4	%	—	—	

Total repossessed collateral	$1,229	100.0 %	$4,606	100.0 %

Repossessed assets sold during 2012 resulted in net losses of $273,000, of which $268,000 was related to real estate asset sales and $5,000 was related to other repossessed assets sales. Repossessed assets sold during 2011 resulted in net gains of $173,000, of which net gains of $174,000 were related to real estate asset sales and a net loss of $1,000 was related to other repossessed assets 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 probable losses existing 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 current state of the economy, management did assess the impact of the 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 of several components in assessing the probability of inherent future losses. Given the continued weakened in economic conditions, management also increased its allocation to various loan categories for economic factors during 2012 and 2011. 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, drought conditions 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, 2012, the Company's loan portfolio included $147.3 million of loans to borrowers whose businesses are directly related to agriculture. Of this amount, $124.4 million was concentrated in other grain farming. Total loans to borrowers whose businesses are directly related to agriculture increased $11.4 million from $135.8 million at December 31, 2011 while loans concentrated in other grain farming increased $4.3 million from $120.1 million at December 31, 2011.

While the Company adheres to sound underwriting practices, including collateralization of loans, any extended period of low commodity prices, drought conditions, 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. Drought conditions present during the second and third quarters of 2012 are expected to reduce the 2012 crop yields. The impact on the cash flow of agricultural customers is mitigated to some extent because most of these customers maintain crop insurance. The Company does not expect the drought conditions to have a material impact on the allowance for loan losses.

In addition, the Company has $45.8 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 $89.9 million of loans to lessors of non-residential buildings and $59.8 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 minimizes credit risk by adhering to sound underwriting and credit review policies. Management and the board of directors of the Company review these policies at least annually. 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. On a quarterly basis, the board of directors and management review the status of problem loans and determine a best estimate of the allowance. In addition to internal policies and controls, regulatory authorities periodically review asset quality and the overall adequacy of the allowance for loan losses.

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):

	2012		2011		2010		2009		2008	
Average loans outstanding, net of unearned income	$866,912		$807,463		$718,669		$701,521		$740,083	
Allowance-beginning of period	11,120		10,393		9,462		7,587		6,118	
Charge-offs:										
Real estate-mortgage	1,423		2,625		2,551		1,240		1,640	
Commercial, financial & agricultural	699		881		287		287		479	
Installment	79		92		103		176		119	
Other	170		162		181		176		184	
Total charge-offs	2,371		3,760		3,122		1,879		2,422	
Recoveries:										
Real estate-mortgage	137		1,171		146		6		75	
Commercial, financial & agricultural	85		97		35		27		98	
Installment	67		28		29		31		38	
Other	91		90		106		96		121	
Total recoveries	380		1,386		316		160		332	
Net charge-offs	1,991		2,374		2,806		1,719		2,090	
Provision for loan losses	2,647		3,101		3,737		3,594		3,559	
Allowance-end of period	$11,776		$11,120		$10,393		$9,462		$7,587	
Ratio of annualized net charge-offs to average loans	0.23	%	0.29	%	0.39	%	0.25	%	0.28	%
Ratio of allowance for loan losses to loans outstanding (less unearned interest at end of period)	1.29	%	1.29	%	1.29	%	1.35	%	1.02	%
Ratio of allowance for loan losses to nonperforming loans	155.1	%	149.5	%	99.6	%	74.4	%	104.1	%

The ratio of the allowance for loan losses to nonperforming loans is 155.1% as of December 31, 2012 compared to 149.5% as of December 31, 2011. Management believes that the overall estimate of the allowance for loan losses appropriately accounts for probable losses attributable to current exposures.

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 2012, the Company had net charge-offs of $2.0 million compared to $2.4 million in 2011. During 2012, the Company's significant charge-offs included $506,000 on commercial real estate loans of seven borrowers, $174,000 on one residential real estate loan and $4,347,000 on commercial operating loans of six borrowers. 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.

At December 31, 2012 the allowance for loan losses amounted to $11.8 million or 1.3% of total loans, and 155% of nonperforming loans. At December 31, 2011 the allowance for loan losses amounted to $11.1 million or 1.3% of total loans and 150% of nonperforming loans.

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, 2012			December 31, 2011			December 31, 2010		
	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	$726	19.7	%	$636	21.5	%	440	25.1	%
Commercial / Commercial real estate	9,301	62.5	%	8,791	58.8	%	8,307	55.7	%
Agricultural / Agricultural real estate	558	16.0	%	546	15.2	%	404	15.3	%
Consumer	403	1.8	%	378	4.5	%	392	3.9	%
Total allocated	10,988	100.0	%	10,351	100.0	%	9,543	100.0	%
Unallocated	788	N/A		769	N/A		850	N/A	
Allowance at end of year	$11,776	100.0	%	$11,120	100.0	%	10,393	100.0	%

	December 31, 2009			December 31, 2008		
	Allowance for loan losses	% of loans to total loans		Allowance for loan losses	% of loans to total loans	
Residential real estate	$488	28.5	%	$510	30.2	%
Commercial / Commercial real estate	7,428	51.4	%	5,345	49.5	%
Agricultural / Agricultural real estate	315	16.6	%	223	16.1	%
Consumer	410	3.5	%	436	4.2	%
Total allocated	8,641	100.0	%	6,514	100.0	%
Unallocated	821	N/A		1,073	N/A	
Allowance at end of year	$9,462	100.0	%	$7,587	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 for 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 the the years ended December 31, 2012, 2011 and 2010 (dollars in thousands):

	2012		2011		2010	
	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate
Demand deposits:						
Non-interest-bearing	$219,218	— %	$197,246	— %	$142,125	— %
Interest-bearing	511,199	0.28 %	499,184	0.47 %	421,743	0.76 %
Savings	281,831	0.42 %	251,268	0.59 %	165,337	0.77 %
Time deposits	224,350	0.98 %	264,508	1.10 %	243,606	1.64 %
Total average deposits	$1,236,598	0.39 %	$1,212,206	0.56 %	$972,811	0.87 %

The following table sets forth the high and low month-end balances for the years ended December 31, 2012, 2011 and 2010 (in thousands):

	2012	2011	2010
High month-end balances of total deposits	$1,274,065	$1,233,633	$1,227,528
Low month-end balances of total deposits	1,193,341	1,170,734	842,653

In 2012, the average balance of deposits increased by $24.4 million from 2011. The increase was primarily attributable to increases in non-interest bearing and savings account balances offset by declines in time deposits. Average non-interest bearing deposits increased by $22 million, average money market account balances decreased by $7.8 million, average savings account balances increased by $30.6 million and average time deposit balances decreased by $40.2 million. In 2011, the average balance of deposits increased by $239.4 million from 2010. The increase was primarily attributable to increases in non-interest 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, average savings account balances increased by $85.9 million and average time deposit balances increased by $20.9 million.

Balances of time deposits of $100,000 or more include time deposits maintained for public fund entities and consumer time deposits. The following table sets forth the maturity of time deposits of $100,000 or more (in thousands):

	December 31,		
	2012	2011	2010
3 months or less	$16,468	$17,095	$31,277
Over 3 through 6 months	10,847	11,037	14,430
Over 6 through 12 months	15,778	22,126	24,906
Over 12 months	19,469	17,596	18,315
Total	$62,562	$67,854	$88,928

The balance of time deposits of $100,000 or more decreased $5.3 million from December 31, 2011 to December 31, 2012. The balance of time deposits of $100,000 or more decreased $21.1 million from December 31, 2010 to

December 31, 2011. These decreases in balances are primarily attributable to higher rate time deposits that matured and were not replaced.

In 2012 the Company maintained account relationships with various public entities throughout its market areas. Four public entities had total balances of $26.4 million in various checking accounts and time deposits as of December 31, 2012. These balances are subject to change depending upon the cash flow needs of the public entity.

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, loans (short-term or long-term debt) that the Company has outstanding and junior subordinated debentures. Information relating to securities sold under agreements to repurchase and other borrowings as December 31, 2012, 2011 and 2010 is presented below (dollars in thousands):

	2012	2011	2010
At December 31:			
Securities sold under agreements to repurchase	$113,484	$132,380	$94,057
Federal Home Loan Bank advances:			
Fixed term – due in one year or less	—	14,750	3,000
Fixed term – due after one year	5,000	5,000	19,750
Junior subordinated debentures	20,620	20,620	20,520
Debt due in one year or less	—	8,250	—
Total	$139,104	$181,000	$137,327
Average interest rate at end of period	0.61 %	1.13 %	1.81 %
Maximum outstanding at any month-end:			
Securities sold under agreements to repurchase	$118,030	$132,380	$94,530
Federal Home Loan Bank advances:			
Fixed term – due in one year or less	9,750	14,750	10,000
Fixed term – due after one year	5,000	14,750	22,750
Debt:			
Debt due in one year or less	8,250	8,250	2,000
Junior subordinated debentures	20,620	20,620	20,620
Averages for the period (YTD):			
Securities sold under agreements to repurchase	$113,443	$108,240	$76,758
Federal funds purchased	59	14	5
Federal Home Loan Bank advances:			
Fixed term – due in one year or less	5,619	9,866	4,984
Fixed term – due after one year	5,000	10,372	21,109
Debt:			
Loans due in one year or less	4,035	927	645
Junior subordinated debentures	20,620	20,620	20,620
Total	$148,776	$150,039	$124,121
Average interest rate during the period	0.88 %	1.19 %	1.94 %

At December 31, 2012 the fixed term advances consisted of one $5 million advance at 4.58% with a 10-year maturity, due July 14, 2016 with a one year lockout and callable quarterly.

At December 31, 2012 and 2011, there was no outstanding loan balance on a revolving credit agreement with The Northern Trust Company. This loan was renewed on April 21, 2012 for one year as a revolving credit agreement with a maximum available balance of $20 million. The interest rate is floating at 2.25% over the federal funds rate (2.5% at December 31, 2012). 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 its subsidiary bank were in compliance with the existing covenants at December 31, 2012 and 2011.

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 Investors who subscribed for the remaining $8,250,000 of our Series C Preferred Stock were the Remaining Investors.

As described in our Current Report on Form 8-K filed on November 21, 2011, the disinterested members of the Board of Directors of the Company, which did not include Benjamin I. Lumpkin and Steve L. Grissom, approved and authorized, and the Remaining Investors agreed to, certain amendments to their 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, in lieu thereof, the issuance by the Company of the Notes to the Remaining Investors. On November 21, 2011, the Company and the Remaining Investors agreed to the release of the escrowed funds in exchange for the Notes.

On June 15, 2012, the Federal Reserve Board stated that it would not disapprove of the Remaining Investors' purchase of the shares of Series C Preferred Stock originally subscribed for by the Remaining Investors. By notices received June 28, 2012, the Remaining Investors notified the Company that they will exercise the prepayment provision allowing them to purchase the shares of Series C Preferred Stock originally subscribed for such that the Remaining Investors will use the funds represented by the Notes to purchase the subscribed for shares of the Series C Preferred Stock. As a result, on June 28, 2012, the Notes were canceled and the final $8,250,000 of the Company's Series C Preferred Stock was issued and sold by the Company to the Remaining Investors.

On February 27, 2004, the Company completed the issuance and sale of $10 million of floating rate trust preferred securities through First Mid-Illinois Statutory Trust I ("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 Trust I, 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 (3.19% and 3.10% at December 31, 2012 and 2011, respectively), reset quarterly, and are callable at par, at the option of the Company, quarterly. 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 First Mid-Illinois Statutory Trust II ("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 (1.91% and 1.95% at December 31, 2012 and 2011, respectively). The net proceeds to the Company were used for general corporate purposes, including the Company's acquisition of Mansfield Bancorp, Inc. in 2006.

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 March 31, 2012. The application of the revised quantitative limits did not and is not expected 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. New issuances of trust preferred securities, however would not count as Tier 1 regulatory capital.

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 interest-bearing assets differ significantly from the maturity or repricing characteristics of interest-bearing 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 GAP for selected maturity periods at December 31, 2012 (dollars in thousands):

	Rate Sensitive Within 1 year	1-2 years	2-3 years	3-4 years	4-5 years	Thereafter	Total	Fair Value
Interest-earning assets:								
Federal funds sold and other interest-bearing deposits	$44,602	$—	$—	$—	$—	$—	$44,602	$44,602
Certificates of deposit investments	6,665	—	—	—	—	—	6,665	6,669
Taxable investment securities	7,884	2,014	6,088	11,966	31,006	393,144	452,102	452,102
Nontaxable investment securities	517	263	578	820	2,035	51,994	56,207	56,207
Loans	429,230	123,510	103,006	103,627	106,399	45,293	911,065	920,269
Total	$488,898	$125,787	$109,672	$116,413	$139,440	$490,431	$1,470,641	$1,479,849
Interest-bearing liabilities:								
Savings and NOW accounts	$111,409	$32,032	$33,206	$46,114	$47,430	$280,048	$550,239	$550,239
Money market accounts	215,331	3,137	3,224	4,182	4,269	22,568	252,711	252,711
Other time deposits	153,026	23,485	10,963	10,535	9,106	162	207,277	208,339
Short-term borrowings/debt	113,484	—	—	—	—	—	113,484	113,490
Long-term borrowings/debt	20,620	—	—	—	5,000	—	25,620	17,105
Total	$613,870	$58,654	$47,393	$60,831	$65,805	$302,778	$1,149,331	$1,141,884
Rate sensitive assets – rate sensitive liabilities	$(124,972)	$67,133	$62,279	$55,582	$73,635	$187,653	$321,310	
Cumulative GAP	$(124,972)	$(57,839)	$4,440	$60,022	$133,657	$321,310		
Cumulative amounts as % of total Rate sensitive assets	-8.5%	4.6%	4.2%	3.4%	5.3%	12.8%		
Cumulative Ratio	-8.5%	-3.9%	0.3%	3.7%	9.1%	21.8%		

The static GAP analysis shows that at December 31, 2012, the Company was liability sensitive, on a cumulative basis, through the twelve-month time horizon. This indicates that future increases in interest rates could have an adverse effect on net interest income.

There are several ways the Company measures and manages the exposure to interest rate sensitivity, including static GAP analysis. 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. The Company is currently experiencing downward pressure on asset yields resulting from the extended period of historically low interest rates and heightened competition for loans. A continuation of this environment could result in a decline in interest income and the net interest margin.

Capital Resources

At December 31, 2012, the Company's stockholders' equity had increased $15.7 million, or 11.2%, to $156,687,000 from $140,967,000 as of December 31, 2011. During 2012, net income contributed $14,025,000 to equity before the payment of dividends to stockholders. The issuance of additional Series C Preferred Stock (1,650 shares) increased stockholders' equity by $8,250,000. The change in market value of available-for-sale investment securities increased stockholders' equity by $1,396,000, net of tax. Additional purchases of treasury stock (165,117 shares at an average cost of $23.69 per share) decreased stockholders' equity by approximately $3,912,000.

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.

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 contained a prepayment provision applicable when approval from the Federal Reserve Board was 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.)

On June 15, 2012, the Federal Reserve Board stated that it would not disapprove of the Remaining Investors' purchase of the shares of Series C Preferred Stock originally subscribed for by the Remaining Investors. By notices received June 28, 2012, the Remaining Investors notified the Company that they would exercise the prepayment provision allowing them to purchase the shares of Series C Preferred Stock originally subscribed for such that the Remaining Investors used the funds represented by the Notes to purchase the subscribed for shares of the Series C Preferred Stock. As a result, on June 28, 2012, the Notes were canceled and the final $8,250,000 of the Company's Series C Preferred Stock was issued and sold by the Company to the Remaining Investors.

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, 2012, the Company classified the cost basis of its common stock issued and held in trust in connection with the DCP of approximately $3,156,000 as treasury stock. The Company also classified the cost basis of its related deferred compensation obligation of approximately $3,156,000 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:

- 6,048 common shares during 2012,
- 5,920 common shares during 2011 and
- 4,766 common shares during 2010.

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:

- 19,366 common shares during 2012,
- 9,693 common shares during 2011 and
- 19,414 common shares during 2010.

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 $3,787,000 in common stock dividends paid during 2012, $944,000 or 24.9% was reinvested into shares of common stock of the Company through the DRIP. Of the $4,087,000 in preferred stock dividends paid during 2012, $299,000 or 7.3% was reinvested into shares of common stock through the DRIP.

Events that resulted in common shares being reinvested in the DRIP:

- During 2012, 41,729 common shares were issued from common stock dividends and 12,215 common shares were issued from preferred stock dividends,
- During 2011, 34,405 common shares were issued from common stock dividends and 10,116 common shares were issued from preferred stock dividends and
- During 2010, 33,879 common shares were issued from common stock dividends and 4,615 common shares were issued from preferred stock dividends

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, 2012, the Company had awarded 59,500 shares as stock options under the SI Plan. There were no shares awarded as stock options during 2012 or 2011. During 2012 and 2011, the Company awarded 15,162 shares and 17,409 shares, respectively, 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 $66.7 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, 209, 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.
- On November 13, 2012, repurchases of $5 million of additional shares of the Company's common stock.

During 2012, the Company repurchased 165,117 (2.8% of common shares) at a total price of $3,912,000. During 2011, the Company repurchased 128,073 shares (2.1% of common shares) at a total price of $2,385,000. As of December 31, 2012, approximately $4.6 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, 2012, 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, 2012 follows:

	Total Capital Ratio		Tier One Capital Ratio		Tier One Leverage Ratio (Capital to Average Assets)	
First Mid-Illinois Bancshares, Inc. (Consolidated)	15.65	%	14.51	%	9.66	%

First Mid-Illinois Bank & Trust, N.A.	14.04 %	12.89 %	8.56 %

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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 of cash include overnight federal fund lines, Federal Home Loan Bank advances, the ability to borrow at the Federal Reserve Bank of Chicago, and the Company's operating line of credit with The Northern Trust Company. Details for these 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 First Mid Bank meeting minimum regulatory capital requirements for total capital to risk-weighted assets and Tier 1 capital to total average assets. As of December 31, 2012, First Mid Bank met these regulatory requirements.

- First Mid Bank can borrow from the Federal Home Loan Bank as a source of liquidity. Availability of the funds is subject to the pledging of collateral to the Federal Home Loan Bank. Collateral that can be pledged includes one-to-four family residential real estate loans and securities. At December 31, 2012, the excess collateral at the FHLB would support approximately $97.5 million of additional advances.

- First Mid Bank is a member of the Federal Reserve System and can borrow funds provided that sufficient collateral is pledged.

- In addition, as of December 31, 2012, the Company had a revolving credit agreement in the amount of $20 million with The Northern Trust Company with an outstanding balance of zero and $20 million in available funds. This loan was renewed on April 21, 2012 for one year as a revolving credit agreement with 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 its subsidiary bank were in compliance with the existing covenants at December 31, 2012 and 2011.

Management continues to monitor 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 provisions on U.S. Treasury and government agency securities; and
- operating activities, including scheduled debt repayments and dividends to stockholders.

The following table summarizes significant contractual obligations and other commitments at December 31, 2012 (in thousands):

	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Time deposits	$207,277	$143,539	$39,908	$23,668	$162
Debt	20,620	—	—	—	20,620

Other borrowings	118,484	118,484	—	—	—
Operating leases	3,705	1,159	1,355	522	669
Supplemental retirement	903	50	200	200	453
	$350,989	$263,232	$41,463	$24,390	$21,904

For the year ended December 31, 2012, net cash of $22.9 million and $60.4 million was provided from operating activities and financing activities, respectively and $73.7 million was used in investing activities. In total, cash and cash equivalents increased by $9.6 million since year-end 2011.

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. The decrease in cash balances during 2011 was primarily 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. The increase in cash balances during 2010 was primarily due to cash received related to the acquisition of the Branches.

For the years ended December 31, 2012 and 2011, the Company also had $10 million of floating rate trust preferred securities outstanding 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

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 did not 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 Company has elected to to present comprehensive income as a separate but consecutive statement to the statement of income thus the adoption of ASU No. 2011-05 resulted in the addition of the condensed consolidated statements of comprehensive income.

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 second step of 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. The adoption of this guidance did not have a material impact on the Company's financial statements.

ASU 2013-02 - Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. In February 2013, the FASB issued ASU 2013-02 which requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component and to present either on the face of the statement where net income is presented, or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2012. 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, 2012, 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:

December 31, 2012	Increase (Decrease) In Net Interest Income				Return On Average Equity	
Prime rate is 3.25%	($000)		(%)		2012=9.88%	
Prime rate increase of:						
200 basis points to 5.25%	$(585	)	(1.8	)%	(0.35	)%
100 basis points to 4.25%	59		0.2	%	0.04	%
Prime rate decrease of:						
200 basis points to 2.25%	(2,595	)	(8.1	)%	(1.57	)%
100 basis points to 1.25%	(2,161	)	(6.8	)%	(1.30	)%

The following table shows the same analysis performed as of December 31, 2011:

December 31, 2011	Increase (Decrease) In Net Interest Income			Return On Average Equity	
Prime rate is 3.25%	($000)	(%)		2011=8.52%	
Prime rate increase of:					
200 basis points to 5.25%	$1,165	3.8	%	0.79	%
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	%	0.72	%
100 basis points to 1.25%	564	1.8	%	0.39	%

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.

The following table presents First Mid Bank's projected change in EVE for the various rate shock levels at December 31, 2012 and 2011 (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)		Economic Value of Equity: Amount of Change ($000)	Economic Value of Equity: Percent of Change
December 31, 2012	+200	bp	$(1,987)	(0.9)%
	+100	bp	3,042	1.4%
	-200	bp	(45,321)	(20.1)%
	-100	bp	(28,890)	(12.8)%
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)%

As indicated above, at December 31, 2012, in the event of a sudden and sustained increase in prevailing market interest rates, First Mid Bank's EVE would be expected to increase rates increased 100 basis points but would be expected to decrease if rates increased 200 basis points. 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, 2012, 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, 2012, 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, 2012 and 2011

(In thousands, except share data)	2012	2011
Assets		
Cash and due from banks:		
Non-interest bearing	$38,110	$43,356
Interest bearing	24,103	8,749
Federal funds sold	20,499	20,997
Cash and cash equivalents	82,712	73,102
Certificates of deposit investments	6,665	13,231
Investment securities:		
Available-for-sale, at fair value	508,309	478,916
Held-to-maturity, at amortized cost (estimated fair value of $0 at December 31, 2012 and $51 at December 31, 2011)	—	51
Loans held for sale	212	1,046
Loans	910,853	859,028
Less allowance for loan losses	(11,776)	(11,120)
Net loans	899,077	847,908
Interest receivable	6,775	7,052
Other real estate owned	1,187	4,606
Premises and equipment, net	29,670	30,717
Goodwill, net	25,753	25,753
Intangible assets, net	3,161	3,934
Other assets	14,511	14,640
Total assets	$1,578,032	$1,500,956
Liabilities and Stockholders' Equity		
Deposits:		
Non-interest bearing	$263,838	$198,962
Interest bearing	1,010,227	971,772
Total deposits	1,274,065	1,170,734
Interest payable	341	510
Other borrowings	118,484	160,380
Junior subordinated debentures	20,620	20,620
Other liabilities	7,835	7,745
Total liabilities	1,421,345	1,359,989
Stockholders' Equity:		
Convertible preferred stock, no par value; authorized 1,000,000 shares; issued 10,427 shares in 2012 and 8,777 shares in 2011	52,035	43,785
Common stock, $4 par value; authorized 18,000,000 shares; issued 7,682,535 shares in 2012 and 7,553,094 shares in 2011	30,730	30,212
Additional paid-in capital	31,685	29,368
Retained earnings	78,986	71,739
Deferred compensation	2,953	2,904
Accumulated other comprehensive income	4,544	3,148
Less treasury stock at cost, 1,711,646 shares in 2012 and 1,546,529 shares in 2011	(44,246)	(40,189)
Total stockholders' equity	156,687	140,967

Total liabilities and stockholders' equity	$1,578,032	$1,500,956

See accompanying notes to consolidated financial statements.

Consolidated Statements of Income
For the years ended December 31, 2012, 2011 and 2010

(In thousands, except per share data)	2012	2011	2010
Interest income:			
Interest and fees on loans	$43,949	$45,399	$41,803
Interest on investment securities:			
Taxable	11,684	9,819	8,329
Exempt from federal income tax	—	1,194	370
Interest on certificates of deposit investments	57	78	110
Interest on federal funds sold	37	69	85
Interest on deposits with other financial institutions	40	213	186
Total interest income	55,767	56,772	50,883
Interest expense:			
Interest on deposits	4,843	6,725	8,471
Interest on securities sold under agreements to repurchase	117	172	133
Interest on FHLB borrowings	308	765	1,090
Interest on other borrowings	326	72	9
Interest on subordinated debentures	563	770	1,053
Total interest expense	6,157	8,504	10,756
Net interest income	49,610	48,268	40,127
Provision for loan losses	2,647	3,101	3,737
Net interest income after provision for loan losses	46,963	45,167	36,390
Other income:			
Trust revenues	3,330	3,030	2,601
Brokerage commissions	688	650	536
Insurance commissions	1,813	1,786	1,779
Service charges	4,808	4,817	4,662
Securities gains, net	934	486	543
Total other-than-temporary impairment recoveries (losses)	127	(886)	(2,829)
Portion of loss recognized in other comprehensive loss	—	—	1,411
Other-than-temporary impairment recoveries (losses) recognized in earnings	127	(886)	(1,418)
Mortgage banking revenue, net	1,509	788	776
ATM / debit card revenue	3,554	3,483	2,869
Other income	1,547	1,633	1,472
Total other income	18,310	15,787	13,820
Other expense:			
Salaries and employee benefits	23,433	22,247	18,649
Net occupancy and equipment expense	8,088	7,960	5,851
Net other real estate owned expense	390	1,471	1,076
FDIC insurance expense	875	1,167	1,508
Amortization of intangible assets	773	1,134	814
Stationery and supplies	609	581	610
Legal and professional	2,093	2,070	2,361
Marketing and donations	1,014	1,050	940
Other expense	5,563	5,373	5,118
Total other expense	42,838	43,053	36,927
Income before income taxes	22,435	17,901	13,283
Income taxes	8,410	6,529	4,522

Net income	14,025	11,372	8,761
Dividends on preferred shares	4,252	3,576	2,240
Net income available to common stockholders	$9,773	$7,796	$6,521
Per share data:			
Basic net income per common share available to common stockholders	1.62	1.29	1.07
Diluted net income per common share available to common stockholders	1.62	1.29	1.07
Cash dividends declared per common share	0.42	0.40	0.38

See accompanying notes to consolidated financial statements.

Consolidated Statements of Comprehensive Income
For the years ended December 31, 2012, 2011 and 2010
(in thousands)

	2012	2011	2010
Net income	$14,025	$11,372	$8,761
Other Comprehensive Income			
Unrealized gains (losses) on available-for-sale securities, net of taxes of $(1,256), $(3,206) and $855, for the years ended December 31, 2012, 2011 and 2010, respectively	1,966	5,020	(1,338)
Less: reclassification adjustment for realized gains included in net income net of taxes of $364, $189 and $212, for the years ended December 31, 2012, 2011 and 2010, respectively	(570)	(297)	(331)
Other-than-temporary impairment losses recognized in earnings net income taxes of $0, $(345), $(553), for the years ended December 31, 2012, 2011 and 2010, respectively	—	541	865
Unrealized losses on available-for-sale securities for which a portion of an other-than-temporary impairment has been recognized in income, net of taxes of $0, $31 and $1,103, for the years ended December 31, 2012, 2011 and 2010, respectively	—	(50)	(1,726)
Other comprehensive income, net of taxes	1,396	5,214	(2,530)
Comprehensive income	$15,421	$16,586	$6,231

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Stockholders' Equity
For the years ended December 31, 2012, 2011 and 2010
(In thousands, except share and per share data)

	Preferred Stock	Common Stock	Additional Paid-In-Capital	Retained Earnings	Deferred Compensation	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
December 31, 2009	$24,635	$29,460	$ 26,811	$62,144	$ 2,894	$ 464	$(35,187)	$111,221
Net income	—	—	—	8,761	—	—	—	8,761
Net unrealized change in available-for-sale investment securities, net of tax	—	—	—	—	—	(2,530)	—	(2,530)
Dividends on preferred stock ($455 per sh)	—	—	—	(2,240)	—	—	—	(2,240)
Dividends on common stock ($.38 per sh)	—	—	—	(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
Net income	—	—	—	11,372	—	—	—	11,372
	—	—	—	—	—	5,214	—	5,214

Net unrealized change in available-for-sale investment securities, net of tax								
Dividends on preferred stock ($407 per sh)	—	—	—	(3,576)	—	—	—	(3,576)
Dividends on common stock ($.40 per sh)	—	—	—	(2,413)	—	—	—	(2,413)
Issuance of 3,850 shares of preferred stock	19,150	—	—	—	—	—	—	19,150
Issuance of 44,521 common shares pursuant to the Dividend Reinvestment Plan	—	178	629	—	—	—	—	807
Issuance of 5,920 common shares pursuant to the Deferred Compensation Plan	—	23	85	—	—	—	—	108
Issuance of 9,693 common shares pursuant to the First Retirement & Savings Plan	—	39	138	—	—	—	—	177
Issuance of 4,436 restricted common shares pursuant to the 2007 Stock Incentive Plan	—	18	65	—	—	—	—	83
Purchase of 128,073 treasury shares	—	—	—	—	—	—	(2,385)	(2,385)
Deferred compensation	—	—	—	—	(25)	—	(83)	(108)
Tax benefit related to deferred compensation distributions	—	—	19	—	—	—	—	19
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

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Consolidated Statements of Changes in Stockholders' Equity
For the years ended December 31, 2012, 2011 and 2010
(In thousands, except share and per share data)

	Preferred Stock	Common Stock	Additional Paid-In-Capital	Retained Earnings	Deferred Compensation	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
December 31, 2011	$43,785	$30,212	$ 29,368	$71,739	$ 2,904	$ 3,148	$(40,189)	$140,967
Net income	—	—	—	14,025	—	—	—	14,025
Net unrealized change in available-for-sale investment securities, net of tax	—	—	—	—	—	1,396	—	1,396
Dividends on preferred stock ($850 per sh)	—	—	—	(4,252)	—	—	—	(4,252)
Dividends on common stock ($.42 per sh)	—	—	—	(2,526)	—	—	—	(2,526)
Issuance of 1,650 shares of preferred stock	8,250	—	—	—	—	—	—	8,250
Issuance of 53,944 common shares pursuant to the Dividend Reinvestment Plan	—	216	1,028	—	—	—	—	1,244
Issuance of 6,048 common shares pursuant to the Deferred Compensation Plan	—	24	107	—	—	—	—	131
Issuance of 19,366 common shares pursuant to the First Retirement & Savings Plan	—	78	335	—	—	—	—	413
Issuance of 5,320 restricted common shares pursuant to the 2007 Stock Incentive Plan	—	21	114	—	(135)	—	—	—
Purchase of 165,117 treasury shares	—	—	—	—	—	—	(3,912)	(3,912)
Deferred compensation	—	—	—	—	145	—	(145)	—
Tax benefit related to deferred compensation distributions	—	—	29	—	—	—	—	29
Grant of restricted stock units pursuant to the 2007 Stock Incentive Plan	—	—	61	—	(61)	—	—	—
Issuance of 44,763 common shares pursuant to the exercise of stock options	—	179	533	—	—	—	—	712
Tax benefit related to exercise of incentive stock options	—	—	71	—	—	—	—	71

Tax benefit related to exercise of non-qualified stock options	—	—	22	—	—	—	—	22
Vested stock options compensation expense	—	—	17	—	—	—	—	17
Vested restricted shares/units compensation expense	—	—	—	—	100	—	—	100
December 31, 2012	$52,035	$30,730	$ 31,685	$78,986	$ 2,953	$ 4,544	$(44,246)	$156,687

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows
For the years ended December 31, 2012, 2011 and 2010

(In thousands)	2012	2011	2010
Cash flows from operating activities:			
Net income	$14,025	$11,372	$8,761
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	2,647	3,101	3,737
Depreciation, amortization and accretion, net	5,403	5,398	3,938
Stock-based compensation expense	227	144	52
Gains on investment securities, net	(934)	(486)	(543)
Other-than-temporary impairment (recoveries) losses recognized in earnings	(127)	886	1,418
(Gains) losses on sales of other real property owned, net	268	853	(12)
Loss on write down of fixed assets	33	2	4
Gains on sale of loans held for sale, net	(1,401)	(782)	(813)
Deferred income taxes	230	(670)	(435)
(Increase) decrease in accrued interest receivable	277	(662)	968
Decrease in accrued interest payable	(169)	(191)	(386)
Origination of loans held for sale	(99,923)	(61,375)	(63,924)
Proceeds from sale of loans held for sale	102,158	61,225	64,772
Increase in other assets	(912)	(1,900)	(5,955)
Increase (decrease) in other liabilities	1,087	2,061	(4,074)
Net cash provided by operating activities	22,889	18,976	7,508
Cash flows from investing activities:			
Proceeds from maturities of certificates of deposit investments	12,982	10,000	10,605
Purchases of certificates of deposit investments	(6,416)	(13,231)	(11,261)
Proceeds from sales of securities available-for-sale	30,500	18,891	10,936
Proceeds from maturities of securities held-to-maturity	235,013	184,564	107,525
Proceeds from maturities of securities available-for-sale	51	—	995
Purchases of securities available-for-sale	(293,654)	(333,222)	(229,482)
Net (increase) decrease in loans	(54,539)	(56,935)	26,445
Purchases of premises and equipment	(1,486)	(4,625)	(1,935)
Proceeds from sales of other real property owned	3,873	3,110	6,634
Cash received related to acquisition, net of cash and cash equivalents acquired	—	—	180,074
Net cash provided by (used in) investing activities	(73,676)	(191,448)	100,536
Cash flows from financing activities:			
Net increase (decrease) in deposits	103,331	(41,976)	34,745
Increase (decrease) in repurchase agreements	(18,896)	38,323	13,671
Repayment of long term FHLB advances	(14,750)	(3,000)	(10,000)
Proceeds from short-term debt	—	8,250	—
Repayment of short-term debt	(8,250)	—	—
Proceeds from long-term debt	—	—	4,000
Repayment of long-term debt	—	—	(4,000)
Proceeds from issuance of common stock	1,255	406	971
Proceeds from issuance of preferred stock	8,250	19,150	—
Purchase of treasury stock	(3,912)	(2,385)	(2,499)
Dividends paid on preferred stock	(3,788)	(2,990)	(2,136)

Dividends paid on common stock	(2,843)	(1,697)	(1,714)
Net cash provided by financing activities	60,397	14,081	33,038
Increase (decrease) in cash and cash equivalents	9,610	(158,391)	141,082
Cash and cash equivalents at beginning of period	73,102	231,493	90,411
Cash and cash equivalents at end of period	$82,712	$73,102	$231,493

	2012	2011	2010
Supplemental disclosures of cash flow information			
Cash paid during the period for:			
Interest	$6,326	$8,695	$10,916
Income taxes	8,203	5,470	6,848
Supplemental disclosures of noncash investing and financing activities			
Loans transferred to other real estate owned	723	2,622	9,897
Dividends reinvested in common stock	1,244	807	680
Net tax benefit related to option and deferred compensation plans	123	31	158

See accompanying notes to consolidated financial statements.

First Mid-Illinois Bancshares, Inc.
Notes to Condensed Consolidated Financial Statements

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 year’s consolidated financial statements have been reclassified to conform to the 2012 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 challenges continue to present financial institutions with circumstances and difficulties, 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 uncertainty 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, 2012, the Company held $317.3 million in commercial real estate loans and $31.3 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 from what it was prior to the credit crisis. Also, at December 31, 2012, the Company held $60.9 million in agricultural production loans and $86.3 million in agricultural real estate loans.

In addition, the Company had $45.8 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 from what it was prior to the credit crisis. 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 $89.9 million of loans to lessors of non-residential buildings and $59.8 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 from what it was prior to the credit crisis.

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.

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 years to 40 years
Leasehold improvements	5 years to 15 years
Furniture and equipment	3 years to 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, 2012 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.

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.

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, 2012, the Company managed or administered 1,486 accounts with assets totaling approximately $633.8 million. At December 31, 2011, the Company managed or administered 1,407 accounts with assets totaling approximately $546.7 million.

Convertible 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.
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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, 2012 was $17.53.

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, May 13, 2011 and June 28, 2012. The current 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 $21.62.

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. On June 28, 2012, the final $8,250,000 of the Company's Series C Preferred Stock was issued and sold by the Company to Investors following their receipt of the required bank regulatory approval, for a total of $27,500,000 of outstanding Series C Preferred Stock. All of the Series C Preferred Stock subscribed for by investors has been issued.

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, 2012 was $12.68 and the NASDAQ Bank Index value at December 31, 2012 was 1,873.21.

Treasury Stock

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

Stock Incentive Awards

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 in the SI Plan.

On September 27, 2011, the Board of Directors passed a resolution relating to the SI Plan whereby they authorized and approved the Executive Long-Term Incentive Plan ("LTIP"). The LTIP was implemented to provide methodology for granting Stock Awards and Stock Unit Awards 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, 2012, the Company had awarded 59,500 shares as stock options under the SI plan. There were no stock options awarded in 2011 or 2012. The Company awarded 15,162 shares and 17,409 shares during 2012 and 2011, respectively, as 50% Stock Awards and 50% Stock Unit Awards under the SI plan.

Accumulated Other Comprehensive Income

The components of accumulated other comprehensive income included in stockholders' equity as of December 31, 2012 and 2011 are as follows (in thousands):

	Unrealized Gain (Loss) on Available for Sale Securities	Securities with Other-Than-Temporary Impairment Losses	Total
December 31, 2012			
Net unrealized gains on securities available-for-sale	$11,836	$ —	$11,836
Securities with other-than-temporary impairment losses	—	(4,389)	(4,389)
Tax benefit (expense)	(4,614)	1,711	(2,903)
Balance at December 31, 2012	$7,222	$ (2,678)	$4,544
December 31, 2011			
Net unrealized gains on securities available-for-sale	$10,066	$ —	$10,066
Securities with other-than-temporary impairment losses	—	(4,906)	(4,906)
Tax benefit (expense)	(3,924)	1,912	(2,012)
Balance at December 31, 2011	$6,142	$ (2,994)	$3,148

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

Note 2 -- Earnings Per Share

Basic net income per common share available to common stockholders is calculated as net income less preferred stock dividends divided by the weighted average number of common shares outstanding. Diluted net income per common share available to common stockholders is computed using the weighted average number of common shares outstanding, increased by the assumed conversion of the Company's convertible preferred stock and the Company's stock options, unless anti-dilutive.

The components of basic and diluted net income per common share available to common stockholders for the years ended December 31, 2012, 2011 and 2010 were as follows:

	2012	2011	2010
Basic Net Income per Common Share			
Available to Common Stockholders:			
Net income	$14,025,000	$11,372,000	$8,761,000
Preferred stock dividends	(4,252,000)	(3,576,000)	(2,240,000)
Net income available to common stockholders	$9,773,000	$7,796,000	$6,521,000
Weighted average common shares outstanding	6,023,289	6,042,015	6,092,670
Basic earnings per common share	$1.62	$1.29	$1.07
Diluted Net Income per Common Share			
Available to Common Stockholders:			
Net income available to common stockholders	$9,773,000	$7,796,000	$6,521,000
Effect of assumed preferred stock conversion	—	—	—
Net income applicable to diluted earnings per share	$9,773,000	$7,796,000	$6,521,000
Weighted average common shares outstanding	6,023,289	6,042,015	6,092,670
Dilutive potential common shares:			
Assumed conversion of stock options	4,473	10,515	24,057
Restricted stock awarded	116	1,741	—
Assumed conversion of preferred stock	—	—	—
Dilutive potential common shares	4,589	12,256	24,057
Diluted weighted average common shares outstanding	6,027,878	6,054,271	6,116,727
Diluted earnings per common share	$1.62	$1.29	$1.07

The following shares were not considered in computing diluted earnings per share for the years ended December 31, 2012, 2011 and 2010 because they were anti-dilutive:

	2012	2011	2010
Stock options to purchase shares of common stock	108,125	202,970	202,970
Average dilutive potential common shares associated with convertible preferred stock	2,290,110	1,998,652	1,122,833

Note 3 -- Cash and Due from Banks

Aggregate cash and due from bank balances of $1,134,000, $873,000 and $318,000 were maintained in satisfaction of statutory reserve requirements of the Federal Reserve Bank at December 31, 2012, 2011 and 2010, respectively. Effective July 21, 2010, the FDIC's insurance limits were permanently increased to $250,000. At December 31, 2012, the Company's cash accounts did not exceed the federally insured limits.

Pursuant to legislation enacted in 2010, the FDIC fully insured all noninterest-bearing transaction accounts beginning December 31, 2010 through December 31, 2012, at all FDIC-insured institutions. This legislation expired on December 31, 2012. Beginning January 1, 2013, noninterest-bearing transaction accounts are subject to the $250,000 limit on FDIC insurance per covered institution.

Note 4 -- Investment Securities

The amortized cost, gross unrealized gains and losses and estimated fair values for available-for-sale and held-to-maturity securities by major security type at December 31, 2012 and December 31, 2011 were as follows (in thousands):

December 31, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
Available-for-sale:				
U.S. Treasury securities and obligations of U.S. government corporations & agencies	$180,851	$1,321	$(3)	$182,169
Obligations of states and political subdivisions	53,064	3,163	(20)	56,207
Mortgage-backed securities: GSE residential	252,310	7,162	(12)	259,460
Trust preferred securities	4,974	—	(4,389)	585
Other securities	9,663	225	—	9,888
Total available-for-sale	$500,862	$11,871	$(4,424)	$508,309
December 31, 2011				
Available-for-sale:				
U.S. Treasury securities and obligations of U.S. government corporations & agencies	$164,812	$1,294	$(40)	$166,066
Obligations of states and political subdivisions	38,828	2,374	—	41,202
Mortgage-backed securities: 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

The trust preferred securities are three trust preferred pooled securities issued by First Tennessee Financial (“FTN”). The unrealized losses of these securities, which have maturities ranging from eighteen years to twenty-six years, are 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.

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, 2012, 2011 and 2010 (in thousands):

	2012	2011	2010
Proceeds from sales	$30,500	$18,891	$10,936
Gross gains	934	486	543
Gross losses	—	—	—
Income tax expense	364	189	212

The following table indicates the expected maturities of investment securities classified as available-for-sale presented at fair value, at December 31, 2012 and the weighted average yield for each range of maturities (dollars in thousands):

	One year or less	After 1 through 5 years	After 5 through 10 years	After ten years	Total
Available-for-sale:					
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$98,367	$82,093	$1,709	$—	$182,169
Obligations of state and political subdivisions	770	29,734	23,952	1,751	56,207
Mortgage-backed securities: GSE residential	8,434	218,584	32,442	—	259,460
Trust preferred securities	—	—	—	585	585
Other securities	—	9,828	—	60	9,888
Total investments	$107,571	$340,239	$58,103	$2,396	$508,309
Weighted average yield	1.93 %	2.52 %	2.77 %	3.28 %	2.45 %
Full tax-equivalent yield	1.95 %	2.76 %	3.85 %	3.81 %	2.74 %

The weighted average yields are calculated on the basis of the amortized cost and effective yields weighted for the scheduled maturity of each security. Tax-equivalent yields have been calculated using a 35% 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, 2012. Investment securities carried at approximately $267,321,000 and $286,568,000 at December 31, 2012 and 2011, respectively, were pledged to secure public deposits and repurchase agreements and for other purposes as permitted or required by law.

The following table presents the aging of gross unrealized losses and fair value by investment category as of December 31, 2012 and 2011 (in thousands):

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2012						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$10,997	$(3)	$—	$—	$10,997	$(3)
Obligations of states and political subdivisions	1,969	(20)	—	—	1,969	(20)
Mortgage-backed securities: GSE residential	697	(12)	—	—	697	(12)
Trust preferred securities	—	—	585	(4,389)	585	(4,389)
Other securities	—	—	—	—	—	—
Total	$13,663	$(35)	$585	$(4,389)	$14,248	$(4,424)
December 31, 2011						
U.S. Treasury securities and obligations of U.S. government	$19,960	$(40)	$—	$—	$19,960	$(40)

corporations and agencies						
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)
Other securities	7,190	(372)	1,907	(93)	9,096	(465)
Total	$43,071	$(449)	$2,626	$(4,999)	$45,696	$(5,448)

U.S. Treasury Securities and Obligations of U.S. Government Corporations and Agencies. At December 31, 2012 and December 31, 2011, 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, 2012 and December 31, 2011, there were no Obligations of states and political subdivisions in a continuous unrealized loss position for twelve months or more.

Mortgage-backed Securities: GSE Residential. At December 31, 2012 and December 31, 2011, there were no mortgage-backed securities in a continuous unrealized loss position for twelve months or more.

Trust Preferred Securities. At December 31, 2012, there were three trust preferred securities with a fair value of $585,000 and unrealized losses of $4,389,000 in a continuous unrealized loss position for twelve months or more. 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. 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, the impending change to the regulatory treatment of these securities, and concerns regarding the underlying financial institutions that have issued the trust preferred securities. The Company recorded no other-than-temporary impairment (OTTI) for these securities during 2012 and $886,000 of OTTI for these securities during 2011. These losses established a new, lower amortized cost basis for these securities and reduced non-interest income as of December 31, 2011. 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, 2012. 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. On July 3, 2012, the Company's holding in PreTSL VI was redeemed in full. The payment received was sufficient to pay-off the book value of the security of $123,000, reverse the recorded OTTI impairment of $127,000 and recover previously unrecorded interest of approximately $11,500 .

Following are the details for each of the three currently impaired trust preferred securities as of December 31, 2012 (in thousands):

	Book Value	Market Value	Unrealized Gains (Losses)	Other-than-temporary Impairment Recorded To-date
PreTSL I	$513	$297	$(216)	$(691)
PreTSL II	809	219	(590)	(2,187)
PreTSL XXVIII	3,652	69	(3,583)	(1,111)
Total	$4,974	$585	$(4,389)	$(3,989)

Other securities. At December 31, 2012, there were no corporate bonds in a continuous unrealized loss position for twelve months or more. At December 31, 2011, there was one bond with a fair value of $1,907,000 and an unrealized loss of $93,000 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, 2012 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 prepayments, defaults and loss severity.

These 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 to the economic models 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 (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.

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, 2012, 2011 and 2010 (in thousands).

	Accumulated Credit Losses as of December 31:		
	2012	2011	2010
Credit losses on trust preferred securities held:			
Beginning of period	$4,116	$3,230	$1,812
Additions related to OTTI losses not previously recognized	—	—	—
Reductions due to sales / (recoveries)	(127)	—	—
Reductions due to change in intent or likelihood of sale	—	—	—
Additions related to increases in previously recognized OTTI losses	—	886	1,418
Reductions due to increases in expected cash flows	—	—	—
End of period	$3,989	$4,116	$3,230

Maturities of investment securities were as follows at December 31, 2012 (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 Cost	Estimated Fair Value
Available-for-sale:		
Due in one year or less	$98,706	$99,137
Due after one-five years	119,277	121,655
Due after five-ten years	23,836	25,661
Due after ten years	6,733	2,396
	248,552	248,849
Mortgage-backed securities: GSE residential	252,310	259,460

Total available-for-sale	$500,862	$508,309

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Note 5 -- Loans and Allowance for Loan Losses

Loans are stated at the principal amount outstanding net of unearned discounts, unearned income and 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 approximated the effective interest rate method. Interest on substantially all loans is credited to income based on the principal amount outstanding. A summary of loans at December 31, 2012 and 2011 follows (in thousands):

	2012	2011
Construction and land development	$31,341	$23,136
Farm loans	86,256	72,586
1-4 Family residential properties	186,205	180,738
Multifamily residential properties	44,863	19,847
Commercial real estate	317,321	321,908
Loans secured by real estate	665,986	618,215
Agricultural loans	60,948	63,182
Commercial and industrial loans	160,193	150,631
Consumer loans	16,264	16,274
All other loans	8,206	11,430
Gross loans	911,597	859,732
Less:		
Net deferred loan fees, premiums and discounts	744	704
Allowance for loan losses	11,776	11,120
Net loans	$899,077	$847,908

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. These loans are primarily for 1-4 family residential properties. The balance of loans held for sale, excluded from the balances above, were $212,000 and $1,046,000 at December 31, 2012 and 2011, respectively.

Most of the Company's business activities are with customers located within central Illinois. At December 31, 2012, the Company's loan portfolio included $147.2 million of loans to borrowers whose businesses are directly related to agriculture. Of this amount, $124.4 million was concentrated in other grain farming. Total loans to borrowers whose businesses are directly related to agriculture increased $11.4 million from $135.8 million at December 31, 2011 while loans concentrated in other grain farming increased $4.3 million from $120.1 million at December 31, 2011. While the Company adheres to sound underwriting practices, including collateralization of loans, any extended period of low commodity prices, drought conditions, 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 $45.8 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 $89.9 million of loans to lessors of non-residential buildings and $59.8 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.

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 65% 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 one-to-four units and home equity loans and lines of credit. The Company sells the vast majority 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.

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 historical loss experience. 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 based on portfolio segment and impairment method as of December 31, 2012, 2011 and 2010 (in thousands):

	Commercial/ Commercial Real Estate	Agricultural/ Agricultural Real Estate	Residential Real Estate	Consumer	Unallocated	Total
2012						
Allowance for loan losses:						
Balance, beginning of year	$8,791	$546	$636	$378	$769	$11,120
Provision charged to expense	1,979	(47)	580	116	19	2,647
Losses charged off	(1,586)	(12)	(524)	(249)	—	(2,371)
Recoveries	117	71	34	158	—	380
Balance, end of period	$9,301	$558	$726	$403	$788	$11,776
Ending balance:						
Individually evaluated for impairment	$457	$54	$—	$—	$—	$511
Collectively evaluated for impairment	$8,844	$504	$726	$403	$788	$11,265
Loans:						

Ending balance	$569,717	$145,695	$179,309	$16,066	$278	$911,065
Ending balance:						
Individually evaluated for impairment	$5,334	$1,230	$—	$—	$—	$6,564
Collectively evaluated for impairment	$564,383	$144,465	$179,309	$16,066	$278	$904,501

	Commercial/ Commercial Real Estate	Agricultural/ Agricultural Real Estate	Residential Real Estate	Consumer	Unallocated	Total
2011						
Allowance for loan losses:						
Balance, beginning of year	$ 8,307	$ 404	$ 440	$ 392	$ 850	$ 10,393
Provision charged to 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 period	$ 8,791	$ 546	$ 636	$ 378	$ 769	$ 11,120
Ending balance:						
Individually evaluated for impairment	$ 575	$ —	$ —	$ —	$ —	$ 575
Collectively evaluated for impairment	$ 8,216	$ 546	$ 636	$ 378	$ 769	$ 10,545
Loans:						
Ending balance	$ 505,693	$ 130,595	$ 185,151	$ 16,270	$ 22,365	$ 860,074
Ending balance:						
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
2010						
Allowance for loan losses:						
Balance, beginning of year	$ 7,428	$ 315	$ 488	$ 410	$ 821	$ 9,462
Provision charged to 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 impairment	$ 1,086	$ —	$ —	$ —	$ —	$ 1,086
Collectively evaluated for impairment	$ 7,221	$ 404	$ 440	$ 392	$ 850	$ 9,307
Loans:						
Ending balance	$ 465,390	$ 118,973	$ 183,000	$ 20,486	$ 16,732	$ 804,581
Ending balance:						
Individually evaluated for impairment	$ 7,332	$ 1,152	$ —	$ —	$ —	$ 8,484
Collectively evaluated for impairment	$ 458,058	$ 117,821	$ 183,000	$ 20,486	$ 16,732	$ 796,097

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-worthiness 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 based on rating category and payment activity as of December 31, 2012 and 2011 (in thousands):

	Construction & Land Development		Farm Loans		1-4 Family Residential Properties		Multifamily Residential Properties	
	2012	2011	2012	2011	2012	2011	2012	2011
Pass	$27,217	$19,708	$82,516	$67,637	$183,880	$180,247	$44,863	$19,638
Watch	2,135	2,168	2,662	2,496	424	497	—	—
Substandard	1,989	1,260	1,093	2,452	2,194	1,105	—	208
Doubtful	—	—	—	—	—	—	—	—
Total	$31,341	$23,136	$86,271	$72,585	$186,498	$181,849	$44,863	$19,846

	Commercial Real Estate (Nonfarm/Nonresidential)		Agricultural Loans		Commercial & Industrial Loans		Consumer Loans	
	2012	2011	2012	2011	2012	2011	2012	2011
Pass	$ 287,794	$ 288,539	$56,899	$58,133	$157,461	$147,591	$16,236	$16,271
Watch	24,213	24,664	958	1,840	1,588	280	14	—
Substandard	4,315	7,798	3,157	3,284	1,250	2,845	14	—
Doubtful	—	—	—	—	—	—	—	—
Total	$ 316,322	$ 321,001	$61,014	$63,257	$160,299	$150,716	$16,264	$16,271

	All Other Loans		Total Loans	
	2012	2011	2012	2011
Pass	$8,193	$11,413	$865,059	$809,177
Watch	—	—	31,994	31,945

Substandard	—	—	14,012	18,952
Doubtful	—	—	—	—
Total	$8,193	$11,413	$911,065	$860,074

The following table presents the Company’s loan portfolio aging analysis at December 31, 2012 and 2011 (in thousands):

	30-59 days Past Due	60-89 days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans Receivable	Total Loans > 90 days & Accruing
December 31, 2012							
Construction and land development	$—	$53	$—	$53	$31,288	$ 31,341	$—
Farm loans	592	—	293	885	85,386	86,271	—
1-4 Family residential properties	1,351	40	944	2,335	184,163	186,498	—
Multifamily residential properties	—	—	—	—	44,863	44,863	—
Commercial real estate	262	911	255	1,428	314,894	316,322	—
Loans secured by real estate	2,205	1,004	1,492	4,701	660,594	665,295	—
Agricultural loans	—	—	620	620	60,394	61,014	—
Commercial and industrial loans	413	275	53	741	159,558	160,299	—
Consumer loans	119	24	39	182	16,082	16,264	—
All other loans	—	—	—	—	8,193	8,193	—
Total loans	$2,737	$1,303	$2,204	$6,244	$904,821	$ 911,065	$—
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	1,079	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	$—

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 following tables present impaired loans as of December 31, 2012 and 2011 (in thousands):

	2012			2011		
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Recorded Balance	Unpaid Principal Balance	Specific Allowance
Loans with a specific allowance:						
Construction and land development	$1,114	$1,529	$295	$833	$1,070	$295
Farm loans	—	—	—	—	—	—
1-4 Family residential properties	636	723	162	71	71	27
Multifamily residential properties	—	—	—	—	—	—
Commercial real estate	—	—	—	1,414	1,693	183
Loans secured by real estate	1,750	2,252	457	2,318	2,834	505
Agricultural loans	310	310	54	—	—	—
Commercial and industrial loans	—	—	—	382	382	70
Consumer loans	—	—	—	—	—	—
All other loans	—	—	—	—	—	—
Total loans	$2,060	$2,562	$511	$2,700	$3,216	$575
Loans without a specific allowance:						
Construction and land development	$408	$694	$—	$—	$—	$—
Farm loans	418	429	—	532	532	—
1-4 Family residential properties	1,269	1,792	—	1,641	1,818	—
Multifamily residential properties	—	—	—	—	—	—
Commercial real estate	2,063	2,253	—	1,226	1,256	—
Loans secured by real estate	4,158	5,168	—	3,399	3,606	—
Agricultural loans	620	1,568	—	673	673	—
Commercial and industrial loans	704	—	—	660	1,255	—
Consumer loans	51	58	—	8	20	—
All other loans	—	—	—	—	—	—
Total loans	$5,533	$6,794	$—	$4,740	$5,554	$—
Total loans:						
Construction and land development	$1,522	$2,223	$295	$833	$1,070	$295
Farm loans	418	429	—	532	532	—
1-4 Family residential properties	1,905	2,515	162	1,712	1,889	27
Multifamily residential properties	—	—	—	—	—	—
Commercial real estate	2,063	2,253	—	2,640	2,949	183
Loans secured by real estate	5,908	7,420	457	5,717	6,440	505
Agricultural loans	930	1,878	54	673	673	—
Commercial and industrial loans	704	—	—	1,042	1,637	70
Consumer loans	51	58	—	8	20	—
All other loans	—	—	—	—	—	—
Total loans	$7,593	$9,356	$511	$7,440	$8,770	$575

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 average recorded investment and interest income recognized on impaired loans for the years ended December 31, 2012, 2011 and 2010 (in thousands):

	2012 Average Investment in Impaired Loans	Interest Income Recognized	2011 Average Investment in Impaired Loans	Interest Income Recognized	2010 Average Investment in Impaired Loans	Interest Income Recognized
Construction and land development	$1,520	$—	$841	$—	$1,975	$—
Farm loans	421	—	532	—	1,317	—
1-4 Family residential properties	1,948	7	1,755	—	2,720	—
Multifamily residential properties	—	—	—	—	670	—
Commercial real estate	2,100	—	2,688	22	4,425	56
Loans secured by real estate	5,989	7	5,816	22	11,107	56
Agricultural loans	1,071	—	673	—	993	—
Commercial and industrial loans	755	—	1,199	14	1,165	19
Consumer loans	56	15	10	—	17	—
All other loans	—	—	—	—	—	—
Total loans	$7,871	$22	$7,698	$36	$13,282	$75

The amount of interest income recognized by the Company within the periods stated above 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 $6,000 of 1-4 Family residential properties, $0 of commercial real estate, $0 of commercial and industrial and $14,000 of consumer loans at December 31, 2012 and $395,000 of commercial real estate at December 31, 2011. For the year ended December 31, 2012 and 2011, 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 recorded balance of nonaccrual loans as December 31, 2012 and December 31, 2011 (in thousands). This table excludes purchased impaired loans and performing troubled debt restructurings.

	2012	2011
Construction and land development	$1,522	$833
Farm loans	418	532
1-4 Family residential properties	1,899	1,712
Multifamily residential properties	—	—
Commercial real estate	2,063	2,245
Loans secured by real estate	5,902	5,322
Agricultural loans	930	673
Commercial and industrial loans	704	720
Consumer loans	37	8
All other loans	—	—
Total loans	$7,573	$6,723

The aggregate principal balances of nonaccrual, past due ninety days or more loans were $7.6 million and $6.7 million at December 31, 2012 and 2011, respectively. Interest income that would have been recorded under the original terms of such nonaccrual loans totaled $173,000 , $239,000 and $428,000 in 2012, 2011 and 2010, respectively.

Troubled Debt Restructuring

The balance of troubled debt restructurings at December 31, 2012 and 2011 was $3,339,000 and $1,834,000, respectively. Approximately $295,000 and $140,000 in specific reserves have been established with respect to these loans as of December 31, 2012 and 2011, respectively. 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 increase in TDRs during the year ended December 31, 2012 was a result of various factors, including the following:

- Two notes restructured in 2011 to lower the monthly payments by re-amortizing the debt were combined with three other non-accrual notes (not considered TDRs). The new note remains on non-accrual however the terms of the new note are considered to be market terms.
- Four construction and land development notes to multiple borrowers that were in non-accrual status were modified to lower interest rates due to cash flow difficulties of the borrower or for changes in payment terms. The notes remain in non-accrual status.
- One 1-4 Family residential property note that was in non-accrual status was modified to a single-pay note due in six months. The note remains in non-accrual status.
- One 1-4 Family residential property note that was in accrual status was restructured to lower the monthly payments by re-amortizing the debt. The note remains in accrual status.
- Four commercial and industrial notes to multiple borrowers that were in non-accrual status were modified to extend the original maturity dates and lower the interest rates of the notes or for changes in payment terms. The notes remain in non-accrual status.
- One consumer note that was in accrual status was modified to extend the maturity terms of the note. The note remains in accrual status.

With respect to TDRs during the year ended December 31, 2011:

- 1 commercial real estate loan that was in non-accrual status was modified by charging down the loan to a level that was expected to be serviced by ongoing operations of the property at a market interest rate and amortization period.
- 1 commercial real estate loan that was in non-accrual status was modified by charging down the loan and the combining of several past due notes which lowered the monthly payment of the notes.
- 1 commercial real estate loan and 1 commercial loan of a single borrower were restructured to lower the monthly payments by re-amortizing the debt.
- 1 commercial loan was modified to interest-only payments for a period with the maturity date extended. 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 December 31, 2012 and 2011 (in thousands).

Troubled debt restructurings:	2012	2011
Construction and land development	$1,522	$—

1-4 Family residential properties	445	393
Commercial real estate	950	952
Loans secured by real estate	2,917	1,345
Commercial and industrial loans	408	489
Consumer Loans	14	—
Total	$3,339	$1,834
Performing troubled debt restructurings:		
1-4 Family residential properties	$6	$—
Commercial real estate	—	395
Loans secured by real estate	6	395
Commercial and industrial loans	—	322
Consumer Loans	14	—
Total	$20	$717

A loan is considered to be in payment default once it is 90 days past due under the modified terms. There were no loans modified as troubled debt restructurings during the prior twelve months that experienced defaults during the year ended December 31, 2012. There were two loans totaling $215,000 modified as troubled debt restructurings during the prior twelve months that experienced defaults during the year ended December 31, 2011.

Note 6 -- Premises and Equipment, Net

Premises and equipment at December 31, 2012 and 2011 consisted of:

	2012	2011
Land	$5,966	$5,966
Buildings and improvements	28,797	28,499
Furniture and equipment	15,898	15,407
Leasehold improvements	3,094	3,083
Construction in progress	45	584
Subtotal	53,800	53,539
Accumulated depreciation and amortization	24,130	22,822
Total	$29,670	$30,717

Depreciation and amortization expense was $2.5 million, $2.5 million and $1.8 million for the years ended December 31, 2012, 2011 and 2010, 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, 2012 and 2011:

	2012		2011	
	Gross Carrying Value	Accumulated Amortization	Gross Carrying Value	Accumulated Amortization
Goodwill not subject to amortization	$29,513	$3,760	$29,513	$3,760
Intangibles from branch acquisition	3,015	3,015	3,015	2,965
Core deposit intangibles	8,986	5,825	8,986	5,119
Customer list intangibles	1,904	1,904	1,904	1,887
	$43,418	$14,504	$43,418	$13,731

Total amortization expense for the years ended December 31, 2012, 2011 and 2010 was as follows:

	2012	2011	2010
Intangibles from branch acquisitions	$50	$201	$201
Core deposit intangibles	706	743	423
Customer list intangibles	17	190	190
	$773	$1,134	$814

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

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
For period ended 12/31/17	$254

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, 2012 and 2011, 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, 2012 and 2011, deposits consisted of the following:

	2012	2011
Demand deposits:		
Non-interest bearing	$263,838	$198,962
Interest-bearing	259,330	213,920
Savings	290,909	259,968
Money market	252,711	263,129
Time deposits	207,277	234,755
Total deposits	$1,274,065	$1,170,734

Total interest expense on deposits for the years ended December 31, 2012, 2011 and 2010 was as follows:

	2012	2011	2010
Interest-bearing demand	$195	$332	$500
Savings	1,186	1,481	1,279
Money market	1,248	1,993	2,690
Time deposits	2,214	2,919	4,002
Total	$4,843	$6,725	$8,471

As of December 31, 2012, 2011 and 2010, the aggregate amount of time deposits in denominations of more than $100,000 and the total interest expense on such deposits was as follows:

	2012	2011	2010
Outstanding	$62,563	$67,854	$88,928
Interest expense for the year	826	1,204	1,719

The following table shows the amount of maturities for all time deposits as of December 31, 2012:

Less than 1 year	$143,539
1 year to 2 years	26,981
2 years to 3 years	12,927
3 years to 4 years	12,875
4 years to 5 years	10,793
Over 5 years	162
Total	$207,277

In 2012 the Company maintained account relationships with various public entities throughout its market areas. Four public entities had total balances of $26.4 million in various checking accounts and time deposits as of December 31, 2012. These balances are subject to change depending upon the cash flow needs of the public entity.

Note 9 -- Borrowings

As of December 31, 2012 and 2011 borrowings consisted of the following:

	2012	2011
Securities sold under agreements to repurchase	$113,484	$132,380
Federal Home Loan Bank advances:		
Fixed-term advances	5,000	19,750
Subordinated debentures	20,620	20,620
Other borrowings:		
Due in one year or less	—	8,250
Total	$139,104	$181,000

Aggregate annual maturities of long-term borrowings at December 31, 2012 are:

2013	$—
2014	—
2015	—
2016	5,000
2017	—
Thereafter	20,625
	$25,625

FHLB advances represent borrowings by First Mid Bank to economically fund loan demand. At December 31, 2012 the advances consisted of one $5 million advance at 4.58% with a 10-year maturity, due July 14, 2016 with a one year lockout and callable quarterly.

Securities sold under agreements to repurchase have overnight maturities and a weighted average rate of .07%. 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, 2012) from the FHLB. The securities underlying the repurchase agreements are under the Company's control.

	2012	2011	2010
Securities sold under agreements to repurchase:			
Maximum outstanding at any month-end	$118,030	$132,380	$94,530
Average amount outstanding for the year	113,443	108,240	76,758

At December 31, 2012 and 2011, there was no outstanding loan balance on a revolving credit agreement with The Northern Trust Company. This loan was renewed on April 21, 2012. 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 (2.5% at December 31, 2012) 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, 2012 and 2011.

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. During 2011, $19,250,000 of the Series C Preferred Stock was issued and sold by the Company.

The Investors who subscribed for the remaining $8,250,000 of the Series C Preferred Stock were (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").

As described in our Current Report on Form 8-K filed on November 21, 2011, the disinterested members of the Board of Directors of the Company, which did not include Benjamin I. Lumpkin and Steve L. Grissom, approved and authorized, and the Remaining Investors agreed to, certain amendments to their 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, in lieu thereof, the issuance by the Company of short-term unsecured promissory notes to the Remaining Investors (the "Notes"). On November 21, 2011, the Company and the Remaining Investors agreed to the release of the escrowed funds in exchange for the Notes.

On June 15, 2012, the Federal Reserve Board stated that it would not disapprove of the Remaining Investors' purchase of the shares of Series C Preferred Stock originally subscribed for by the Remaining Investors. By notices received June 28, 2012, the Remaining Investors notified the Company that they would exercise the prepayment provision allowing them to purchase the shares of Series C Preferred Stock originally subscribed for such that the Remaining Investors would use the funds represented by the Notes to purchase the subscribed for shares of the Series C Preferred Stock. As a result, on June 28, 2012, the Notes were canceled and the final $8,250,000 of the Company's Series C Preferred Stock was issued and sold by the Company to the Remaining Investors.

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, 2012 and 2011 the rate was 3.19% and 3.10%, 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 (1.91% and 1.95% at December 31, 2012 and 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 Board of Governors of the Federal Reserve System ("Federal Reserve System"), and First Mid Bank follows similar minimum regulatory requirements established for national banks by the Office of the Comptroller of the Currency ("OCC"). Failure to meet minimum capital requirements can initiate 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 a minimum total risk-based capital ratio of 8%, a minimum Tier 1 risk-based capital ratio of 4% and a minimum leverage ratio of 3% for the most highly rated banks that do not expect significant growth. All other institutions are required to maintain a minimum leverage ratio of 4%. Management believes that, as of December 31, 2012 and 2011, the Company and First Mid Bank met all capital adequacy requirements.

As of December 31, 2012 and 2011, 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 below. At December 31, 2012, there are no conditions or events since the most recent notification that management believes have changed this categorization.

	Actual			Required Minimum For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio		Amount	Ratio	Amount	Ratio
December 31, 2012							
Total Capital (to risk-weighted assets)							
Company	$161,799	15.65	%	$82,693	> 8.00%	N/A	N/A
First Mid Bank	143,942	14.04	%	82,047	> 8.00	$102,559	> 10.00%
Tier 1 Capital (to risk-weighted assets)							
Company	150,023	14.51	%	41,346	> 4.00	N/A	N/A
First Mid Bank	132,166	12.89	%	41,024	> 4.00	61,535	> 6.00
Tier 1 Capital (to average assets)							
Company	150,023	9.66	%	62,093	> 4.00	N/A	N/A
First Mid Bank	132,166	8.56	%	61,771	> 4.00	77,213	> 5.00
December 31, 2011							
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

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Note 11 -- Disclosures of Fair Values of Financial Instruments

Fair value is 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. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

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.

Available-for-Sale Securities. The fair value of available-for-sale securities is determined by various valuation methodologies. Where quoted market prices are available in an active market, securities are classified within Level 1. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sources market parameters, including but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. 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.

Fair value determinations for Level 3 measurements of securities are the responsibility of the Treasury function of the Company. The Company contracts with a pricing specialist to generate fair value estimates on a monthly basis. The Treasury function of the Company challenges the reasonableness of the assumptions used and reviews the methodology to ensure the estimated fair value complies with accounting standards generally accepted in the United States, analyzes the changes in fair value and compares these changes to internally developed expectations and monitors these changes for appropriateness.

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, 2012 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 and will continue to be, as a result of the Dodd-Frank Act's elimination of trust preferred securities from Tier 1 capital for certain holding companies. There are currently very few market participants who are willing and or able to transact for these securities. The market values for these securities 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, 2012,
- 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 trust preferred securities held by the Company 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, 2012 and 2011 (in thousands):

		Fair Value Measurements Using:		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2012				
Available-for-sale securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$182,169	$—	$182,169	$—
Obligations of states and political subdivisions	56,207	—	56,207	—
Mortgage-backed securities	259,460	—	259,460	—
Trust preferred securities	585	—	—	585
Other securities	9,888	60	9,828	—
Total available-for-sale securities	$508,309	$60	$507,664	$585
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	—
Mortgage-backed securities	261,833	—	261,775	58
Trust preferred securities	719	—	—	719
Other securities	9,096	29	9,067	—
Total available-for-sale securities	$478,916	$29	$478,110	$777

The change in fair value of assets measured on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2012 and 2011 is summarized as follows (in thousands):

	Available-for-Sale Securities		
	Mortgage-backed Securities	Trust Preferred Securities	Total
December 31, 2012			
Beginning balance	$58	$719	$777
Transfers into Level 3	—	—	—
Transfers out of Level 3	(58)	—	(58)
Total gains or losses			
Included in net income	—	127	127
Included in other comprehensive income (loss)	—	517	517
Purchases, issuances, sales and settlements			
Purchases	—	—	—
Issuances	—	—	—
Sales	—	—	—
Settlements	—	(778)	(778)
Ending balance	$—	$585	$585

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	$—	$—	$—

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	Available-for-Sale Securities		
	Mortgage-backed Securities	Trust Preferred Securities	Total
December 31, 2011			
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)

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.

Management establishes a specific allowance for loans that have an estimated fair value that is below the carrying value. The total carrying amount of loans for which a specific allowance has been established as of December 31, 2012 was $3,192,000 and a fair value of $2,681,000 resulting in specific loss exposures of $511,000. As of December 31, 2011, the total carrying amount of loans for which a specific reserve had been established was $2,562,000. These loans had a fair value of $2,282,000 which resulted in specific loss exposures of $280,000.

When there is little prospect of collecting 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 affected 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, 2012 was $1,187,000. Other real estate owned included in the total carrying amount and measured at fair value on a nonrecurring basis during the period amounted to $70,000. The total carrying amount of other real estate owned as of December 31, 2011 was $4,606,000. Other real estate owned included in the total carrying amount and measured at fair value on a nonrecurring basis during the period amounted to $2,336,000.

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, 2012 and 2011 (in thousands):

	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2012				
Impaired loans (collateral dependent)	$2,681	$—	$—	$2,681
Foreclosed assets held for sale	70	—	—	70
December 31, 2011				
Impaired loans (collateral dependent)	$2,282	$—	$—	$2,282
Foreclosed assets held for sale	2,336	—	—	2,336

Sensitivity of Significant Unobservable Inputs

The following is a discussion of the sensitivity of significant unobservable inputs, the interrelationships between those inputs and other unobservable inputs used in recurring fair value measurement and of how those inputs might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement.

Trust Preferred Securities. The significant unobservable inputs used in the fair value measurement of the Company's trust preferred securities are offered quotes and comparability adjustments. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, changes in either of those inputs will not affect the other input.
The following table presents quantitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements other than goodwill.

	Fair Value at December 31, 2012	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Trust Preferred Securities	$585	Discounted cash flow	Discount rate	9.3 %- 22.1% (19.3 %)
			Constant prepayment rate (1)	1 %
			Cumulative projected prepayments	10.8 %- 56.0% (20.8 %)
			Probability of default	0.7 %- 1.9% (1.7 %)
			Projected cures given deferral	0 %- 11% (2 %)
			Loss severity	92.4 %- 96.8% (94.8 %)
Impaired loans (collateral dependent)	$2,681	Third party valuations	Discount to reflect realizable value	0 %- 40% (20 %)
	$70			0 %- 40% (35 %)

Foreclosed assets held for sale	Third party valuations	Discount to reflect realizable value less estimated selling costs

(1) Every five years

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.

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 tables present estimated fair values of the Company's financial instruments at December 31, 2012 and 2011 in accordance with FAS 107-1 and APB 28-1, codified with ASC 805 (in thousands):

	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
December 31, 2012					
Financial Assets					
Cash and due from banks	$62,213	$62,213	$62,213	$—	$—
Federal funds sold	20,499	20,499	20,499	—	—
Certificates of deposit investments	6,665	6,669	6,669	—	—
Available-for-sale securities	508,309	508,309	60	507,664	585
Loans held for sale	212	212	—	212	—
Loans net of allowance for loan losses	899,077	908,281	—	—	908,281
Interest receivable	6,775	6,775	—	6,775	—
Federal Reserve Bank stock	1,522	1,522	—	1,522	—
Federal Home Loan Bank stock	3,293	3,293	—	3,293	—
Financial Liabilities					
Deposits	$1,274,065	$1,275,127	$—	$1,066,788	$208,339
Securities sold under agreements to repurchase	113,484	113,490	—	113,490	—
Interest payable	341	341	—	341	—
Federal Home Loan Bank borrowings	5,000	5,719	—	5,719	—
Junior subordinated debentures	20,620	11,386	—	11,386	—

	Carrying Amount	Fair Value
December 31, 2011		
Financial Assets		
Cash and due from banks	$52,105	$52,105
Federal funds sold	20,997	20,997
Certificates of deposit investments	13,231	13,225
Available-for-sale securities	478,916	478,916
Held-to-maturity securities	51	51
Loans held for sale	1,046	1,046
Loans net of allowance for loan losses	847,908	850,308
Interest receivable	7,052	7,052
Federal Reserve Bank stock	1,520	1,520
Federal Home Loan Bank stock	3,727	3,727
Financial Liabilities		
Deposits	$1,170,734	$1,172,069
Securities sold under agreements to repurchase	132,380	132,383
Interest payable	510	510
Federal Home Loan Bank borrowings	19,750	20,619
Other Borrowings	8,250	8,250
Junior subordinated debentures	20,620	11,969

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, 2012, the Company classified the cost basis of its common stock issued and held in trust in connection with the DCP of approximately $3,156,000 as treasury stock. The Company also classified the cost basis of its related deferred compensation obligation of approximately $3,156,000 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 2012 and 2011 the Company issued 6,048 common shares and 5,920 common shares, respectively, pursuant to the DCP.

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, 2012, the Company had awarded 59,500 shares as stock options under the SI Plan. During 2012 and 2011, the Company awarded 15,162 shares and 17,409 shares, respectively as 50% Stock Awards and 50% Stock Unit Awards under the LTIP of the SI Plan.

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 2012, 2011 or 2010.

The following table summarizes the compensation cost, net of forfeitures, related to stock-based compensation for the years ended December 31, 2012, 2011 and 2010:

	2012	2011	2010
Stock and stock unit awards:			
Pre-tax compensation expense	$210	$92	$—
Income tax benefit	(73)	(32)	—
Stock and stock unit awards expense, net of income taxes	$137	$60	$—
Stock options:			
Pre-tax compensation expense	$17	$52	$52
Income tax benefit	(6)	(1)	(1)
Stock options expense, net of income taxes	$11	$51	$51
Total share-based compensation:			
Pre-tax compensation expense	$227	$144	$52
Income tax benefit	(79)	(33)	(1)
Total share-based compensation expense, net of income taxes	$148	$111	$51

A summary of option activity under the SI Plan and the 1997 Stock Incentive Plan as of December 31, 2012, 2011 and 2010, and changes during the years then ended is presented below:

	2012			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, beginning of year	228,140	$23.09		
Granted	0	$0.00		
Exercised	(44,763)	$15.90		
Forfeited or expired	(6,752)	$24.00		
Outstanding, end of year	176,625	$24.88	2.81	$89,061
Exercisable, end of year	170,000	$24.95	2.69	$89,061

The total intrinsic value of options exercised during 2012 was $332,000. Stock options for 108,125 shares of common stock were not considered in computing the aggregate intrinsic value of outstanding shares and exercisable shares for 2012 because they were anti-dilutive.

	2011			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, beginning of year	239,532	$22.50		
Granted	0	$0.00		
Exercised	(11,392)	$10.67		
Forfeited or expired	0	$0.00		
Outstanding, end of year	228,140	$23.09	3.32	$159,552
Exercisable, end of year	207,265	$22.98	2.99	$159,552

The total intrinsic value of options exercised during 2011 was $90,000. 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.

	2010			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, beginning of year	289,033	$20.54		
Granted	0	$0.00		
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

The total intrinsic value of options exercised during 2010 was $365,000. 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.

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, 2012, 2011 and 2010, and changes during the years then ended, is presented below:

	2012		2011		2010	
	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	20,875	$3.16	35,125	$3.29	49,375	$3.34
Granted	0	$0	0	$0	0	$0
Vested	(14,250)	$3.47	(14,250)	$3.47	(14,250)	$3.47
Forfeited	0	$0	0	$0	0	$0.00
Unvested, end of year	6,625	$2.51	20,875	$3.16	35,125	$3.29

As of December 31, 2012, 2011 and 2010, there was $0, $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. The total fair value of shares subject to options that vested during the years ended December 31, 2012, 2011 and 2010, was $49,000. The following table summarizes information about stock options under the SI Plan outstanding at December 31, 2012:

		Options Outstanding		Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
Below $22.50	42,750	0.96	$20.67	42,750	$20.67
$22.50 to $24.50	25,750	5.96	$23.00	19,125	$23.00
$24.50 to $26.50	30,500	4.95	$26.10	30,500	$26.10
Above $26.50	77,625	1.95	$27.33	77,625	$27.33
	176,625	2.81	$24.88	170,000	$24.95

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 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 years ended December 31, 2012 and 2011:

	2012		2011	
	Shares	Weighted-avg Grant-date Fair Value	Shares	Weighted-avg Grant-date Fair Value
Nonvested, beginning of year	15,096	$18.70	0	$0.00
Granted	15,162	$25.50	17,409	$18.70
Vested	(4,179)	$21.84	(2,313)	$18.70

Forfeited	(742)	$21.87	0	$0.00
Nonvested, end of year	25,337	$22.16	15,096	$18.70
Fair value of shares vested		$91,259		$42,675

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, 2012 and 2011, there was $400,000 and $216,000, respectively, 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 $1,070,000, $930,000 and $803,000 in 2012, 2011 and 2010, 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 $35,000, $55,000 and $60,000 in 2012, 2011 and 2010, respectively. The current liability recorded for these two agreements was $904,000 and $918,000, as of December 31, 2012 and 2011, respectively.

Note 15 -- Income Taxes

The components of federal and state income tax expense (benefit) for the years ended December 31, 2012, 2011 and 2010 were as follows:

	2012	2011	2010
Current			
Federal	$6,247	$5,558	$4,167
State	1,933	1,641	790
Total Current	8,180	7,199	4,957
Deferred			
Federal	219	(435)	(286)
State	11	(235)	(149)
Total Deferred	230	(670)	(435)
Total	$8,410	$6,529	$4,522

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 2012, 2011 and 2010, the Company was in a graduated tax rate position. The principal reasons for the difference are as follows:

	2012	2011	2010
Expected income taxes	$7,852	$6,265	$4,649
Effects of:			
Tax-exempt income	(761)	(618)	(511)
Nondeductible interest expense	14	16	20
State taxes, net of federal taxes	1,264	914	417
Other items	41	52	47
Effect of marginal tax rate	—	(100)	(100)
Total	$8,410	$6,529	$4,522

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 2012, 2011 and 2010 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 2009.

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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, 2012 and 2011 are presented below:

	2012	2011
Deferred tax assets:		
Allowance for loan losses	$4,753	$4,489
Available-for-sale investment securities	—	—
Deferred compensation	1,014	984
Supplemental retirement	365	370
Core deposit premium amortization	192	120
Interest on non-accrual loans	93	155
Other-than-temporary impairment on securities	1,610	1,662
Expense from other real estate properties held for sale	46	492
Deferred loan costs	96	—
Other	346	148
Total gross deferred tax assets	$8,515	$8,420
Deferred tax liabilities:		
Deferred loan costs	$—	$82
Goodwill	2,534	2,069
Prepaid expenses	260	187
FHLB stock dividend	285	334
Depreciation	786	790
Purchase accounting	168	274
Accumulated accretion	87	59
Available-for-sale investment securities	2,903	2,012
Total gross deferred tax liabilities	$7,023	$5,807
Net deferred tax assets	$1,492	$2,613

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, 2012 and 2011 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, 2012. As of December 31, 2012, approximately $27.7 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, 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.

The off-balance sheet financial instruments whose contract amounts represent credit risk at December 31, 2012 and 2011 were as follows (in thousands):

	2012	2011
Unused commitments and lines of credit:		
Commercial real estate	$27,800	$33,970
Commercial operating	132,040	119,102
Home equity	25,255	24,804
Other	46,430	44,433
Total	$231,525	$222,309
Standby letters of credit	$3,351	$6,267

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 lines 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, 2012 and 2011. The Company's deferred revenue under standby letters of credit 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 $21,638,000 and $21,220,000 at December 31, 2012 and 2011, respectively. Activity during 2012 and 2011 was as follows:

	2012	2011

Beginning balance	$21,220	$21,271
New loans	8,199	4,935
Loan repayments	(7,781)	(4,986)
Ending balance	$21,638	$21,220

Deposits from related parties held by First Mid Bank at December 31, 2012 and 2011 totaled $41,904,000 and $35,095,000, respectively. See Note 1-"Preferred Stock" regarding the Series C Preferred Stock, the Remaining Investors and the Notes.

Note 19 -- Business Combinations

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.

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

	Acquired Book Value	Fair Value Adjustments	As Recorded by First Mid Bank
Assets			
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
Liabilities			
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 ended December 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
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

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. These leases are for terms from one year to fifteen years and generally contain renewal options for periods ranging from one year to five years. Rental expense for these leases was $1,293,000, $1,331,000 and $884,000 for the years ended December 31, 2012, 2011 and 2010, respectively. Future minimum lease payments under operating leases are:

	Operating Leases
2013	$1,159
2014	678
2015	677
2016	261
2017	261
Thereafter	669

Total minimum lease payments	$3,705

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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, 2012	2011
Assets		
Cash	$11,658	$20,538
Premises and equipment, net	3,012	3,112
Investment in subsidiaries	162,674	147,225
Other assets	2,415	2,495
Total Assets	$179,759	$173,370
Liabilities and Stockholders’ equity		
Liabilities		
Dividends payable	$1,104	$2,200
Debt	20,620	28,870
Other liabilities	1,348	1,333
Total Liabilities	23,072	32,403
Stockholders’ equity	156,687	140,967
Total Liabilities and Stockholders’ equity	$179,759	$173,370

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

Statements of Income and Comprehensive Income	Years ended December 31, 2012	2011	2010
Income:			
Dividends from subsidiaries	$1,438	$938	$6,744
Other income	64	40	8
Total income	1,502	978	6,752
Operating expenses	2,519	2,414	2,728
Income (loss) before income taxes and equity in undistributed earnings of subsidiaries	(1,017)	(1,436)	4,024
Income tax benefit	990	1,005	1,062
Income (loss) before equity in undistributed earnings of subsidiaries	(27)	(431)	5,086
Equity in undistributed earnings of subsidiaries	14,052	11,803	3,675
Net income	$14,025	$11,372	$8,761
Comprehensive income	$15,421	$16,586	$6,231

First Mid-Illinois Bancshares, Inc. (Parent Company)
Statements of Cash Flows

	Years ended December 31, 2012	2011	2010
Cash flows from operating activities:			
Net income	$14,025	$11,372	$8,761
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation, amortization, accretion, net	114	71	47
Dividends received from subsidiary	1,438	938	6,744
Equity in undistributed earnings of subsidiaries	(14,052)	(11,803)	(3,675)
(Increase) decrease in other assets	(1,436)	(3,283)	(9,966)
Increase (decrease) in other liabilities	319	128	(12)
Net cash provided by (used in) operating activities	408	(2,577)	1,899
Cash flows from financing activities:			
Repayment of short-term debt	(8,250)	—	—
Proceeds from short-term debt	—	8,250	—
Proceeds from issuance of preferred stock	8,250	19,150	—
Proceeds from issuance of common stock	1,255	406	971
Purchase of treasury stock	(3,912)	(2,385)	(2,499)
Dividends paid on preferred stock	(3,788)	(2,990)	(2,136)
Dividends paid on common stock	(2,843)	(1,697)	(1,714)
Net cash provided by (used in) financing activities	(9,288)	20,734	(5,378)
Increase (decrease) in cash	(8,880)	18,157	(3,479)
Cash at beginning of year	20,538	2,381	5,860
Cash at end of year	$11,658	$20,538	$2,381

Note 22 -- Quarterly Financial Data - Unaudited

The following table presents summarized quarterly data for each of the two years ended December 31, 2012 and 2011:

	Quarters ended in 2012			
	March 31	June 30	September 30	December 31
Selected operations data:				
Interest income	$13,948	$13,958	$13,958	$13,903
Interest expense	1,895	1,700	1,348	1,214
Net interest income	12,053	12,258	12,610	12,689
Provision for loan losses	615	416	720	896
Net interest income after provision for loan losses	11,438	11,842	11,890	11,793
Other income	4,580	4,497	4,523	4,710
Other expense	10,617	10,782	10,562	10,877
Income before income taxes	5,401	5,557	5,851	5,626
Income taxes	2,011	2,078	2,204	2,117
Net income	3,390	3,479	3,647	3,509
Dividends on preferred shares	939	1,105	1,104	1,104
Net income available to common stockholders	$2,451	$2,374	$2,543	$2,405
Basic earnings per common share	$0.41	$0.39	$0.42	$0.40
Diluted earnings per common share	$0.41	$0.39	$0.42	$0.40

	Quarters ended in 2011			
	March 31	June 30	September 30	December 31
Selected operations data:				
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

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, 2012 and 2011 and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2012. 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, 2012 and 2011, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, 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, 2012, 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 7, 2013 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ BKD, LLP

Decatur, Illinois
March 7, 2013

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, 2012. 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, 2012, 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, 2012 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, 2012, 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, 2012 has been audited by BKD, LLP, an independent registered public accounting firm, as stated in their report following.

March 7, 2013
William S. Rowland
President and Chief Executive Officer

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 2012 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

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, 2012, 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, 2012, 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 7, 2013 expressed an unqualified opinion thereon.

Decatur, Illinois

March 7, 2013

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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 2013 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 2013 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 2013 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 2013 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.

ITEM 11. EXECUTIVE COMPENSATION

The information called for by Item 11 is incorporated by reference to the Company's Proxy Statement for the 2013 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.

Equity Compensation Plan Information

Plan category	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)	
Equity compensation plans approved by security holders:						
(A) Deferred Compensation Plan	—		—		392,406	(1)
(B) Stock Incentive Plan	176,625	(2)	$ 24.88	(3)	210,431	(4)
Equity compensation plans not approved by security holders (5)	—		—		—	
Total	176,625		$ 24.88		602,837	

(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 Plan 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 2013 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 2013 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 2013 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, 2012 and 2011
- Consolidated Statements of Income -- For the Years Ended December 31, 2012, 2011 and 2010
- Consolidated Statements of Comprehensive Income -- For the Years Ended December 31, 2012, 2011 and 2010
- Consolidated Statements of Changes in Stockholders' Equity -- For the Years Ended December 31, 2012, 2011 and 2010
- Consolidated Statements of Cash Flows -- For the Years Ended December 31, 2012, 2011 and 2010.

(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.

SIGNATURES

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

FIRST MID-ILLINOIS BANCSHARES, INC.
(Registrant)

Date: March 7, 2013
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 7th day of March 2013, by the following persons on behalf of the Company and in the capacities listed.

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

Michael L. Taylor, Executive Vice President and Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)
Joseph R. Dively, Senior Executive Vice President and Director
Charles A. Adams, Director
Holly A. Bailey, Director
Steven L. Grissom, Director
Benjamin I. Lumpkin, Director

Gary W. Melvin, Director

Ray A. Sparks, Director

Exhibit Index to Annual Report on Form 10-K

Exhibit Number	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 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. 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 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 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 Computershares Trust Company, N.A., as Rights Agent 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 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 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 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 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 CUrrent 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 Current 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 22,2012.
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 22, 2012.
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 22, 2012.
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 March 2, 2012.
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.

Exhibit Index to Annual Report on Form 10-K

Exhibit Number	Description and Filing or Incorporation Reference
10.11	2007 Stock Incentive Plan Incorporated by reference to Exhibit 10.1 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed wi May 23, 2007.
10.12	First Amendment to 2007 Stock Incentive Plan Incorporated by reference to Exhibit 10.12 to First Mid-Illinois Bancshares, Inc.'s Annual Report on Form 10-K for th ended December 31, 2009.
10.13	1997 Stock Incentive Plan Incorporated by reference to Exhibit 10.5 to First Mid-Illinois Bancshares, Inc.'s Annual Report on Form 10-K for the ended December 31, 1998.
10.14	Form of 2007 Stock Incentive Plan Stock Option Agreement Incorporated by reference to Exhibit 10.1 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed wi December 12, 2007.
10.15	Form of Stock Award/Stock Unit Award Agreement Incorporated by reference to Exhibit 10.1 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed wi September 27, 2011.
10.16	Form of Stock Unit Award Agreement Incorporated by reference to Exhibit 10.1 to First Mid-Illinois Bancshares, Inc.'s Current Report on Form 8-K filed wi September 27, 2011.
10.17	Supplemental Executive Retirement Plan Incorporated by reference to Exhibit 10.8 to First Mid-Illinois Bancshares, Inc.'s Annual Report on Form 10-K for the ended December 31, 2005.
10.18	First Amendment to Supplemental Executive Retirement Plan Incorporated by reference to Exhibit 10.9 to First Mid-Illinois Bancshares, Inc.'s Annual Report on Form 10-K for the ended December 31, 2005.
10.19	Participation Agreement (as Amended and Restated) to Supplemental Executive Retirement Plan between the Compa William S. Rowland Incorporated by reference to Exhibit 10.10 to First Mid-Illinois Bancshares, Inc.'s Annual Report on Form 10-K for th December 31, 2005.
10.20	Description of Incentive Compensation Plan Incorporated by reference to Exhibit 10.16 to First Mid-Illinois Bancshares, Inc.'s Annual Report on Form 10-K for th December 31, 2008.

11.1	Statement re: Computation of Earnings Per Share (Filed herewith)
21.1	Subsidiaries of the Company herewith)
23.1	Consent of BKD LLP 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)