

FIRST MID ILLINOIS BANCSHARES INC
Form 10-Q
August 07, 2018

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

FORM 10-Q

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

For the quarterly period ended June 30, 2018

Or

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

For the transition period from _____ to _____

Commission file number 0-13368

FIRST MID-ILLINOIS BANCSHARES, INC.
(Exact name of Registrant as specified in its charter)

Delaware 37-1103704
(State or other jurisdiction of incorporation or organization) (I.R.S. employer identification no.)

1421 Charleston Avenue,
Mattoon, Illinois 61938
(Address of principal executive offices) (Zip code)

(217) 234-7454
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of August 6, 2018, 15,290,146 common shares, \$4.00 par value, were outstanding.

PART I

ITEM 1. FINANCIAL STATEMENTS

First Mid-Illinois Bancshares, Inc.

Condensed Consolidated Balance Sheets

(In thousands, except share data)

	(Unaudited)	
	June 30, 2018	December 31, 2017
Assets		
Cash and due from banks:		
Non-interest bearing	\$46,917	\$ 75,398
Interest bearing	37,963	12,990
Federal funds sold	695	491
Cash and cash equivalents	85,575	88,879
Certificates of deposit investments	2,930	1,685
Investment securities:		
Available-for-sale, at fair value	616,303	578,579
Held-to-maturity, at amortized cost (estimated fair value of \$67,525 and \$68,457 at June 30, 2018 and December 31, 2017, respectively)	69,383	69,332
Loans held for sale	2,454	1,025
Loans	2,374,229	1,938,476
Less allowance for loan losses	(22,045)	(19,977)
Net loans	2,352,184	1,918,499
Interest receivable	12,612	10,832
Other real estate owned	2,440	2,754
Premises and equipment, net	47,003	38,266
Goodwill, net	87,504	60,150
Intangible assets, net	15,114	10,679
Bank owned life insurance	51,101	41,883
Other assets	24,870	18,976
Total assets	\$3,369,473	\$ 2,841,539
Liabilities and Stockholders' Equity		
Deposits:		
Non-interest bearing	\$526,117	\$ 480,283
Interest bearing	2,144,747	1,794,356
Total deposits	2,670,864	2,274,639
Securities sold under agreements to repurchase	141,662	155,388
Interest payable	1,145	602
FHLB borrowings	95,708	60,038
Other borrowings	9,375	10,313
Junior subordinated debentures	28,792	24,000
Other liabilities	10,601	8,595
Total liabilities	2,958,147	2,533,575
Stockholders' Equity:		
Common stock, \$4 par value; authorized 30,000,000 shares; issued 15,858,211 and 13,231,225 shares in 2018 and 2017, respectively	65,433	54,925
Additional paid-in capital	250,433	163,603
Retained earnings	118,721	104,683
Deferred compensation	2,403	3,540
Accumulated other comprehensive loss	(9,274)	(2,304)

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Less treasury stock at cost, 573,065 shares in 2018 and 570,477 shares in 2017	(16,390)	(16,483)
Total stockholders' equity	411,326		307,964	
Total liabilities and stockholders' equity	\$3,369,473		\$ 2,841,539	

See accompanying notes to unaudited condensed consolidated financial statements.

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First Mid-Illinois Bancshares, Inc.

Condensed Consolidated Statements of Income (unaudited)

(In thousands, except per share data)

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Interest income:				
Interest and fees on loans	\$25,362	\$21,025	\$46,369	\$40,952
Interest on investment securities	4,679	4,366	8,760	8,406
Interest on certificates of deposit investments	12	7	21	32
Interest on federal funds sold	1	—	2	61
Interest on deposits with other financial institutions	77	48	137	177
Total interest income	30,131	25,446	55,289	49,628
Interest expense:				
Interest on deposits	1,670	933	2,932	1,812
Interest on securities sold under agreements to repurchase	65	46	124	86
Interest on FHLB borrowings	475	168	750	319
Interest on other borrowings	118	119	226	242
Interest on subordinated debentures	349	227	608	444
Total interest expense	2,677	1,493	4,640	2,903
Net interest income	27,454	23,953	50,649	46,725
Provision for loan losses	1,877	1,840	2,932	3,562
Net interest income after provision for loan losses	25,577	22,113	47,717	43,163
Other income:				
Trust revenues	938	841	2,015	1,771
Brokerage commissions	661	509	1,326	1,014
Insurance commissions	838	853	2,325	2,478
Service charges	1,803	1,690	3,438	3,402
Securities gains, net	881	335	901	335
Mortgage banking revenue, net	410	335	571	528
ATM / debit card revenue	1,860	1,665	3,464	3,233
Bank owned life insurance	315	282	591	563
Other	655	1,459	1,217	2,141
Total other income	8,361	7,969	15,848	15,465
Other expense:				
Salaries and employee benefits	11,057	10,102	21,251	20,037
Net occupancy and equipment expense	3,505	3,116	6,778	6,249
Net other real estate owned expense	7	127	83	145
FDIC insurance	285	290	566	469
Amortization of intangible assets	716	559	1,221	1,106
Stationery and supplies	186	186	397	371
Legal and professional	1,717	894	2,854	1,725
Marketing and donations	431	277	785	571
Other	2,892	2,404	5,235	6,484
Total other expense	20,796	17,955	39,170	37,157
Income before income taxes	13,142	12,127	24,395	21,471
Income taxes	3,105	3,927	5,968	7,007
Net income	10,037	8,200	18,427	14,464
Per share data:				
Basic net income per common share available to common stockholders	\$0.72	\$0.66	\$1.38	\$1.16

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Diluted net income per common share available to common stockholders	\$0.72	\$0.66	\$1.38	\$1.16
Cash dividends declared per common share	\$0.34	\$0.32	\$0.34	\$0.32

See accompanying notes to unaudited condensed consolidated financial statements.

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First Mid-Illinois Bancshares, Inc.

Condensed Consolidated Statements of Comprehensive Income (unaudited)

(in thousands)

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Net income	\$10,037	\$8,200	\$18,427	\$14,464
Other Comprehensive Income				
Unrealized gains (losses) on available-for-sale securities, net of taxes of \$64 and \$(3,444) for three months ended June 30, 2018 and 2017, respectively and \$2,605 and \$(5,481) for six months ended June 30, 2018 and 2017, respectively.	(150	) 5,391	(6,370	) 8,580
Amortized holding losses on held-to-maturity securities transferred from available-for-sale, net of taxes of \$(8) and \$(11) for three months ended June 30, 2018 and 2017, respectively and \$(17) and \$(22) for six months ended June 30, 2018 and 2017, respectively.	21	17	40	34
Less: reclassification adjustment for realized gains included in net income, net of taxes of \$255 and \$131 for three months ended June 30, 2018 and 2017, respectively and \$261 and \$131 for six months ended June 30, 2018 and 2017, respectively.	(626	) (204	) (640	) (204
Other comprehensive income (loss), net of taxes	(755	) 5,204	(6,970	) 8,410
Comprehensive income	\$9,282	\$13,404	\$11,457	\$22,874

See accompanying notes to unaudited condensed consolidated financial statements.

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First Mid-Illinois Bancshares, Inc.

Condensed Consolidated Statements of Cash Flows (unaudited)	Six months ended June 30,	
(In thousands)	2018	2017
Cash flows from operating activities:		
Net income	\$18,427	\$14,464
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,932	3,562
Depreciation, amortization and accretion, net	3,478	4,124
Change in cash surrender value of bank owned life insurance	(591)	(563)
Stock-based compensation expense	160	129
Gains on investment securities, net	(901)	(335)
Loss on sales of repossessed assets, net	11	30
Loss on write down of premises and equipment	1	1
Gains on sale of loans held for sale, net	(462)	(507)
Increase in accrued interest receivable	549	933
Increase (decrease) in accrued interest payable	216	(19)
Origination of loans held for sale	(27,596)	(32,256)
Proceeds from sale of loans held for sale	26,629	32,006
Decrease (increase) in other assets	1,435	(2,353)
(Decrease) increase in other liabilities	(6,242)	5,269
Net cash provided by operating activities	18,046	24,485
Cash flows from investing activities:		
Proceeds from maturities of certificates of deposit investments	—	12,958
Proceeds from sales of securities available-for-sale	13,152	28,140
Proceeds from maturities of securities available-for-sale	25,950	31,105
Purchases of securities available-for-sale	(28,260)	(109,166)
Net increase in loans	(73,973)	(6,162)
Purchases of premises and equipment	(753)	(741)
Proceeds from sales of other real property owned	1,040	5,068
Net cash provided by acquisition	10,323	—
Net cash used in investing activities	(52,521)	(38,798)
Cash flows from financing activities:		
Net increase (decrease) in deposits	10,601	(40,481)
Decrease in repurchase agreements	(13,726)	(43,352)
Proceeds from FHLB advances	15,000	10,000
Repayment of FHLB advances	(10,000)	(5,000)
Repayment from short-term debt	—	(5,875)
Repayment of long-term debt	(938)	—
Proceeds from issuance of common stock	36,263	475
Direct expenses related to capital transactions	(2,078)	—
Purchase of treasury stock	(95)	—
Dividends paid on common stock	(3,856)	(3,467)
Net cash provided by (used in) financing activities	31,171	(87,700)
Decrease in cash and cash equivalents	(3,304)	(102,013)
Cash and cash equivalents at beginning of period	88,879	175,902
Cash and cash equivalents at end of period	\$85,575	\$73,889

First Mid-Illinois Bancshares, Inc.

Condensed Consolidated Statements of Cash Flows (unaudited) (In thousands)	Six months ended June 30,	
	2018	2017
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	\$4,097	\$2,936
Income taxes	5,020	4,198
Supplemental disclosures of noncash investing and financing activities		
Loans transferred to other real estate owned	214	5,171
Dividends reinvested in common stock	533	527
Net tax benefit related to option and deferred compensation plans	161	216
Supplemental disclosure of purchase of capital stock of First Bank		
Fair value of assets acquired	\$501,285	\$—
Consideration paid:		
Cash paid	10,275	—
Common stock issued	61,350	—
Total consideration paid	71,625	—
Fair value of liabilities assumed	\$429,660	\$—

See accompanying notes to unaudited condensed consolidated financial statements.

Notes to Condensed Consolidated Financial Statements
(unaudited)

Note 1 -- Basis of Accounting and Consolidation

The unaudited condensed consolidated financial statements include the accounts of First Mid-Illinois Bancshares, Inc. (“Company”) and its wholly-owned subsidiaries: First Mid Bank & Trust, N.A. (“First Mid Bank”), formerly known as First Mid-Illinois Bank & Trust, N.A., First Bank & Trust, IL (“First Bank & Trust”), First Mid Wealth Management, Mid-Illinois Data Services, Inc. (“MIDS”) 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. The financial information reflects all adjustments which, in the opinion of management, are necessary for a fair presentation of the results of the interim periods ended June 30, 2018 and 2017, and all such adjustments are of a normal recurring nature. Certain amounts in the prior year’s consolidated financial statements have been reclassified to conform to the June 30, 2018 presentation and there was no impact on net income or stockholders’ equity. The results of the interim period ended June 30, 2018 are not necessarily indicative of the results expected for the year ending December 31, 2018. The Company operates as a one-segment entity for financial reporting purposes.

The 2017 year-end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all of the information required by U.S. generally accepted accounting principles (“GAAP”) for complete financial statements and related footnote disclosures although the Company believes that the disclosures made are adequate to make the information not misleading. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s 2017 Annual Report on Form 10-K.

Website

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

Capital Raise

On June 13, 2018, the Company and First Mid Bank, entered into an underwriting agreement (the “Underwriting Agreement”) with FIG Partners, LLC, as the representative of the several underwriters named therein (the “Underwriters”), pursuant to which the Company agreed to issue and sell to the Underwriters and the Underwriters agreed to purchase, subject to and upon the terms and conditions of the Underwriting Agreement, an aggregate of 823,799 shares of the Company’s common stock, par value \$4.00 per share, at a public offering price of \$38.00 per share, in an underwritten public offering (the “Offering”). The Company granted the Underwriters an option for a period of 30 days after the date of the Underwriting Agreement to purchase up to an additional 123,569 shares of common stock at the public offering price, less discounts and commissions. The Underwriters exercised their option in full on June 13, 2018, resulting in 947,368 shares of common stock being offered in the Offering. The Offering closed on June 15, 2018. The net proceeds to the Company, after deducting underwriting discounts and commissions and offering expenses, were approximately \$34.0 million.

First BancTrust Corporation

On December 11, 2017, the Company and Project Hawks Merger Sub LLC (formerly known as Project Hawks Merger Sub Corp.), a newly formed Delaware limited liability company and wholly-owned subsidiary of the Company (“Hawks Merger Sub”), entered into an Agreement and Plan of Merger (as amended as of January 18, 2018, the “First Bank Merger Agreement”) with First BancTrust Corporation, a Delaware corporation (“First Bank”), pursuant to which, among other things, the Company agreed to acquire 100% of the issued and outstanding shares of First Bank pursuant to a business combination whereby First Bank merged with and into Hawks Merger Sub, with Hawks Merger Sub as the surviving entity and a wholly-owned subsidiary of the Company (the “First Bank Merger”).

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Subject to the terms and conditions of the First Bank Merger Agreement, at the effective time of the First Bank Merger, each share of common stock, par value \$0.01 per share, of First Bank issued and outstanding immediately prior to the effective time of the First Bank Merger (other than shares held in treasury by First Bank and shares held by stockholders who have properly made and not withdrawn a demand for appraisal rights under Delaware law) converted into and become the right to receive, (a) \$5.00 in cash and (b) 0.800 shares of common stock, par value \$4.00 per share, of the Company and cash in lieu of fractional shares, less any applicable taxes required to be withheld and subject to certain adjustments, all as set forth in the First Bank Merger Agreement.

The First Bank Merger closed on May 1, 2018 and the Company issued an aggregate total of 1,643,900 shares of common stock paying approximately \$10,275,000, including cash in lieu of fractional shares. The accounting for the First Bank Merger is presented in Note 8 to the consolidated financial statements. First Bank's wholly-owned bank subsidiary, First Bank & Trust, will merge with and into the Company's wholly owned bank subsidiary, First Mid Bank, on August 10, 2018. At the time of the bank merger, First Bank & Trust's banking offices will become branches of First Mid Bank.

SCB Bancorp, Inc.

On June 12, 2018, The Company and Project Almond Merger Sub LLC, a newly formed Illinois limited liability company and wholly-owned subsidiary of the Company ("Almond Merger Sub"), entered into an Agreement and Plan of Merger (the "SCB Merger Agreement") with SCB Bancorp, Inc., an Illinois corporation ("SCB"), pursuant to which, among other things, the Company agreed to acquire 100% of the issued and outstanding shares of SCB pursuant to a business combination whereby SCB will merge with and into Almond Merger Sub, whereupon the separate corporate existence of SCB will cease and Merger Sub will continue as the surviving company and a wholly-owned subsidiary of the Company (the "SCB Merger").

Subject to the terms and conditions of the SCB Merger Agreement, at the effective time of the SCB Merger, each share of common stock, par value \$7.50 per share, of SCB issued and outstanding immediately prior to the effective time of the SCB Merger (other than shares held in treasury by SCB and shares held by stockholders who have properly made and not withdrawn a demand for appraisal rights under Illinois law) will be converted into and become the right to receive, at the election of each stockholder, either \$307.93 in cash or 8.0228 shares of common stock, par value \$4.00 per share, of the Company and cash in lieu of fractional shares, less any applicable taxes required to be withheld and subject to certain potential adjustments. Overall elections are subject to proration such that, depending on the number of shares of SCB common stock electing shares of the Company's common stock, between 19 and 32.5 percent of the SCB shares will be exchanged for cash, and between 67.5 and 81 percent will be exchanged for the Company's common stock. Additionally, SCB's outstanding stock options will be fully vested upon consummation of the SCB Merger, and all outstanding SCB options that are unexercised prior to the effective time of the SCB Merger will be cashed out. In addition, immediately prior to the closing of the proposed merger, SCB will pay a special dividend to its shareholders in the aggregate amount of approximately \$25 million. The SCB Merger is subject to customary closing conditions, including the approval of the appropriate regulatory authorities and of the stockholders of SCB. The SCB Merger is anticipated to be completed in late 2018.

It is anticipated that SCB's wholly-owned bank subsidiary, Soy Capital Bank and Trust Company ("Soy Capital Bank"), will be merged with and into First Mid Bank at a date following completion of the Merger. At the time of the bank merger, Soy Capital Bank's banking offices will become branches of First Mid Bank.

At-The-Market Program

On August 16, 2017, the Company entered into a Sales Agency Agreement, pursuant to which the Company may sell, from time to time, up to an aggregate of \$20 million of its common stock. Shares of common stock are offered pursuant to the Company's shelf registration statement filed within the SEC. During the six months ended June 30, 2018, the company sold no shares of common stock under the program. As of June 30, 2018, approximately \$16.53 million of common stock remained available for issuance under the At The Market program.

Bank Owned Life Insurance

First Mid Bank has purchased life insurance policies on certain senior management. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts that are probable at settlement.

Stock Plans

At the Annual Meeting of Stockholders held April 26, 2017, the stockholders approved the First Mid-Illinois Bancshares, Inc. 2017 Stock Incentive Plan (“SI Plan”). The SI Plan was implemented to succeed the Company’s 2007 Stock Incentive Plan, which had a ten-year term. 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.

A maximum of 149,983 shares of common stock may be issued under the SI Plan. There have been no stock options awarded under any Company plan since 2008. The Company has awarded 13,250 shares of restricted stock during 2018 and 15,450 and 18,391 restricted stock units during 2018 and 2017, respectively.

Employee Stock Purchase Plan

At the Annual Meeting of Stockholders held April 25, 2018, the stockholders approved the First Mid-Illinois Bancshares, Inc. Employee Stock Purchase Plan (“ESPP”). The ESPP is intended to promote the interests of the Company by providing eligible employees with the opportunity to purchase shares of common stock of the Company at a 5% discount through payroll deductions. The ESPP is also intended to qualify as an employee stock purchase plan under Section 423 of the Internal Revenue Code. A maximum of 600,000 shares of common stock may be issued under the ESPP.

General Litigation

The Company is subject to claims and lawsuits that arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the consolidated financial position, results of operations and cash flows of the Company.

Revenue Recognition

Accounting Standards Codification 606, Revenue from Contracts with Customers (“ASC 606”), establishes a revenue recognition model for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts to provide goods or services to customers. Most of the Company’s revenue-generating transactions are not subject to ASC 606, including revenue generated from financial instruments, such as loans and investment securities, and revenue related to mortgage servicing activities, which are subject to other accounting standards. A description of the revenue-generating activities that are within the scope of ASC 606, and included in other income in the Company’s condensed consolidated statements of income are as follows:

Trust revenues. The Company generates fee income from providing fiduciary services through its trust department. Fees are billed in arrears based upon the preceding period account balance. Revenue from the farm management department is recorded when service is complete, for example when crops are sold.

Brokerage commissions. The primary brokerage revenue is recorded at the beginning of each quarter through billing to customers based on the account asset size on the last day of the previous quarter. If a withdrawal of funds takes place, a prorated refund may occur; this is reflected within the same quarter as the original billing occurred. All performance obligations are met within the same quarter that the revenue is recorded.

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Insurance commissions. The Company’s insurance agency subsidiary, First Mid Insurance Group (“FMIG”), receives commissions on premiums of new and renewed business policies. FMIG records commission revenue on direct bill policies as the cash is received. For agency bill policies, FMIG retains its commission portion of the customer premium payment and remits the balance to the carrier. In both cases, the entire performance obligation is held by the carriers.

Service charges on deposits. The Company generates revenue from fees charged for deposit account maintenance, overdrafts, wire transfers, and check fees. The revenue related to deposit fees is recognized at the time the performance obligation is satisfied.

ATM/debit card revenue. The Company generates revenue through service charges on the use of its ATM machines and interchange income from the use of Company issued credit and debit cards. The revenue is recognized at the time the service is used and the performance obligation is satisfied.

Other income. Treasury management fees and lock box fees are received and recorded after the service performance obligation is completed. Merchant bank card fees are received from various vendors, however the performance obligation is with the vendors. The Company records gains on the sale of loans and the sale of OREO properties after the transactions are complete and transfer of ownership has occurred.

As each of the Company’s facilities is located in markets with similar economies, no disaggregation of revenue is necessary.

Accumulated Other Comprehensive Income (Loss)

The components of accumulated other comprehensive income (loss) included in stockholders’ equity as of June 30, 2018 and December 31, 2017 are as follows (in thousands):

	Unrealized Gain (Loss) on Securities	Securities with Other-Than-Temporary Impairment Losses	Total
June 30, 2018			
Net unrealized losses on securities available-for-sale	\$(12,840)	\$ —	\$(12,840)
Unamortized losses on held-to-maturity securities transferred from available-for-sale	(224)	—	(224)
Securities with other-than-temporary impairment losses	—	—	—
Tax benefit	3,790	—	3,790
Balance at June 30, 2018	\$(9,274)	\$ —	\$(9,274)
December 31, 2017			
Net unrealized losses on securities available-for-sale		\$(2,619)	\$(2,619)
Unamortized losses on held-to-maturity securities transferred from available-for-sale	(281)	—	(281)
Securities with other-than-temporary impairment losses	—	(345)	(345)
Tax benefit		841	941
Balance at December 31, 2017		\$(2,059)	\$(2,304)

Amounts reclassified from accumulated other comprehensive income and the affected line items in the statements of income during the six months ended June 30, 2018 and 2017, were as follows (in thousands):

	Amounts Reclassified from Other Comprehensive Income				Affected Line Item in the Statements of Income
	Three months ended June 30, 2018		Six months ended June 30, 2017		
Realized gains on available-for-sale securities	\$881	\$335	\$901	\$335	Securities gains, net (Total reclassified amount before tax)
	(255)	(131)	(261)	(131)	Income taxes
Total reclassifications out of accumulated other comprehensive income	\$626	\$204	\$640	\$204	Net reclassified amount

See "Note 3 – Investment Securities" for more detailed information regarding unrealized losses on available-for-sale securities.

Adoption of New Accounting Guidance

Accounting Standards Update 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification ("ASU 2017-09"). In May 2017, FASB issued ASU 2017-09. This update provides guidance on determining which changes to the terms and conditions of share-based payment awards require the application of modification accounting under Topic 718. The guidance is effective for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The amendments should be applied on a prospective basis to an award modified on or after adoption date. ASU 2017-09 did not have a significant impact on the Company's consolidated financial statement.

Accounting Standards Update 2017-08, Receivables-Nonrefundable Fees and Other Costs ("ASU 2017-08"). In March 2017, FASB issued ASU 2017-08. This update amends the amortization period for certain purchased callable debt securities held at a premium. The update shortens the premium's amortization period to the earliest call date to more closely align the amortization period of premiums to expectations incorporated in market pricing on the underlying securities. For public companies, the update is effective for annual periods beginning after December 15, 2018, and is to be applied on a modified retrospective basis with a cumulative-effect adjustment directly to retained earnings as of the beginning of the adoption period. Early adoption is permitted, including adoption in an interim period. The Company adopted ASU 2017-08 early and there was not a significant impact on the Company's consolidated financial statements.

Accounting Standards Update 2017-04, Intangibles--Goodwill and Other (Topic 350: Simplifying the Test for Goodwill Impairment ("ASU 2017-04"). In January 2017, FASB issued ASU 2017-04. The amendments in this update simplify the measurement of goodwill by eliminating Step 2 from the goodwill impairment test. Under this guidance, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss should not exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 is effective for public companies for the reporting periods beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. Although the Company cannot anticipate future goodwill impairment, based on the most recent assessment, it is unlikely that an impairment amount would need to be calculated and, therefore, does not

anticipate a material impact on the Company's consolidated financial statements. The current accounting policies and procedures of the Company are not anticipated to change, except for the elimination of the Step 2 analysis.

Accounting Standards Update 2016-08, Revenue from Contracts with Customers (Topic 606) ("ASU 2016-08"). In March 2016, the FASB issued ASU 2016-08 which amended the accounting guidance issued by the FASB in May 2014 that revised the criteria for determining when to recognize revenue from contracts with customers and expanded disclosure requirements. The amendment defers the effective date by one year. This accounting guidance can be implemented using either a retrospective method or a cumulative-effect approach. This new guidance is effective for interim and annual reporting

periods beginning after December 15, 2017. The Company completed its overall assessment of revenue streams and review of related contracts potentially affected by the ASU, including trust and asset management fees, deposit related fees, interchange fees, merchant income, and annuity and insurance commissions. Based on this assessment, the Company concluded that ASU 2014-09 did not materially change the method in which the Company currently recognizes revenue for these revenue streams.

Accounting Standards Update 2016-01, Financial Instruments (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"). In January 2016, FASB issued ASU 2016-01 which amends prior guidance to require an entity to measure its equity investments (except those accounted for under the equity method of accounting) to be measured at fair value with changes in fair value recognized in net income. An entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of same issuer. The new guidance simplifies the impairment assessment of equity investments without readily determinable fair values, requires public entities to use the exit price notion when measuring fair value of financial instruments for disclosure purposes, requires an entity to present separately in other comprehensive income the portion of the total change in fair value of a liability resulting from changes in the instrument-specific credit risk when the entity has selected fair value option for financial instruments and requires separate presentation of financial assets and liabilities by measurement category and form of financial asset. The new guidance is effective for reporting periods after January 1, 2018 and did not have a significant impact on the Company's consolidated financial statements other than adoption of the standard resulted in the use of an exit price rather than an entrance price to determine the fair value of loans not measured at fair value on a non-recurring basis. See Note 7 - Fair Value of Assets and Liabilities for further information regarding the valuation of these loans.

Pending New Accounting Guidance

Accounting Standards Update 2016-02, Leases (Topic 842) ("ASU 2016-02"). On February 25, 2016, FASB issued ASU 2016-02 which creates Topic 842, Leases and supersedes Topic 840, Leases. ASU 2016-02 is intended to improve financial reporting about leasing transactions, by increasing transparency and comparability among organizations. Under the new guidance, a lessee will be required to record all leases with lease terms of more than 12 months on their balance sheet as lease liabilities with a corresponding right-of-use asset. ASU 2016-02 maintains the dual model for lease accounting, requiring leases to be classified as either operating or finance, with lease classification determined in a manner similar to existing lease guidance. The new guidance will be effective for public companies for fiscal years beginning on or after December 15, 2018, and for private companies for fiscal years beginning on or after December 15, 2019. Early adoption is permitted for all entities. Management continues to evaluate the impact ASU 2016-02 will have on the Company's consolidated financial statements.

Accounting Standards Update 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses of Financial Instruments ("ASU 2016-13"). In June 2016, FASB issued ASU 2016-13. The provisions of ASU 2016-13 requires an entity to utilize a new impairment model known as the current expected credit loss ("CECL") model to estimate its lifetime "expected credit loss" and record an allowance that, when deducted from the amortized cost basis of the financial asset, presents the net amount expected to be collected on the financial asset. The CECL model is expected to result in more timely recognition of credit losses. ASU 2016-13 also requires new disclosures for financial assets measured at amortized cost, loans and available-for-sale debt securities. ASU 2016-13 is effective for annual periods beginning after December 15, 2019, including interim periods within those fiscal years. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. Management has formed an internal committee to evaluate implementation steps and assess the impact ASU 2016-13 will have on the Company's consolidated financial statements. The committee has assigned roles and responsibilities, key tasks to complete, and has established a general timeline for implementation. The Company has also engaged an outside consultant to assist with the methodology

review and data validation, as well as other key aspects of implementing the standard. The committee meets periodically to discuss the latest developments and ensure progress is being made. The team also keeps current on evolving interpretations and industry practices related to ASU 2016-13. The committee continues to evaluate and validate data resources and different loss methodologies. The committee is still evaluating the impact ASU 2016-13 will have on the Company's consolidated financial statements.

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 Company's stock options, unless anti-dilutive.

The components of basic and diluted net income per common share available to common stockholders for the three and six-month period ended June 30, 2018 and 2017 were as follows:

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Basic Net Income per Common Share Available to Common Stockholders:				
Net income	\$10,037,000	\$8,200,000	\$18,427,000	\$14,464,000
Weighted average common shares outstanding	13,956,674	12,491,757	13,317,395	12,483,788
Basic earnings per common share	\$0.72	\$0.66	\$1.38	\$1.16
Diluted Net Income per Common Share Available to Common Stockholders:				
Net income applicable to diluted earnings per share	10,037,000	8,200,000	\$18,427,000	\$14,464,000
Weighted average common shares outstanding	13,956,674	12,491,757	13,317,395	12,483,788
Dilutive potential common shares:				
Assumed conversion of stock options	4,124	836	4,053	836
Restricted stock awarded	13,250	7,338	13,250	7,338
Assumed conversion of preferred stock	—	—	—	—
Dilutive potential common shares	17,374	8,174	17,303	8,174
Diluted weighted average common shares outstanding	13,974,048	12,499,931	13,334,698	12,491,962
Diluted earnings per common share	\$0.72	\$0.66	\$1.38	\$1.16

There were no shares not considered in computing diluted earnings per share for the three and six-month periods ended June 30, 2018 and 2017 because they were anti-dilutive.

Note 3 -- 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 June 30, 2018 and December 31, 2017 were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
June 30, 2018				
Available-for-sale:				
U.S. Treasury securities and obligations of U.S. government corporations & agencies	\$ 127,342	\$ —	\$ (4,304)	\$ 123,038
Obligations of states and political subdivisions	176,376	1,064	(2,200)	175,240
Mortgage-backed securities: GSE residential	323,238	359	(7,926)	315,671
Trust preferred securities	—	—	—	—
Other securities	2,187	167	—	2,354
Total available-for-sale	\$ 629,143	\$ 1,590	\$ (14,430)	\$ 616,303
Held-to-maturity:				
U.S. Treasury securities and obligations of U.S. government corporations & agencies	\$ 69,383	\$ —	\$ (1,858)	\$ 67,525
December 31, 2017				
Available-for-sale:				
U.S. Treasury securities and obligations of U.S. government corporations & agencies	\$ 115,796	\$ 8	\$ (2,034)	\$ 113,770
Obligations of states and political subdivisions	165,037	2,254	(1,025)	166,266
Mortgage-backed securities: GSE residential	295,778	493	(2,460)	293,811
Trust preferred securities	2,893	—	(345)	2,548
Other securities	2,039	145	—	2,184
Total available-for-sale	\$ 581,543	\$ 2,900	\$ (5,864)	\$ 578,579
Held-to-maturity:				
U.S. Treasury securities and obligations of U.S. government corporations & agencies	\$ 69,332	\$ 103	\$ (978)	\$ 68,457

Trust preferred securities represents one trust preferred pooled security issued by First Tennessee Financial (“FTN”). This security was sold during the second quarter of 2018.

Realized gains and losses resulting from sales of securities were as follows during the six months ended June 30, 2018 and 2017 (in thousands):

	Three months ended June 30, 2018		Six months ended June 30, 2017	
Gross gains	\$921	\$352	\$941	\$352
Gross losses	(40)	(17)	(40)	(17)

The following table indicates the expected maturities of investment securities classified as available-for-sale presented at fair value, and held-to-maturity presented at amortized cost, at June 30, 2018 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	\$85,405	\$37,633	\$—	\$—	\$123,038	
Obligations of state and political subdivisions	16,785	77,266	80,129	1,060	175,240	
Mortgage-backed securities: GSE residential	—	104,930	176,494	34,247	315,671	
Trust preferred securities	—	—	—	—	—	
Other securities	—	2,013	—	341	2,354	
Total available-for-sale investments	\$102,190	\$221,842	\$256,623	\$35,648	\$616,303	
Weighted average yield	2.35	% 2.68	% 2.92	% 3.40	% 2.77	%
Full tax-equivalent yield	2.52	% 3.05	% 3.28	% 3.43	% 3.08	%
Held to Maturity:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$39,994	\$29,389	\$—	\$—	\$69,383	
Weighted average yield	1.76	% 2.08	% —	% —	% 2.68	%
Full tax-equivalent yield	1.76	% 2.08	% —	% —	% 2.68	%

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 21% 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 June 30, 2018.

Investment securities carried at approximately \$492 million and \$479 million at June 30, 2018 and December 31, 2017, respectively, were pledged to secure public deposits and repurchase agreements and for other purposes as permitted or required by law.

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The following table presents the aging of gross unrealized losses and fair value by investment category as of June 30, 2018 and December 31, 2017 (in thousands):

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2018						
Available-for-sale:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$74,660	\$(1,917)	\$48,378	\$(2,387)	\$123,038	\$(4,304)
Obligations of states and political subdivisions	72,991	(1,357)	14,936	(843)	87,927	(2,200)
Mortgage-backed securities: GSE residential	211,083	(4,680)	68,005	(3,246)	279,088	(7,926)
Total	\$358,734	\$(7,954)	\$131,319	\$(6,476)	\$490,053	\$(14,430)
Held-to-maturity:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$29,438	\$(387)	\$38,087	\$(1,471)	\$67,525	\$(1,858)
December 31, 2017						
Available-for-sale:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$58,584	\$(540)	\$47,972	\$(1,494)	\$106,556	\$(2,034)
Obligations of states and political subdivisions	42,618	(769)	9,267	(256)	51,885	(1,025)
Mortgage-backed securities: GSE residential	187,949	(1,942)	22,609	(518)	210,558	(2,460)
Trust preferred securities	—	—	2,548	(345)	2,548	(345)
Total	\$289,151	\$(3,251)	\$82,396	\$(2,613)	\$371,547	\$(5,864)
Held-to-maturity:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$34,101	\$(525)	\$14,540	\$(453)	\$48,641	\$(978)

U.S. Treasury Securities and Obligations of U.S. Government Corporations and Agencies. At June 30, 2018 there were twelve available-for sale U.S. Treasury securities and obligations of U.S. government corporations and agencies with a fair value of \$48,378,000 and unrealized losses of \$2,387,000 in a continuous unrealized loss position for twelve months or more. At December 31, 2017, there were eleven available-for sale U.S. Treasury securities and obligations of U.S. government corporations and agencies with a fair value of \$47,972,000 and unrealized losses of \$1,494,000 in a continuous unrealized loss position for twelve months or more. At June 30, 2018 there were seven held-to-maturity U.S. Treasury securities and obligations of U.S. government corporations and agencies with a fair value of \$38,087,000 and unrealized losses of \$1,471,000 in a continuous unrealized loss position for twelve months or more. At December 31, 2017 there were seven held-to-maturity U.S. Treasury securities and obligations of U.S. government corporations and agencies with a fair value of \$14,540,000 and unrealized losses of \$453,000 in a continuous unrealized loss position for twelve months or more.

Obligations of states and political subdivisions. At June 30, 2018 there were thirty-three obligations of states and political subdivisions with a fair value of \$14,936,000 and unrealized losses of \$843,000 in a continuous loss position for twelve months or more. At December 31, 2017, there were thirty-nine obligations of states and political subdivisions with a fair value of \$9,267,000 and unrealized losses of \$256,000 in a continuous unrealized loss position for twelve months or more.

Mortgage-backed Securities: GSE Residential. At June 30, 2018 there were twenty-eight mortgage-backed securities with a fair value of \$68,005,000 and unrealized losses of \$3,246,000 in a continuous unrealized loss position for

twelve months or more. At December 31, 2017, there were twenty-six mortgage-backed securities with a fair value of \$22,609,000 and unrealized losses of \$518,000 in a continuous unrealized loss position for twelve months or more.

Trust Preferred Securities. At December 31, 2017, there was one trust preferred security with a fair value of \$2,548,000 and unrealized loss of \$345,000 in a continuous unrealized loss position for twelve months or more. The unrealized loss was primarily due to the long-term nature of the trust preferred security, a lack of demand or inactive market for the security, 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 sold this security during the second quarter of 2018.

Other securities. At June 30, 2018 and December 31, 2017, there were no other securities in a continuous unrealized loss position for twelve months or more.

The Company does not believe any other individual unrealized loss as of June 30, 2018 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 determines whether it is within the scope of the accounting guidance for investments in debt and equity securities or whether it must be evaluated for impairment under the accounting guidance for beneficial interests in securitized financial assets.

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. The following table provides information about the trust preferred security for which only a credit loss was recognized in income and other losses were recorded in other comprehensive income (loss) for the six months ended June 30, 2018 and 2017 (in thousands).

	Accumulated Credit Losses	
	June 30, 2018	June 30, 2017
Credit losses on trust preferred securities held		
Beginning of period	\$1,111	\$1,111
Additions related to OTTI losses not previously recognized	—	—
Reductions due to sales / (recoveries)	(1,111)	—
Reductions due to change in intent or likelihood of sale	—	—
Additions related to increases in previously recognized OTTI losses	—	—
Reductions due to increases in expected cash flows	—	—
End of period	\$—	\$1,111

On May 29, 2018 the Company sold its trust preferred security. This sale resulted in recovery of all of the book value of the security. The net proceeds exceeded the aggregate book value of these securities by approximately \$846,000 and this amount was recorded as a security gain during the second quarter of 2018.

Note 4 – 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 June 30, 2018 and December 31, 2017 follows (in thousands):

	June 30, 2018	December 31, 2017
Construction and land development	\$88,945	\$ 107,721
Agricultural real estate	185,217	127,232
1-4 Family residential properties	380,302	294,483
Multifamily residential properties	106,728	61,966
Commercial real estate	807,630	684,639
Loans secured by real estate	1,568,822	1,276,041
Agricultural loans	113,823	86,602
Commercial and industrial loans	503,423	445,378
Consumer loans	59,932	30,070
All other loans	141,345	108,023
Total Gross loans	2,387,345	1,946,114
Less: Loans held for sale	2,454	1,025
	2,384,891	1,945,089
Less:		
Net deferred loan fees, premiums and discounts	10,662	6,613
Allowance for loan losses	22,045	19,977
Net loans	\$2,352,184	\$ 1,918,499

Net loans increased \$433.7 million as of June 30, 2018 compared to December 31, 2017. Of this increase, approximately \$364.9 million is a result of the acquisition of First Bank & Trust. 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.

Most of the Company's business activities are with customers located near the Company's branch locations in Illinois and Missouri. At June 30, 2018, the Company's loan portfolio included \$299.0 million of loans to borrowers whose businesses are directly related to agriculture. Of this amount, \$172.3 million was concentrated in other grain farming. Total loans to borrowers whose businesses are directly related to agriculture increased \$85.2 million from \$213.8 million at December 31, 2017 due to \$81.8 million acquired from First Bank & Trust and seasonal paydowns based upon timing of cash flow requirements. Loans concentrated in other grain farming increased \$1.5 million from \$170.8 million at December 31, 2017. 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 \$121.1 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 \$189.7 million of loans to lessors of non-residential buildings, \$130.0 million of loans

to lessors of residential buildings and dwellings, and \$95.4 million of loans to other gambling industries.

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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 and the vast majority of borrowers are below regulatory thresholds. The Company can occasionally have outstanding balances to one borrower up to but not exceeding the regulatory threshold should underwriting guidelines warrant. 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.

Purchase Credit-Impaired Loans. Loans acquired with evidence of credit deterioration since origination and for which it is probable that all contractually required payments will not be collected are considered to be credit impaired. Evidence of credit quality deterioration as of the purchase date may include information such as past-due and nonaccrual status, borrower credit scores and recent loan to value percentages. Purchase credit-impaired ("PCI") loans are accounted for under ASC 310-30, Receivables--Loans and Debt Securities Acquired with Deteriorated Credit Quality ("ASC 310-30"), and are initially measured at fair value, which includes the estimated future credit losses expected to be incurred over the life of the loan. Accordingly, an allowance for credit losses related to these loans is not carried over and recorded at the acquisition date. The cash flows expected to be collected were estimated using current key assumptions, such as default rates, value of underlying collateral, severity and prepayment speeds.

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. 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 and nonimpaired loans.

The Company has loans acquired from business combinations with uncollected principal balances. These loans are carried net of a fair value adjustment for credit risk and interest rates and are only included in the allowance calculation to the extent that the reserve requirement exceeds the fair value adjustment. However, as the acquired loans renew, it is necessary to establish an allowance which represents an amount that, in management's opinion, will be adequate to absorb probable credit losses inherent in such 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 \$250,000, 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.

Non-Impaired loans

Non-impaired loans comprise the vast majority of the Company's total loan portfolio and include loans in accrual status and those credits not identified as troubled debt restructurings. A small portion of these loans are considered "criticized" due to the risk rating assigned reflecting elevated credit risk due to characteristics, such as a strained cash flow position, associated

with the individual borrowers. Criticized loans are those assigned risk ratings of Special Mention, Substandard, or Doubtful. Determining the appropriate level of the allowance for loan losses for all non-impaired loans is based on a migration analysis of net losses over a rolling twelve quarter period by loan segment. A weighted average of the net losses is determined by assigning more weight to the most recent quarters in order to recognize current risk factors influencing the various segments of the loan portfolio more prominently than past periods. 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 are evaluated each quarter to determine if adjustments to the weighted average historical net losses is appropriate given these current influences on the risk profile of each loan segment. 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. Consumer loans are evaluated for adverse classification based primarily on the Uniform Retail Credit Classification and Account Management Policy established by the federal banking regulators. Classification standards are generally based on delinquency status, collateral coverage, bankruptcy and the presence of fraud.

Due to weakened economic conditions during prior years, the Company established qualitative factor adjustments for each of the loan segments at levels above the historical net loss averages. 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 allowance for loan losses.

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 for the three and six-months ended June 30, 2018 and 2017 and for the year ended December 31, 2017 (in thousands):

	Commercial/ Commercial Real Estate	Agricultural/ Agricultural Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Three months ended June 30, 2018						
Allowance for loan losses:						
Balance, beginning of period	\$ 17,368	\$ 1,581	\$ 961	\$ 861	\$	—\$20,771
Provision charged to expense	1,334	319	92	132	—	1,877
Losses charged off	(536)	) —	(55)	) (128)	) —	(719)
Recoveries	—	—	53	63	—	116
Balance, end of period	\$ 18,166	\$ 1,900	\$ 1,051	\$ 928	\$	—\$22,045
Ending balance:						
Individually evaluated for impairment	\$ 493	\$ 30	\$ 19	\$ —	\$	—\$542
Collectively evaluated for impairment	\$ 17,673	\$ 1,870	\$ 1,032	\$ 928	\$	—\$21,503
Acquired with deteriorated credit quality	\$ —	\$ —	\$ —	\$ —	\$	—\$—

	Commercial/ Commercial Real Estate	Agricultural/ Agricultural Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Three months ended June 30, 2017						
Allowance for loan losses:						
Balance, beginning of period	\$ 13,771	\$ 2,319	\$ 978	\$ 751	\$ 27	\$ 17,846
Provision charged to expense	1,667	86	23	57	7	1,840
Losses charged off	(871	) (662	) (50	) (135	) —	(1,718
Recoveries	180	—	18	43	—	241
Balance, end of period	\$ 14,747	\$ 1,743	\$ 969	\$ 716	\$ 34	\$ 18,209
Ending balance:						
Individually evaluated for impairment	\$ 194	\$ —	\$ 47	\$ 1	\$ —	\$ 242
Collectively evaluated for impairment	\$ 14,553	\$ 1,743	\$ 922	\$ 715	\$ 34	\$ 17,967
Acquired with deteriorated credit quality	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
	Commercial/ Commercial Real Estate	Agricultural/ Agricultural Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Six months ended June 30, 2018						
Allowance for loan losses:						
Balance, beginning of year	\$ 16,546	\$ 1,742	\$ 886	\$ 803	\$ —	\$ 19,977
Provision charged to expense	2,270	158	269	235	—	2,932
Losses charged off	(773	) —	(158	) (264	) —	(1,195
Recoveries	123	—	54	154	—	331
Balance, end of period	\$ 18,166	\$ 1,900	\$ 1,051	\$ 928	\$ —	\$ 22,045
Ending balance:						
Individually evaluated for impairment	\$ 493	\$ 30	\$ 19	\$ —	\$ —	\$ 542
Collectively evaluated for impairment	\$ 17,673	\$ 1,870	\$ 1,032	\$ 928	\$ —	\$ 21,503
Acquired with deteriorated credit quality	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Loans:						
Individually evaluated for impairment	\$ 12,163	\$ 150	\$ 2,743	\$ 153	\$ —	\$ 15,209
Collectively evaluated for impairment	1,593,116	294,768	383,791	73,773	\$ —	2,345,448
Acquired with deteriorated credit quality	12,300	238	3,482	6	\$ —	16,026
Ending balance	\$ 1,617,579	\$ 295,156	\$ 390,016	\$ 73,932	\$ —	\$ 2,376,683

	Commercial/ Commercial Real Estate	Agricultural/ Agricultural Real Estate	Residential Real Estate	Consumer	Unallocated	Total
Six months ended June 30, 2017						
Allowance for loan losses:						
Balance, beginning of year	\$ 12,901	\$ 2,249	\$ 874	\$ 693	\$ 36	\$ 16,753
Provision charged to expense	3,133	155	169	107	(2)	3,562
Losses charged off	(1,483)	(662)	(99)	(237)	—	(2,481)
Recoveries	196	1	25	153	—	375
Balance, end of period	\$ 14,747	\$ 1,743	\$ 969	\$ 716	\$ 34	\$ 18,209
Ending balance:						
Individually evaluated for impairment	\$ 194	\$ —	\$ 47	\$ 1	\$ —	\$ 242
Collectively evaluated for impairment	\$ 14,553	\$ 1,743	\$ 922	\$ 715	\$ 34	\$ 17,967
Acquired with deteriorated credit quality	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Loans:						
Individually evaluated for impairment	\$ 5,653	\$ 261	\$ 1,494	\$ 248	\$ —	\$ 7,656
Collectively evaluated for impairment	1,241,763	202,620	331,874	35,611	—	1,811,868
Acquired with deteriorated credit quality	6,110	—	—	—	—	6,110
Ending balance	\$ 1,253,526	\$ 202,881	\$ 333,368	\$ 35,859	\$ —	\$ 1,825,634
Year ended December 31, 2017						
Allowance for loan losses:						
Balance, beginning of year	\$ 12,901	\$ 2,249	\$ 874	\$ 693	\$ 36	\$ 16,753
Provision charged to expense	6,884	153	100	361	(36)	7,462
Losses charged off	(3,795)	(662)	(217)	(521)	—	(5,195)
Recoveries	556	2	129	270	—	957
Balance, end of year	\$ 16,546	\$ 1,742	\$ 886	\$ 803	\$ —	\$ 19,977
Ending balance:						
Individually evaluated for impairment	\$ 586	\$ 2	\$ 25	\$ 1	\$ —	\$ 614
Collectively evaluated for impairment	\$ 15,951	\$ 1,740	\$ 861	\$ 802	\$ —	\$ 19,354
Acquired with deteriorated credit quality	\$ 9	\$ —	\$ —	\$ —	\$ —	\$ 9
Loans:						
Individually evaluated for impairment	\$ 11,372	\$ 488	\$ 1,026	\$ 200	\$ —	\$ 13,086
Collectively evaluated for impairment	1,360,156	213,033	314,097	38,870	—	1,926,156
Acquired with deteriorated credit quality	259	—	—	—	—	259
Ending balance	\$ 1,371,787	\$ 213,521	\$ 315,123	\$ 39,070	\$ —	\$ 1,939,501

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 is performed on a continuous basis. The Company uses the following definitions for risk ratings which are commensurate with a loan considered "criticized":

Special Mention. Loans classified as special mention 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 June 30, 2018 and December 31, 2017 (in thousands):

	Construction & Land Development		Agricultural Real Estate		1-4 Family Residential Properties		Multifamily Residential Properties	
	2018	2017	2018	2017	2018	2017	2018	2017
Pass	\$87,955	\$107,140	\$175,635	\$120,767	\$360,561	\$282,441	\$103,653	\$60,954
Special Mention	444	454	6,628	4,829	3,342	2,654	464	476
Substandard	82	—	2,624	1,587	14,670	8,572	1,831	368
Doubtful	—	—	—	—	—	—	—	—
Total	\$88,481	\$107,594	\$184,887	\$127,183	\$378,573	\$293,667	\$105,948	\$61,798

	Commercial Real Estate (Nonfarm/Nonresidential)		Agricultural Loans		Commercial & Industrial Loans		Consumer Loans	
	2018	2017	2018	2017	2018	2017	2018	2017
Pass	\$766,400	\$647,208	\$109,985	\$83,469	\$489,913	\$425,846	\$58,377	\$29,375
Special Mention	14,079	16,941	2,622	2,304	4,112	11,492	9	5
Substandard	22,702	17,608	926	858	8,186	6,925	704	369
Doubtful	181	—	—	—	—	—	—	—
Total	\$803,362	\$681,757	\$113,533	\$86,631	\$502,211	\$444,263	\$59,090	\$29,749

	All Other Loans		Total Loans	
	2018	2017	2018	2017
Pass	\$137,824	\$103,339	\$2,290,303	\$1,860,539
Special Mention	2,743	3,520	34,443	42,675
Substandard	31	—	51,756	36,287
Doubtful	—	—	181	—
Total	\$140,598	\$106,859	\$2,376,683	\$1,939,501

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The following table presents the Company's loan portfolio aging analysis at June 30, 2018 and December 31, 2017 (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
June 30, 2018							
Construction and land development	\$—	\$—	\$44	\$44	\$88,437	\$88,481	\$ —
Agricultural real estate	640	—	—	640	184,247	184,887	—
1-4 Family residential properties	2,396	977	882	4,255	374,318	378,573	—
Multifamily residential properties	281	—	—	281	105,667	105,948	—
Commercial real estate	3,445	1,495	2,532	7,472	795,890	803,362	—
Loans secured by real estate	6,762	2,472	3,458	12,692	1,548,559	1,561,251	—
Agricultural loans	365	11	110	486	113,047	113,533	—
Commercial and industrial loans	1,891	1,140	2,105	5,136	497,075	502,211	—
Consumer loans	784	313	2	1,099	57,991	59,090	—
All other loans	—	—	—	—	140,598	140,598	—
Total loans	\$9,802	\$3,936	\$5,675	\$19,413	\$2,357,270	\$2,376,683	\$ —
December 31, 2017							
Construction and land development	\$26	\$48	\$—	\$74	\$107,520	\$107,594	\$ —
Agricultural real estate	—	—	396	396	126,787	127,183	—
1-4 Family residential properties	3,023	538	1,767	5,328	288,339	293,667	—
Multifamily residential properties	—	—	—	—	61,798	61,798	—
Commercial real estate	90	38	3,566	3,694	678,063	681,757	—
Loans secured by real estate	3,139	624	5,729	9,492	1,262,507	1,271,999	—
Agricultural loans	—	32	158	190	86,441	86,631	—
Commercial and industrial loans	192	3	770	965	443,298	444,263	—
Consumer loans	178	67	27	272	29,477	29,749	—
All other loans	—	—	—	—	106,859	106,859	—
Total loans	\$3,509	\$726	\$6,684	\$10,919	\$1,928,582	\$1,939,501	\$ —

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.

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

The following tables present impaired loans as of June 30, 2018 and December 31, 2017 (in thousands):

	June 30, 2018			December 31, 2017		
	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Recorded Balance	Unpaid Principal Balance	Specific Allowance
Loans with a specific allowance:						
Construction and land development	\$—	\$—	\$ —	\$—	\$—	\$ —
Agricultural real estate	—	—	—	276	276	—
1-4 Family residential properties	3,540	3,912	19	1,026	1,347	25
Multifamily residential properties	301	301	—	313	313	—
Commercial real estate	8,160	8,160	429	5,544	5,565	531
Loans secured by real estate	12,001	12,373	448	7,159	7,501	556
Agricultural loans	154	1,002	30	212	1,009	2
Commercial and industrial loans	6,414	6,921	64	5,774	6,037	64
Consumer loans	159	159	—	200	200	1
Total loans	\$18,728	\$20,455	\$ 542	\$13,345	\$14,747	\$ 623
Loans without a specific allowance:						
Construction and land development	\$58	\$58	\$ —	\$—	\$—	\$ —
Agricultural real estate	235	235	—	15	15	—
1-4 Family residential properties	3,178	3,270	—	2,239	2,664	—
Multifamily residential properties	—	—	—	55	55	—
Commercial real estate	432	493	—	303	368	—
Loans secured by real estate	3,903	4,056	—	2,612	3,102	—
Agricultural loans	955	359	—	545	—	—
Commercial and industrial loans	953	968	—	909	1,249	—
Consumer loans	170	195	—	102	119	—
All other loans	21	21	—	—	—	—
Total loans	\$6,002	\$5,599	\$ —	\$4,168	\$4,470	\$ —
Total loans:						
Construction and land development	\$58	\$58	\$ —	\$—	\$—	\$ —
Agricultural real estate	235	235	—	291	291	—
1-4 Family residential properties	6,718	7,182	19	3,265	4,011	25
Multifamily residential properties	301	301	—	368	368	—
Commercial real estate	8,592	8,653	429	5,847	5,933	531
Loans secured by real estate	15,904	16,429	448	9,771	10,603	556
Agricultural loans	1,109	1,361	30	757	1,009	2
Commercial and industrial loans	7,367	7,889	64	6,683	7,286	64
Consumer loans	329	354	—	302	319	1

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All other loans	21	21	—	—	—	—
Total loans	\$24,730	\$26,054	\$ 542	\$17,513	\$19,217	\$ 623

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The following tables present average recorded investment and interest income recognized on impaired loans for the three and six-month periods ended June 30, 2018 and 2017 (in thousands):

	For the three months ended			
	June 30, 2018		June 30, 2017	
	Average		Average	
	Investment	Interest	Investment	Interest
	in	Income	in	Income
	Impaired	Recognized	Impaired	Recognized
	Loans		Loans	
Construction and land development	\$44	\$ —	\$594	\$ —
Agricultural real estate	235	—	16	—
1-4 Family residential properties	6,719	22	2,929	106
Multifamily residential properties	301	—	4,129	51
Commercial real estate	8,675	3	7,068	31
Loans secured by real estate	15,974	25	14,736	188
Agricultural loans	1,109	—	826	—
Commercial and industrial loans	7,672	—	1,781	2
Consumer loans	329	—	625	—
All other loans	21	—	—	—
Total loans	\$25,105	\$ 25	\$17,968	\$ 190
	For the six months ended			
	June 30, 2018		June 30, 2017	
	Average		Average	
	Investment	Interest	Investment	Interest
	in	Income	in	Income
	Impaired	Recognized	Impaired	Recognized
	Loans		Loans	
Construction and land development	\$44	\$ —	\$347	\$ —
Agricultural real estate	235	—	17	—
1-4 Family residential properties	6,777	28	3,121	117
Multifamily residential properties	302	—	4,133	94
Commercial real estate	8,680	6	5,316	62
Loans secured by real estate	16,038	34	12,934	273
Agricultural loans	1,061	—	930	—
Commercial and industrial loans	7,892	2	1,841	4
Consumer loans	349	—	628	—
All other loans	21	—	—	—
Total loans	\$25,361	\$ 36	\$16,333	\$ 277

The amount of interest income recognized by the Company within the periods stated above was due to loans modified in troubled debt restructurings that remained on accrual status. The balance of loans modified in troubled debt restructurings included in the impaired loans at June 30, 2018 stated above that were still accruing was \$2,396,000 of 1-4 Family residential properties and \$683,000 of commercial real estate. The balance of loans modified in a troubled debt restructurings at June 30, 2017 included in the impaired loans stated above that were still accruing was \$594,000 of 1-4 family residential properties, \$3,395,000 of multifamily residential properties, \$2,087,000 commercial real estate, \$33,000 commercial and industrial loans, and \$2,000 of consumer loans. For the six months ended June 30, 2018 and 2017, 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 June 30, 2018 and December 31, 2017 (in thousands). This table excludes purchased impaired loans and performing troubled debt restructurings.

	June 30, December 31,	
	2018	2017
Construction and land development	\$58	\$ —
Agricultural real estate	235	291
1-4 Family residential properties	4,323	2,687
Multifamily residential properties	301	368
Commercial real estate	7,909	5,596
Loans secured by real estate	12,826	8,942
Agricultural loans	1,109	757
Commercial and industrial loans	7,365	6,658
Consumer loans	329	302
All other loans	21	—
Total loans	\$21,650	\$ 16,659

Interest income that would have been recorded under the original terms of such nonaccrual loans totaled \$758,000 and \$140,000 for the six months ended June 30, 2018 and 2017, respectively.

Purchased Credit-Impaired Loans

The Company acquired certain loans considered to be credit-impaired ("PCI") in its business combinations with First Clover Leaf Bank during the third quarter of 2016 and First Bank & Trust during the second quarter of 2018. At acquisition, these loans evidenced deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. The carrying amount of these loans is included in the consolidated balance sheet amounts for Loans. The Company had no PCI loans prior to the First Clover Leaf Bank acquisition. The amount of these loans at June 30, 2018 and December 31, 2017 are as follows (in thousands):

	June 30, December 31,	
	2018	2017
Construction and land development	\$299	\$ —
Agricultural real estate	121	—
1-4 Family residential properties	\$3,183	\$ —
Multifamily residential properties	3,951	—
Commercial real estate	7,780	251
Loans secured by real estate	15,334	251
Agricultural loans	117	—
Commercial and industrial loans	569	8
Consumer loans	6	—
Carrying amount	16,026	259
Allowance for loan losses	—	9
Carrying amount, net of allowance	\$16,026	\$ 250

As of September 8, 2016, the First Clover Leaf acquisition date, the principal outstanding of PCI loans totaled \$10,650,000 and the fair value of PCI loans totaled \$8,688,000. The balance of these loans at June 30, 2018 was \$385,000 and the fair value was \$247,000. As of May 1, 2018, the First Bank acquisition date, the principal outstanding of PCI loans totaled \$20,357,000 and the fair value of PCI loans totaled \$16,126,000. The balance of

these loans at June 30, 2018 was \$20,011,000 and the fair value totaled \$15,780,000.

For PCI loans, the difference between contractually required payments at acquisition and the cash flow expected to be collected is referred to as the non-accretable difference. Any excess of expected cash flows over the fair value is referred to as the accretable yield. As of June 30, 2018 there is no accretable yield on the PCI loans acquired. Subsequent decreases to the expected cash flows will result in a provision for loan and lease losses. Subsequent increases in expected cash flows will result in a reversal of the provision for loan and lease losses to the extent of prior charges and then an adjustment to accretable yield, which would have a positive impact on interest income. As of June 30, 2018, there was one loan with a change in expected cash flows and as a result, the previously recorded provision was reversed. As of December 31, 2017, there was one loan with a change in expected cash flows and as a result, approximately \$9,000 of provision was recorded.

The PCI loans acquired from First Bank & Trust during the second quarter of 2018 for which it was probable that all contractually required payments would not be collected were as follows:

Contractually required payments	\$20,357
Non-accretable difference	(4,231)
Cash flows expected to be collected at acquisition	16,126
Accretable yield	—
Fair value of acquired loans at acquisition	\$16,126

Troubled Debt Restructuring

The balance of troubled debt restructurings ("TDRs") at June 30, 2018 and December 31, 2017 was \$10.6 million and \$8.9 million, respectively. There was \$56,000 and \$37,000 in specific reserves established with respect to these loans as of June 30, 2018 and December 31, 2017, 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 following table presents the Company's recorded balance of troubled debt restructurings at June 30, 2018 and December 31, 2017 (in thousands).

Troubled debt restructurings:	June 30, December 31,	
	2018	2017
1-4 Family residential properties	2,883	874
Commercial real estate	1,897	1,376
Loans secured by real estate	4,780	2,250
Agricultural loans	745	757
Commercial and industrial loans	4,933	5,690
Consumer loans	153	201
Total	\$10,611	\$ 8,898
Performing troubled debt restructurings:		
1-4 Family residential properties	2,396	\$ 578
Commercial real estate	683	251
Loans secured by real estate	3,079	829
Commercial and industrial loans	—	25
Total	\$3,079	\$ 854

The increase in TDRs during the period was primarily due to loans acquired in the acquisition of First Bank net of loans that paid off during the period. The following table presents loans modified as TDRs during the six months ended June 30, 2018 and 2017, as a result of various modified loan factors (in thousands):

	June 30, 2018		June 30, 2017	
	Number of Recorded Investment Modifications	Type of Modifications	Number of Recorded Investment Modifications	Type of Modifications
1-4 Family residential properties	1 161	(b)	—	
Agricultural loans	—		1 819	(b)(c)
Total	1 \$ 161		1 \$ 819	

Type of modifications:

- (a) Reduction of stated interest rate of loan
- (b) Change in payment terms
- (c) Extension of maturity date
- (d) Permanent reduction of the recorded investment

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 for six months ended June 30, 2018. There was one loan modified as troubled debt restructuring during the prior twelve months that experienced defaults as of December 31, 2017.

The balance of real estate owned includes \$2,440,000 and \$2,754,000 of foreclosed real estate properties recorded as a result of obtaining physical possession of the property at June 30, 2018 and December 31, 2017, respectively. The recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure procedures are in process was \$738,000 and \$404,000 at June 30, 2018 and December 31, 2017, respectively.

Note 5 -- 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 First Mid Insurance. The following table presents gross carrying value and accumulated amortization by major intangible asset class as of June 30, 2018 and December 31, 2017 (in thousands):

	June 30, 2018		December 31, 2017	
	Gross Carrying Value	Accumulated Amortization	Gross Carrying Value	Accumulated Amortization
Goodwill not subject to amortization (effective 1/1/02)	\$91,264	\$ 3,760	\$63,910	\$ 3,760
Intangibles from branch acquisition	3,015	3,015	3,015	3,015
Core deposit intangibles	25,086	12,484	19,862	11,473
Other intangibles	3,731	2,376	3,731	2,285
	\$123,096	\$ 21,635	\$90,518	\$ 20,533

Goodwill of \$27.4 million was recorded for acquisition and merger of First Bank during the second quarter of 2018. All of the goodwill was assigned to the banking segment of the Company. The Company expects this goodwill will not be deductible for tax purposes.

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

Purchase price (in excess of net book value)	\$26,946
Purchase accounting adjustments:	
Fair value of securities	320
Fair value of loans, net	3,886
Fair value of OREO	12
Fair value of premises and equipment	689
Fair value of time deposits	1,301
Fair value of FHLB advances	(328)
Fair value of subordinated debentures	(1,451)
Core deposit intangible	(5,224)
Other assets and other liabilities, net	1,203
	408
Resulting goodwill from acquisition	\$27,354

As part of the First Bank acquisition, the Company acquired mortgage servicing rights valued at \$425,000. The following table summarizes the activity pertaining to mortgage servicing rights included in intangible assets as of June 30, 2018, June 30, 2017 and December 31, 2017 (in thousands):

	June 30, 2018	June 30, 2017	December 31, 2017
Beginning Balance	\$ 844	\$985	\$ 985
Mortgage servicing rights acquired during period	425	—	—
Mortgage servicing rights capitalized	7	—	—
Mortgage servicing rights amortized	(119)	(72)	(141)
Ending Balance	\$ 1,157	\$913	\$ 844

Total amortization expense for the six months ended June 30, 2018 and 2017 was as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Core deposit intangibles	591	472	\$1,011	\$943
Other intangibles	45	45	91	91
Mortgage servicing rights	80	42	119	72
	\$716	\$559	\$1,221	\$1,106

Aggregate amortization expense for the current year and estimated amortization expense for each of the five succeeding years is shown in the table below (in thousands):

Aggregate amortization expense:	
For period 01/01/18-06/30/18	\$1,221
Estimated amortization expense:	
For period 07/01/18-12/31/18	1,556
For year ended 12/31/19	2,903
For year ended 12/31/20	2,409
For year ended 12/31/21	1,943

For year ended 12/31/22	1,730
For year ended 12/31/23	1,547

In accordance with the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets," codified within ASC 350, the Company performed testing of goodwill for impairment as of September 30, 2017 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.

Note 6 -- Repurchase Agreements and Other Borrowings

Securities sold under agreements to repurchase were \$141.7 million at June 30, 2018, a decrease of \$13.7 million from \$155.4 million at December 31, 2017. The decrease during the first six months of 2018 was primarily due to decreases in balances of customers due to changes in cash flow needs for their businesses. All of the transactions have overnight maturities with a weighted average rate of 0.14%.

The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral pledged by the Company would be used to settle the fair value of the repurchase agreement should the Company be in default (e.g., declare bankruptcy), the Company could cancel the repurchase agreement (i.e., cease payment of principal and interest), and attempt collection on the amount of collateral value in excess of the repurchase agreement fair value.

The collateral is held by a third party financial institution in the counterparty's custodial account. The counterparty has the right to sell or repledge the investment securities. For government entity repurchase agreements, the collateral is held by the Company in a segregated custodial account under a tri-party agreement. The Company is required by the counterparty to maintain adequate collateral levels. In the event the collateral fair value falls below stipulated levels, the Company will pledge additional securities. The Company closely monitors collateral levels to ensure adequate levels are maintained, while mitigating the potential of over-collateralization in the event of counterparty default.

Collateral pledged by class for repurchase agreements are as follows (in thousands):

	June 30, 2018	December 31, 2017
US Treasury securities and obligations of U.S. government corporations & agencies	\$94,460	\$ 100,895
Mortgage-backed securities: GSE: residential	47,202	54,493
Total	\$141,662	\$ 155,388

FHLB borrowings increased to \$96 million at June 30, 2018 from \$60 million at December 31, 2017. At June 30, 2018 the advances were as follows:

- \$5 million advance with a 3-month maturity, at 2.11%, due August 23, 2018
- \$5 million advance with a 6-month maturity, at 2.10%, due October 16, 2018
- \$10 million advance with a 3-year maturity, at 1.42%, due November 5, 2018
- \$5 million advance with a 1.5-year maturity, at 1.49%, due December 28, 2018
- \$4 million advance with a 3-year maturity, at 1.72% due April 12, 2019
- \$5 million advance with a 2-year maturity, at 1.56%, due June 28, 2019
- \$5 million advance with a 15-month maturity, at 2.63%, due September 27, 2019
- \$2 million advance with a 5-year maturity, at 1.89%, due October 17, 2019
- \$5 million advance with a 1.5-year maturity, at 2.67%, due December 27, 2019
- \$5 million advance with a 2.5-year maturity, at 1.67%, due January 31, 2020
- \$5 million advance with a 4-year maturity, at 1.79%, due April 30, 2020
- \$5 million advance with a 2-year maturity, at 2.75%, due June 26, 2020

- \$5 million advance with a 3-year maturity, at 1.75%, due July 31, 2020
- \$5 million advance with a 6-year maturity, at 2.30%, due August 24, 2020
- \$5 million advance with a 3.5-year maturity, at 1.83%, due February 1, 2021
- \$5 million advance with a 5-year maturity, at 1.85%, due April 12, 2021
- \$5 million advance with a 7-year maturity, at 2.55%, due October 1, 2021
- \$5 million advance with a 5-year maturity, at 2.71%, due March 21, 2022
- \$5 million advance with a 8-year maturity, at 2.40%, due January 9, 2023

Note 7 -- Fair Value of Assets and Liabilities

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 independent sources of 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 June 30, 2018 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

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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 June 30, 2018,

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 were 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 June 30, 2018 and December 31, 2017 (in thousands):

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2018				
Available-for-sale securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 123,038	\$ —	\$ 123,038	\$ —
Obligations of states and political subdivisions	175,240	—	175,240	—
Mortgage-backed securities	315,671	—	315,671	—
Trust preferred securities	—	—	—	—
Other securities	2,354	341	2,013	—
Total available-for-sale securities	\$ 616,303	\$ 341	\$ 615,962	\$ —
December 31, 2017				
Available-for-sale securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 113,770	\$ —	\$ 113,770	\$ —
Obligations of states and political subdivisions	166,266	—	166,266	—
Mortgage-backed securities	293,811	—	293,811	—
Trust preferred securities	2,548	—	—	2,548
Other securities	2,184	172	2,012	—
Total available-for-sale securities	\$ 578,579	\$ 172	\$ 575,859	\$ 2,548

The change in fair value of assets measured on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended June 30, 2018 and 2017 is summarized as follows (in thousands):

	Trust Preferred Securities			
	Three months ended		Six months ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Beginning balance	\$2,522	\$1,638	\$2,548	\$1,652
Transfers into Level 3	—	—	—	—
Transfers out of Level 3	—	—	—	—
Total gains or losses:				
Included in net income	—	—	—	—
Included in other comprehensive income (loss)	—	825	18	848
Purchases, issuances, sales and settlements:				
Purchases	—	—	—	—
Issuances	—	—	—	—
Sales	(2,522)	—	(2,522)	—
Settlements		(39)	(44)	(76)
Ending balance	\$—	\$2,424	\$—	\$2,424
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	\$—	\$—	\$—	\$—

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 impaired loans that have an estimated fair value that is below the carrying value. The total carrying amount of loans for which a change in specific allowance has occurred as of June 30, 2018 was \$25,578,000 and a fair value of \$20,756,000 resulting in specific loss exposures of \$4,822,000.

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

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carrying amount of other real estate owned as of June 30, 2018 was \$2,440,000. Other real estate owned included in the total carrying amount and measured at fair value on a nonrecurring basis during the period amounted to \$163,000.

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 June 30, 2018 and December 31, 2017 (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2018				
Impaired loans (collateral dependent)	\$20,756	\$ —	\$ —	\$ 20,756
Foreclosed assets held for sale	163	—	—	163
December 31, 2017				
Impaired loans (collateral dependent)	\$3,053	\$ —	\$ —	\$ 3,053
Foreclosed assets held for sale	91	—	—	91

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 was 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 at June 30, 2017 and December 31, 2016 (in thousands).

June 30, 2018	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans (collateral dependent)	\$20,756	Third party valuations	Discount to reflect realizable value	0% - 40% (20%)
Foreclosed assets held for sale	\$163	Third party valuations	Discount to reflect realizable value less estimated selling costs	0% - 40% (35%)
December 31, 2017				
	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
			Discount rate	12.7%
			Constant prepayment rate (1)	1.3%
Trust Preferred Securities	\$2,548	Discounted cash flow		

			Cumulative projected prepayments	21.6%
			Probability of default	0.5%
			Projected cures given deferral	0.0%
			Loss severity	97.7%
Impaired loans (collateral dependent)	\$3,053	Third party valuations	Discount to reflect realizable value	0% -40% (20%)
Foreclosed assets held for sale	\$91	Third party valuations	Discount to reflect realizable value less estimated selling costs	0% -40% (35%)

(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, Federal Funds Sold, Interest Receivable 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 Held for Sale. Loans expected to be sold are classified as held for sale and are recorded at the lower of aggregate cost or market value.

Loans. For June 30, 2018, fair value of loans is estimated on an exit price basis incorporating discounts for credit, liquidity and marketability factors. This is not comparable with the fair values disclosed for December 31, 2017, which were based on an entrance price basis. For that date, fair values of variable rate loans that reprice frequently and with no significant change in credit risk were based on carrying values. The fair values of other loans as of that date were estimated using discounted cash flow analyses which used interest rates then being offered for loans with similar terms to borrowers of similar credit quality. 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.

Interest Payable. The carrying amount approximates fair value.

Junior Subordinated Debentures, Federal Home Loan Bank Borrowings and Other Borrowings. Rates currently available to the Company for debt with similar terms and remaining maturities are used to estimate the fair value of existing debt.

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The following tables present estimated fair values of the Company's financial instruments at June 30, 2018 and December 31, 2017 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
June 30, 2018					
Financial Assets					
Cash and due from banks	\$84,880	\$84,880	\$84,880	\$—	\$—
Federal funds sold	695	695	695	—	—
Certificates of deposit investments	2,930	2,930	—	2,930	—
Available-for-sale securities	616,303	616,303	341	615,962	—
Held-to-maturity securities	69,383	67,525	—	67,525	—
Loans held for sale	2,454	2,454	—	2,454	—
Loans net of allowance for loan losses	2,352,184	2,301,723	—	—	2,301,723
Interest receivable	12,612	12,612	—	12,612	—
Federal Reserve Bank stock	5,160	5,160	—	5,160	—
Federal Home Loan Bank stock	2,050	2,050	—	2,050	—
Financial Liabilities					
Deposits	\$2,670,864	\$2,668,442	\$—	\$2,147,323	\$521,119
Securities sold under agreements to repurchase	141,662	141,645	—	141,645	—
Interest payable	1,145	1,145	—	1,145	—
Federal Home Loan Bank borrowings	95,708	95,372	—	95,372	—
Other borrowings	9,375	9,375	—	9,375	—
Junior subordinated debentures	28,792	23,532	—	23,532	—
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
December 31, 2017					
Financial Assets					
Cash and due from banks	\$88,388	\$88,388	\$88,388	\$—	\$—
Federal funds sold	491	491	491	—	—
Certificates of deposit investments	1,685	1,692	—	1,692	—
Available-for-sale securities	578,579	578,579	172	575,859	2,548
Held-to-maturity securities	69,332	68,457	—	68,457	—
Loans held for sale	1,025	1,025	—	1,025	—
Loans net of allowance for loan losses	1,918,499	1,899,678	—	—	1,899,678
Interest receivable	10,832	10,832	—	10,832	—
Federal Reserve Bank stock	5,160	5,160	—	5,160	—
Federal Home Loan Bank stock	2,407	2,407	—	2,407	—
Financial Liabilities					
Deposits	\$2,274,639	\$2,272,868	\$—	\$1,930,604	\$342,264
Securities sold under agreements to repurchase	155,388	155,394	—	155,394	—
Interest payable	602	602	—	602	—
Federal Home Loan Bank borrowings	60,038	59,968	—	59,968	—
Other borrowings	10,313	10,313	—	10,313	—
Junior subordinated debentures	24,000	18,050	—	18,050	—

Note 8 -- Business Combinations

First BancTrust Corporation

On December 11, 2017, the Company and Project Hawks Merger Sub LLC (formerly known as Project Hawks Merger Sub Corp.), a newly formed Delaware limited liability company and wholly-owned subsidiary of the Company (“Hawks Merger Sub”), entered into an Agreement and Plan of Merger (as amended as of January 18, 2018, the “First Bank Merger Agreement”) with First BancTrust Corporation, a Delaware corporation (“First Bank”), pursuant to which, among other things, the Company agreed to acquire 100% of the issued and outstanding shares of First Bank pursuant to a business combination whereby First Bank will merge with and into Hawks Merger Sub, with Hawks Merger Sub as the surviving entity and a wholly-owned subsidiary of the Company (the “First Bank Merger”).

At the effective time of the First Bank Merger, each share of common stock, par value \$0.01 per share, of First Bank issued and outstanding immediately prior to the effective time of the First Bank Merger (other than shares held in treasury by First Bank and shares held by stockholders who had properly made and not withdrawn a demand for appraisal rights under Delaware law) converted into and become the right to receive, (a) \$5.00 in cash and (b) 0.800 shares of common stock, par value \$4.00 per share, of the Company and cash in lieu of fractional shares, less any applicable taxes required to be withheld and subject to certain adjustments, all as set forth in the First Bank Merger Agreement.

On May 1, 2018, the Company issued an aggregate total of 1,643,900 shares of common stock valued at \$37.32 per share and approximately \$10,275,000, including cash in lieu of fractional shares. First Bank’s wholly-owned bank subsidiary, First Bank & Trust, IL (“First Bank & Trust”), will be merged with and into First Mid Bank on August 10, 2018. At the time of the bank merger, First Bank & Trust’s banking offices will become branches of First Mid Bank. As a result of the acquisition, the Company will have an opportunity to increase its deposit base and reduce transaction costs. The Company also expects to reduce costs through economies of scale.

The acquisition was accounted for under the acquisition method of accounting in accordance with ASC 805, “Business Combinations (“ASC 805”),” and accordingly the assets and liabilities were recorded at their estimated fair values as of the date of acquisition. Fair values are subject to refinement for up to one year after the closing date of May 1, 2018 as additional information regarding the closing date fair values become available. The total consideration paid was used to determine the amount of goodwill resulting from the transaction. As the total consideration paid exceeded the net assets acquired, goodwill of \$27.4 million was recorded for the acquisition. Goodwill recorded in the transaction, which reflects the synergies and economies of scale expected from combining operations and the enhanced revenue opportunities from the Company’s service capabilities, is not tax deductible, and was all assigned to the banking segment of the Company.

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

	Acquired Book Value	Fair Value Adjustments	As Recorded by First Bank & Trust
Assets			
Cash & due from banks	\$20,598		\$20,598
Investment Securities	59,906	(320)	) 59,586
Loans	371,156	(8,298)	) 362,858
Allowance for loan losses	(4,412)	)4,412	—
Other real estate owned	547	(12)	) 535
Premises and equipment	10,126	(689)	) 9,437
Goodwill	543	26,811	27,354
Core deposit intangible	—	5,224	5,224
Other assets	16,389	(696)	) 15,693
Total assets acquired	\$474,853	\$ 26,432	\$ 501,285
Liabilities and Stockholders' Equity			
Deposits	\$384,323	\$ 1,301	\$ 385,624
FHLB advances	31,000	(328)	) 30,672
Subordinated debentures	6,186	(1,451)	) 4,735
Other liabilities	8,665	(36)	) 8,629
Total liabilities assumed	430,174	(514)	) 429,660
Net assets acquired	\$44,679	\$ 26,946	\$ 71,625
Consideration Paid			
Cash			\$ 10,275
Common stock			61,350
Total consideration paid			\$ 71,625

The Company has recognized approximately \$3.1 million, pre-tax, of acquisition costs for the First Bank acquisition. These costs are included in legal and professional and other expense. Of the \$8.3 million fair value adjustment to loans, approximately \$4.1 million is being accreted to interest income over the remaining term of the loans. The differences between fair value and acquired value of the assumed time deposits of \$1.3 million, of the assumed FHLB advances of \$(328,000) and of the assumed subordinated debentures of \$(1,451,000), are being amortized to interest expense over the remaining life of the liabilities. The core deposit intangible asset, with a fair value of \$5.2 million, will be 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 First Bank acquisition taken place at the beginning of the period (dollars in thousands):

	Three months ended		Six months ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Net interest income	\$29,062	\$ 29,305	\$57,035	\$ 55,917
Provision for loan losses	1,927	1,910	3,132	3,867
Non-interest income	8,640	8,675	16,960	17,214
Non-interest expense	21,870	24,885	43,654	46,945
Income before income taxes	13,905	11,185	27,209	22,319
Income tax expense	3,307	3,505	6,715	7,323
Net income	10,598	\$ 7,680	20,494	\$ 14,996
Earnings per share				
Basic	\$0.76	\$ 0.51	\$1.42	\$ 1.06
Diluted	\$0.76	\$ 0.51	\$1.42	\$ 1.06

Basic weighted average shares outstanding	13,956,673	13,092,373	14,407,273	13,127,688
Diluted weighted average shares outstanding	13,974,048	13,100,547	14,424,576	13,135,862

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 First Bank 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.

Actual revenue and earnings of First Bank & Trust included in the consolidated statement of income of the Company from the acquisition date to June 30, 2018 was \$4,298,000 and \$919,000, respectively.

ITEM 2. 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 as of, and for the three and six-month periods ended June 30, 2018 and 2017. This discussion and analysis should be read in conjunction with the consolidated financial statements, related notes and selected financial data appearing elsewhere in this report.

Forward-Looking Statements

This report may contain certain forward-looking statements, such as discussions of the Company's pricing and fee trends, credit quality and outlook, liquidity, new business results, expansion plans, anticipated expenses and planned schedules. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are identified by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project," or similar expressions. Actual results could differ materially from the results indicated by these statements because the realization of those results is subject to many risks and uncertainties, including those described in Item 1A—"Risk Factors" and other sections of the Company's Annual Report on Form 10-K and the Company's other filings with the SEC, and changes in interest rates, general economic conditions and those in the Company's market area, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios and the valuation of the investment portfolio, the Company's success in raising capital and effecting and integrating acquisitions, 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. Further information concerning the Company and its business, including a discussion of these and additional factors that could materially affect the Company's financial results, is included in the Company's 2017 Annual Report on Form 10-K under the headings "Item 1. Business" and "Item 1A. Risk Factors."

Acquisitions

On May 1, 2018, the Company completed its acquisition of First Bank. Financial results for the second quarter of 2018 include the income and expenses of First Bank & Trust for the period May 1 through June 30, 2018. At the date of the acquisition, the fair value of First Bank's total assets was \$501 million, including \$363 million of loans. The fair value of First Bank's deposits was \$386 million. Net income before taxes was positively impacted by \$447,000 due to First Bank & Trust's purchase accounting net accretion and amortization expense of intangibles during the second quarter of 2018. During the second quarter of 2018, the Company incurred \$2,897,000 of pre-tax acquisition expenses related to the acquisition of First Bank, comprised primarily of legal, consulting and change-in-control costs. During the six months ended June 30, 2018, pre-tax expenses related to the acquisition totaled \$3,229,000.

On June 12, 2018, the Company and Almond Merger Sub, entered into an Agreement and Plan of Merger with SCB pursuant to which, among other things, the Company agreed to acquire 100% of the issued and outstanding shares of SCB pursuant to a business combination whereby SCB will merge with and into Almond Merger Sub, whereupon the separate corporate existence of SCB will cease and Almond Merger Sub will continue as the surviving company and a wholly-owned subsidiary of the Company.

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 which have an impact on the Company's financial condition and results of operations you should carefully read this entire document.

Net income was \$18,427,000 and \$14,464,000 for the six months ended June 30, 2018 and 2017, respectively. Diluted net income per common share available to common stockholders was \$1.38 and \$1.16 for the six months ended June 30, 2018 and 2017.

The following table shows the Company's annualized performance ratios for the six months ended June 30, 2018 and 2017, compared to the performance ratios for the year ended December 31, 2017:

	Six months ended		Year ended	
	June 30, 2018	June 30, 2017	December 31, 2017	
Return on average assets	1.23 %	1.02 %	0.94 %	%
Return on average common equity	11.06%	9.96 %	8.92 %	%
Average equity to average assets	11.09%	10.22 %	10.59 %	%

Total assets were \$3.4 billion at June 30, 2018, compared to \$2.8 billion as of December 31, 2017. From December 31, 2017 to June 30, 2018, cash and interest bearing deposits decreased \$3.3 million, net loan balances increased \$433.7 million and investment securities increased \$37.8 million. Net loan balances were \$2.35 billion at June 30, 2018 compared to \$1.92 billion at December 31, 2017.

Net interest margin, defined as net interest income divided by average interest-earning assets, was 3.66% for the six months ended June 30, 2018, up from 3.58% for the same period in 2017. This increase was primarily due to an increase in loan balances, higher yields on investments, and accretion income from the acquisitions of First Bank and First Clover Leaf Bank. Net interest income before the provision for loan losses was \$50.6 million compared to net interest income of \$46.7 million for the same period in 2017. The increase in net interest income was primarily due to the growth in average earnings assets primarily due to loans and investment securities acquired from First Bank offset by an increase in cost of deposits and borrowings.

Total non-interest income of \$15,848,000 increased \$383,000 or 2.5% from \$15,465,000 for the same period last year. Trust revenues increased \$244,000, primarily due to an increase in revenue from defined contribution and other retirement accounts, and an increase in brokerage revenue of \$312,000, primarily due to an increase in the number of brokerage accounts, and an increase in net securities gains of \$566,000 offset by a decrease in other income of \$924,000 primarily due to a income tax refund received in 2017 resulting from overpayment of taxes in 2016 by First Clover Leaf Financial Corp.

Total non-interest expense of \$39.2 million increased \$2,013,000 or 5.4% from \$37.2 million for the same period last year. This increase was primarily due to legal and professional costs associated with the acquisition of First Bank and an increase in salaries and benefits expense.

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

	Change in Net Income	
	2018 versus 2017	
	Three months ended	Six months ended
	June 30,	June 30,
Net interest income	\$3,501	\$3,924
Provision for loan losses	(37)	630

Other income, including securities transactions	392	383
Other expenses	(2,841)	(2,013)
Income taxes	822	1,039
Increase in net income	\$1,837	\$3,963

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Credit quality is an area of importance to the Company. Total nonperforming loans were \$24.7 million at June 30, 2018, compared to \$17.1 million at June 30, 2017 and \$17.5 million at December 31, 2017. See the discussion under the heading “Loan Quality and Allowance for Loan Losses” for a detailed explanation of these balances. Repossessed asset balances totaled \$2.5 million at June 30, 2018 compared to \$4.4 million at June 30, 2017 and \$2.8 million at December 31, 2017. The Company’s provision for loan losses for the six months ended June 30, 2018 and 2017 was \$2,932,000 and \$3,562,000, respectively. Total loans past due 30 days or more were 0.82% of loans at June 30, 2018 compared to 0.48% at June 30, 2017, and 0.56% of loans at December 31, 2017. At June 30, 2018, the composition of the loan portfolio remained similar to the same period last year. Loans secured by both commercial and residential real estate comprised approximately 65.7% of the loan portfolio as of June 30, 2018 and 65.6% as of December 31, 2017.

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 to risk weighted assets ratio calculated under the regulatory risk-based capital requirements at June 30, 2018 and 2017 and December 31, 2017 was 13.16%, 11.98% and 11.83%, respectively. The Company’s total capital to risk weighted assets ratio calculated under the regulatory risk-based capital requirements at June 30, 2018 and 2017 and December 31, 2017 was 13.97%, 12.81% and 12.70%, respectively. The increase in these ratios from December 31, 2017 was primarily due to net income added to retained earnings. The increase in these ratios was primarily due to the Company's capital raise that occurred during the second quarter of 2018.

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 the discussion under the heading “Liquidity” for a full listing of 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 June 30, 2018 and 2017 were \$512 million and \$457 million, respectively.

Federal Deposit Insurance Corporation Insurance Coverage. As FDIC-insured institutions, First Mid Bank and First Bank are required to pay deposit insurance premium assessments to the FDIC. A number of requirements with respect to the FDIC insurance system have affect results, including insurance assessment rates. The Company expensed \$514,000 and \$407,000 for this assessment during the first six months of 2018 and 2017, respectively.

In addition to its insurance assessment, each insured bank is subject to quarterly debt service assessments in connection with bonds issued by a government corporation that financed the federal savings and loan bailout. The Company expensed \$52,000 and \$62,000 during the first six months of 2018 and 2017 for this assessment, respectively.

Basel III. In September 2010, the Basel Committee on Banking Supervision proposed higher global minimum capital standards, including a minimum Tier 1 common capital ratio and additional capital and liquidity requirements. On July 2, 2013, the Federal Reserve Board approved a final rule to implement these reforms and changes required by the Dodd-Frank Act. This final rule was subsequently adopted by the OCC and the FDIC.

As included in the proposed rule of June 2012, the final rule includes new risk-based capital and leverage ratios, which will be phased in from 2015 to 2019, and refines the definition of what constitutes “capital” for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Company and First Mid Bank and First Bank beginning in 2015 are: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6%; (iii) a total capital ratio of 8%; and (iv) a Tier 1 leverage ratio of 4%. The rule also establishes a “capital conservation buffer” of 2.5% above the new regulatory minimum capital requirements, which must consist entirely of

common equity Tier 1 capital and would result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. The new capital conservation buffer requirement is being phased in beginning in January 2016 at 0.625% of risk weighted assets and will increase by that amount each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if its capital level falls below the buffer amount.

The final rule also makes three changes to the proposed rule of June 2012 that impact the Company. First, the proposed rule would have required banking organizations to include accumulated other comprehensive income ("AOCI") in common

equity tier 1 capital. AOCI includes accumulated unrealized gains and losses on certain assets and liabilities that have not been included in net income. Under existing general risk-based capital rules, most components of AOCI are not included in a banking organization's regulatory capital calculations. The final rule allows community banking organizations to make a one-time election not to include these additional components of AOCI in regulatory capital and instead use the existing treatment under the general risk-based capital rules that excludes most AOCI components from regulatory capital.

Second, the proposed rule would have modified the risk-weight framework applicable to residential mortgage exposures to require banking organizations to divide residential mortgage exposure into two categories in order to determine the applicable risk weight. The final rule, however, retains the existing treatment for residential mortgage exposures under the general risk-based capital rules.

Third, the proposed rule would have required banking organizations with total consolidated assets of less than \$15 billion as of December 31, 2009, such as the Company, to phase out over ten years any trust preferred securities and cumulative perpetual preferred securities from its Tier 1 capital regulatory capital. The final rule, however, permanently grandfathers into Tier 1 capital of depository institution holding companies with total consolidated assets of less than \$15 billion as of December 31, 2009 any trust preferred securities or cumulative perpetual preferred stock issued before May 19, 2010.

See discussion under the heading "Capital Resources" for a description of the Company's, First Mid Bank's, and First Bank's risk-based capital.

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 included in the Company's 2017 Annual Report on Form 10-K. 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 formally 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 non-impaired 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 non-impaired loan is

more subjective. Generally, the allowance assigned to non-impaired loans is determined based on migration analysis of historical net losses on each loan segment 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 as of September 30, 2017 as part of the goodwill impairment test and no impairment was identified.

As a result of the Company's acquisition activity, goodwill, an intangible asset with an indefinite life, is reflected on the consolidated 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 7 – Fair Value of Assets and Liabilities.

Results of Operations

Net Interest Income

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

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The Company's average balances, interest income and expense and rates earned or paid for major balance sheet categories are set forth for the three and six months ended June 30, 2018 and 2017 in the following table (dollars in thousands):

	Three months ended June 30, 2018			Three months ended June 30, 2017		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Assets						
Interest-bearing deposits with other financial institutions	\$ 19,904	\$ 76	1.53 %	\$ 20,573	\$ 48	0.95 %
Federal funds sold	632	2	1.27 %	490	—	— %
Certificates of deposit investments	2,520	12	1.91 %	1,685	7	1.68 %
Investment securities						
Taxable	511,833	3,414	2.67 %	601,906	3,147	2.09 %
Tax-exempt (1)	169,616	1,265	2.98 %	175,721	1,219	2.77 %
Loans (2)	2,244,639	25,362	4.53 %	1,815,417	21,025	4.70 %
Total earning assets	2,949,144	30,131	4.10 %	2,615,792	25,446	3.95 %
Cash and due from banks	43,930			54,117		
Premises and equipment	44,493			39,254		
Other assets	160,076			142,049		
Allowance for loan losses	(24,159)			(18,169)		
Total assets	\$ 3,173,484			\$ 2,833,043		
Liabilities and Stockholders' Equity						
Interest-bearing deposits						
Demand deposits	\$ 1,158,531	\$ 602	0.21 %	\$ 1,149,578	\$ 420	0.15 %
Savings deposits	398,371	145	0.15 %	372,732	120	0.13 %
Time deposits	462,988	923	0.80 %	338,705	393	0.47 %
Securities sold under agreements to repurchase	147,633	65	0.18 %	154,192	46	0.12 %
FHLB advances	99,533	475	1.91 %	45,724	168	1.49 %
Fed Funds Purchased	4,140	22	2.13 %	3,291	12	1.36 %
Junior subordinated debt	27,697	349	5.05 %	23,945	227	3.86 %
Other debt	9,375	96	4.11 %	13,115	107	3.30 %
Total interest-bearing liabilities	2,308,268	2,677	0.47 %	2,101,282	1,493	0.29 %
Non interest-bearing demand deposits	502,694			428,279		
Other liabilities	5,174			8,289		
Stockholders' equity	357,348			295,193		
Total liabilities & equity	\$ 3,173,484			\$ 2,833,043		
Net interest income		\$ 27,454			\$ 23,953	
Net interest spread			3.63 %			3.66 %
Impact of non-interest bearing funds			0.10 %			0.05 %
Net yield on interest- earning assets			3.73 %			3.71 %

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

(2) Nonaccrual loans and loans held for sale are included in the average balances. Balances are net of unaccreted discount related to loans acquired.

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	Six months ended June 30, 2018			Six months ended June 30, 2017		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
Assets						
Interest-bearing deposits with other financial institutions	\$ 17,048	\$ 136	1.61 %	\$ 39,824	\$ 177	0.90 %
Federal funds sold	562	3	1.02 %	17,701	61	0.70 %
Certificates of deposit investments	2,105	21	2.04 %	4,976	32	1.30 %
Investment securities:						
Taxable	500,309	6,295	2.52 %	579,657	6,015	2.07 %
Tax-exempt (1)	167,090	2,465	2.95 %	172,360	2,391	2.81 %
Loans (2)	2,101,194	46,369	4.45 %	1,809,942	40,952	4.56 %
Total earning assets	2,788,308	55,289	3.99 %	2,624,460	49,628	3.81 %
Cash and due from banks	47,212			54,801		
Premises and equipment	41,295			39,739		
Other assets	149,453			141,389		
Allowance for loan losses	(22,293)			(17,686)		
Total assets	\$3,003,975			\$2,842,703		
Liabilities and Stockholders' Equity						
Interest-bearing deposits						
Demand deposits	\$ 1,116,810	\$ 1,133	0.20 %	\$ 1,128,273	\$ 789	0.14 %
Savings deposits	381,356	282	0.15 %	369,180	234	0.13 %
Time deposits	400,679	1,517	0.76 %	367,484	789	0.43 %
Securities sold under agreements to repurchase	155,023	124	0.16 %	157,413	86	0.11 %
FHLB advances	83,748	750	1.81 %	42,922	319	1.50 %
Fed Funds Purchased	3,510	35	1.94 %	1,725	12	1.33 %
Junior subordinated debt	25,862	608	4.74 %	23,935	444	3.75 %
Other debt	9,836	191	3.91 %	14,907	230	3.12 %
Total interest-bearing liabilities	2,176,824	4,640	0.43 %	2,105,839	2,903	0.28 %
Non interest-bearing demand deposits	486,930			438,839		
Other liabilities	6,931			7,610		
Stockholders' equity	333,290			290,415		
Total liabilities & equity	\$3,003,975			\$2,842,703		
Net interest income		\$50,649			\$46,725	
Net interest spread			3.56 %			3.53 %
Impact of non-interest bearing funds			0.10 %			0.05 %
Net yield on interest-earning assets			3.66 %			3.58 %

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

(2) Nonaccrual loans and loans held for sale are included in the average balances. Balances are net of unaccreted discount related to loans acquired.

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 three and six-months ended June 30, 2018, compared to the same periods in 2017 (in thousands):

	Three months ended June 30, 2018 compared to 2017			Six months ended June 30, 2018 compared to 2017		
	Total Change	Volume (1)	Rate (1)	Total Change	Volume (1)	Rate (1)
Earning Assets:						
Interest-bearing deposits	\$28	\$(10)	\$38	\$(41)	\$(255)	\$214
Federal funds sold	2	—	2	(58)	(117)	59
Certificates of deposit investments	5	4	1	(11)	(43)	32
Investment securities:						
Taxable	267	(2,353)	2,620	280	(1,943)	2,223
Tax-exempt (2)	46	(43)	89	74	(44)	118
Loans (3)	4,337	9,115	(4,778)	5,417	8,174	(2,757)
Total interest income	4,685	6,713	(2,028)	5,661	5,772	(111)
Interest-Bearing Liabilities:						
Interest-bearing deposits						
Demand deposits	182	3	179	344	(23)	367
Savings deposits	25	8	17	48	9	39
Time deposits	530	182	348	728	77	651
Securities sold under agreements to repurchase	19	(13)	32	38	(4)	42
FHLB advances	307	248	59	431	354	77
Federal Funds Purchased	10	4	6	23	16	7
Junior subordinated debt	122	40	82	164	38	126
Other debt	(11)	(120)	109	(39)	(157)	118
Total interest expense	1,184	352	832	1,737	310	1,427
Net interest income	\$3,501	\$6,361	\$(2,860)	\$3,924	\$5,462	\$(1,538)

(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 have been included in the average balances.

Net interest income increased \$3.9 million, or 8.4%, to \$50.6 million for the six months ended June 30, 2018, from \$46.7 million for the same period in 2017. Net interest income increased primarily due to the growth in average earning assets including loans and investments acquired from First Bank. The net interest margin increased primarily due higher yields on investments.

For the six months ended June 30, 2018, average earning assets increased by \$163.8 million, or 6.2%, and average interest-bearing liabilities increased \$71.0 million or 3.4%, compared with average balances for the same period in 2017.

The changes in average balances for these periods are shown below:

- ▲Average interest-bearing deposits held by the Company decreased \$22.8 million or 57.2%.
- ▲Average federal funds sold decreased \$17.1 million or 96.8%.
- ▲Average certificates of deposits investments decreased \$2.9 million or 57.7%
- ▲Average loans increased by \$291.3 million or 16.1%.
- ▲Average securities decreased by \$84.6 million or 11.3%.
- ▲Average interest-bearing customer deposits increased by \$33.9 million or 1.8%.
- ▲Average securities sold under agreements to repurchase decreased by \$2.4 million or 1.5%.
- ▲Average borrowings and other debt increased by \$39.5 million or 47.3%.
- ▲Net interest margin increased to 3.66% for the first six months of 2018 from 3.58% for the first six months of 2017.

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 (TE) where the interest earned on tax-exempt loans and securities is adjusted to an amount comparable to interest subject to normal income taxes assuming a federal tax rate of 21% (referred to as the tax equivalent adjustment). The year-to-date net yield on interest-earning assets (TE) was 3.73% and 3.72% for the first six months of 2018 and 2017, respectively. The TE adjustments to net interest income for the six months ended June 30, 2018 and 2017 were \$963,000 and \$1,739,000, respectively.

Provision for Loan Losses

The provision for loan losses for the six months ended June 30, 2018 and 2017 was \$2,932,000 and \$3,562,000, respectively. The decrease in provision expense was primarily due to a decrease in net charge-offs. Net charge-offs were \$864,000 for the six months ended June 30, 2018, compared to net charge offs of \$2,106,000 for June 30, 2017. Nonperforming loans were \$24.7 million and \$17.1 million as of June 30, 2018 and 2017, respectively. For information on loan loss experience and nonperforming loans, see discussion under the “Nonperforming Loans” and “Loan Quality and Allowance for Loan Losses” sections below.

Other Income

An important source of the Company’s revenue is other income. The following table sets forth the major components of other income for the three and six-months ended June 30, 2018 and 2017 (in thousands):

	Three months ended June 30,			Six months ended June 30,		
	2018	2017	\$ Change	2018	2017	\$ Change
Trust revenues	\$938	\$841	\$ 97	\$2,015	\$1,771	\$ 244
Brokerage commissions	661	509	152	1,326	1,014	312
Insurance commissions	838	853	(15)	2,325	2,478	(153)
Service charges	1,803	1,690	113	3,438	3,402	36
Security gains, net	881	335	546	901	335	566
Mortgage banking revenue, net	410	335	75	571	528	43
ATM / debit card revenue	1,860	1,665	195	3,464	3,233	231
Bank Owned Life Insurance	315	282	33	591	563	28
Other	655	1,459	(804)	1,217	2,141	(924)
Total other income	\$8,361	\$7,969	\$ 392	\$15,848	\$15,465	\$ 383

Following are explanations of the changes in these other income categories for the three months ended June 30, 2018 compared to the same period in 2017:

Trust revenues increased \$97,000 or 11.5% to \$938,000 from \$841,000 primarily due to an increase in revenue from defined contribution and other retirement accounts based on increases in the market value of the assets.

- Trust assets, at market value, were \$998.0 million at June 30, 2018 compared to \$881.5 million at June 30, 2017.

- Revenues from brokerage increased \$152,000 or 29.9% to \$661,000 from \$509,000 primarily due to an increase in the number of brokerage accounts from new business development efforts.

Insurance commissions decreased \$15,000 or 1.8% to \$838,000 from \$853,000 primarily due to a decrease in commissions and contingency income received from carriers based on claims experience during 2018 compared to 2017.

Fees from service charges increased \$113,000 or 6.7% to \$1,803,000 from \$1,690,000 primarily due to a increase in income from the First Bank acquisition offset by a decrease in service charges based on the number of deposit transactions.

The sale of securities during the three months ended June 30, 2018 resulted in net securities gains of \$881,000 compared to \$335,000 during the three months ended June 30, 2017.

Mortgage banking income increased \$75,000 or 22.4% to \$410,000 from \$335,000. Loans sold balances were as follows:

\$16.9 million (representing 136 loans) for the three months ended June 30, 2018

\$17.7 million (representing 138 loans) for the three months ended June 30, 2017

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

Revenue from ATMs and debit cards increased \$195,000 or 11.7% to \$1,860,000 from \$1,665,000 due to an increase in electronic transactions.

Bank owned life insurance income increased \$33,000 or 11.7%.

Other income decreased \$804,000 or 55.1% to \$655,000 from \$1,459,000 primarily due to income tax refunds received in 2017 resulting from overpayment of taxes in 2016 by First Clover Leaf Financial and a decline in loan late charges and closing fees resulting from less loan transaction activity.

Following are explanations of the changes in these other income categories for the six months ended June 30, 2018 compared to the same period in 2017:

Trust revenues increased \$244,000 or 13.8% to \$2,015,000 from \$1,771,000 primarily from an increase in revenue from defined contribution and other retirement accounts due to increases in the market value of the assets. Trust assets, at market value, were \$998.0 million at June 30, 2018 compared to \$881.5 million at June 30, 2017.

Revenues from brokerage increased \$312,000 or 30.8% to \$1,326,000 from \$1,014,000 primarily due to an increase in the number of brokerage accounts from new business development efforts.

Insurance commissions decreased \$153,000 or 6.2% to \$2,325,000 from \$2,478,000 primarily due to a decrease in commissions and contingency income received from carriers based on claims experience during 2018 compared to 2017.

Fees from service charges increased \$36,000 or 1.1% to \$3,438,000 from \$3,402,000 primarily due to a increase in income from the First Bank acquisition offset by a decrease in service charges based on the number of deposit transactions.

The sale of securities during the six months ended June 30, 2018 resulted in net securities gains of \$901,000 compared to \$335,000 during the six months ended June 30, 2017.

Mortgage banking income increased \$43,000 or 8.1% to \$571,000 from \$528,000. Loans sold balances were as follows:

\$28.4 million (representing 222 loans) for the six months ended June 30, 2018

\$31.5 million (representing 241 loans) for the six months ended June 30, 2017

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

Revenue from ATMs and debit cards increased \$231,000 or 7.1% to \$3,464,000 from \$3,233,000 due to an increase in electronic transactions.

Bank owned life insurance income increased \$28,000 or 5.0%.

Other income decreased \$924,000 or 43.2% to \$1,217,000 from \$2,141,000 primarily due to income tax refunds received in 2017 resulting from overpayment of taxes in 2016 by First Clover Leaf Financial and a decline in loan late charges and closing fees resulting from less loan transaction activity.

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 three and six-months ended June 30, 2018 and 2017 (in thousands):

	Three months ended June 30,			Six months ended June 30,		
	2018	2017	\$ Change	2018	2017	\$ Change
Salaries and employee benefits	\$11,057	\$10,102	\$955	\$21,251	\$20,037	\$1,214
Net occupancy and equipment expense	3,505	3,116	389	6,778	6,249	529
Net other real estate owned expense	7	127	(120)	83	145	(62)
FDIC insurance	285	290	(5)	566	469	97
Amortization of intangible assets	716	559	157	1,221	1,106	115
Stationery and supplies	186	186	—	397	371	26
Legal and professional	1,717	894	823	2,854	1,725	1,129
Marketing and donations	431	277	154	785	571	214
Other operating expenses	2,892	2,404	488	5,235	6,484	(1,249)
Total other expense	\$20,796	\$17,955	\$2,841	\$39,170	\$37,157	\$2,013

Following are explanations for the changes in these other expense categories for the three months ended June 30, 2018 compared to the same period in 2017:

Salaries and employee benefits, the largest component of other expense, increased \$955,000 or 9.5% to \$11,057,000 from \$10,102,000. The increase is primarily due to the addition of 112 employees with the First Bank acquisition on May 1, 2018 and merit increases in 2018 for continuing employees during the first quarter of 2018. There were 711 and 590 full-time equivalent employees at June 30, 2018 and 2017, respectively.

Occupancy and equipment expense increased \$389,000 or 12.5% to \$3,505,000 from \$3,116,000. The increase was primarily due to increases maintenance and repair expense, rent expense, and building insurance related to the acquisition of First Bank during the second quarter of 2018.

Net other real estate owned expense decreased \$120,000 or 94.5% to \$7,000 from \$127,000. The decrease in 2018 was primarily due to more losses on properties sold during 2017 than properties sold in 2018.

Expense for amortization of intangible assets increased \$157,000 or 28.1% to \$716,000 from \$559,000 for the three months ended June 30, 2018 and 2017, respectively. The increase in 2018 was due to additional core deposit intangibles amortization from the acquisition of First Bank.

- Other operating expenses increased \$488,000 or 20.3% to \$2,892,000 in 2018 from \$2,404,000 in 2017 primarily due costs associated with the acquisition of First Bank.

On a net basis, all other categories of operating expenses increased \$972,000 or 59.0% to \$2,619,000 in 2018 from \$1,647,000 in 2017. The increase is primarily due to an increase in legal and professional fees primarily associated with the acquisition of First Bank.

Following are explanations for the changes in these other expense categories for the six months ended June 30, 2018 compared to the same period in 2017:

Salaries and employee benefits, the largest component of other expense, increased \$1,214,000 or 6.1% to \$21,251,000 from \$20,037,000. The increase is primarily due to the addition of 112 employees with the First Bank acquisition and merit increases in 2018 for continuing employees during the first quarter of 2018. There were 711 and 590 full-time equivalent employees at June 30, 2018 and 2017, respectively.

Occupancy and equipment expense increased \$529,000 or 8.5% to \$6,778,000 from \$6,249,000. The increase was primarily due to increases maintenance and repair expense, rent expense, and building insurance related to the acquisition of First Bank.

Net other real estate owned expense decreased \$62,000 or 42.8% to \$83,000 from \$145,000. The increase in 2018 was primarily due to losses on properties sold during 2017.

Expense for amortization of intangible assets increased \$115,000 or 10.4% to \$1,221,000 from \$1,106,000 for the six months ended June 30, 2018 and 2017, respectively. The increase in 2018 was due to amortization of core deposit intangibles from the First Bank acquisition.

Other operating expenses decreased \$1,249,000 or 19.3% to \$5,235,000 in 2018 from \$6,484,000 in 2017 primarily due costs associated with the merger of First Clover Leaf Bank into First Mid Bank during the first quarter of 2017.

On a net basis, all other categories of operating expenses increased \$1,466,000 or 46.7% to \$4,602,000 in 2018 from \$3,136,000 in 2017. The increase is primarily due to an increase in legal and professional fees primarily associated with the acquisition of First Bank.

Income Taxes

Total income tax expense amounted to \$6.0 million (24.4% effective tax rate) for the six months ended June 30, 2018, compared to \$7.0 million (32.6% effective tax rate) for the same period in 2017. The decline in effective tax rate for the six months ended June 30, 2018 compared to the same period in 2017 is primarily due to a change in the federal statutory corporate tax rate from 35% to 21% effective January 1, 2018 following the enactment of certain tax reforms through the Tax Cuts and Jobs Act, offset by an increase in State of Illinois tax rate from 7.75% to 9.50% beginning July 1, 2017.

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 2015.

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 as of June 30, 2018 and December 31, 2017 (dollars in thousands):

	June 30, 2018			December 31, 2017		
	Amortized Cost	Weighted Average Yield	%	Amortized Cost	Weighted Average Yield	%
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 196,725	2.14	%	\$ 185,128	1.98	%
Obligations of states and political subdivisions	176,376	2.99	%	165,037	2.86	%
Mortgage-backed securities: GSE residential	323,238	2.84	%	295,778	2.59	%
Trust preferred securities	—	—	%	2,893	2.15	%
Other securities	2,187	3.25	%	2,039	2.50	%
Total securities	\$ 698,526	2.68	%	\$ 650,875	2.55	%

At June 30, 2018, the Company's investment portfolio increased by \$47.7 million from December 31, 2017 primarily due to securities added in the acquisition of First Bank, net of declines due to securities that were sold to provide cash flow to fund loans. 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 June 30, 2018 for certain investment securities (in thousands):

	Amortized Cost	Average Credit Rating of Fair Value at June 30, 2018						
		Estimated (1) Fair Value	AAA	AA +/-	A +/-	BBB +/-	< BBB	Not rated
Available-for-sale:								
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 127,342	\$ 123,038	\$—	\$ 123,038	\$—	\$—	\$—	\$—
Obligations of state and political subdivisions	176,376	175,240	13,041	108,364	51,733	494	—	1,608
Mortgage-backed securities (2)	323,238	315,671	1,018	—	—	—	—	314,653
Other securities	2,187	2,354	—	—	—	2,013	—	341
Total available-for-sale	\$ 629,143	\$ 616,303	\$ 14,059	\$ 231,402	\$ 51,733	\$ 2,507	\$—	\$ -316,602
Held-to-maturity:								
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 69,383	\$ 67,525	\$—	\$ 67,525	\$—	\$—	\$—	\$—

(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.

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 3 -- Investment Securities in the Notes to Condensed Consolidated Financial Statements (unaudited) for a discussion of the Company's evaluation and subsequent 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, as of June 30, 2018 and December 31, 2017 (in thousands):

	June 30, 2018	% Outstanding Loans		December 31, 2017	% Outstanding Loans	
Construction and land development	\$88,481	3.7	%	\$ 107,594	5.5	%
Agricultural real estate	184,887	7.8	%	127,183	6.6	%
1-4 Family residential properties	378,573	15.9	%	293,667	15.1	%
Multifamily residential properties	105,948	4.5	%	61,798	3.2	%
Commercial real estate	803,362	33.8	%	681,757	35.2	%
Loans secured by real estate	1,561,251	65.7	%	1,271,999	65.6	%
Agricultural loans	113,533	4.8	%	86,631	4.5	%
Commercial and industrial loans	502,211	21.1	%	444,263	22.9	%
Consumer loans	59,090	2.5	%	29,749	1.5	%
All other loans	140,598	5.9	%	106,859	5.5	%
Total loans	\$2,376,683	100.0	%	\$ 1,939,501	100.0	%

Overall loan balances increased \$437.2 million, or 22.54% primarily due to the loans acquired from First Bank. The balance of real estate loans held for sale, included in the balances shown above, amounted to \$2,454,000 and \$1,025,000 as of June 30, 2018 and December 31, 2017, 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 June 30, 2018 and December 31, 2017 (dollars in thousands):

	June 30, 2018			December 31, 2017		
	Principal balance	% Outstanding Loans	%	Principal balance	% Outstanding loans	%
Central region	568,215	23.9	%	543,938	28.0	%
Sullivan region	176,612	7.4	%	167,977	8.7	%
Decatur region	750,960	31.6	%	378,867	19.5	%
Peoria region	213,988	9.0	%	189,639	9.8	%
Highland region	529,760	22.3	%	525,983	27.1	%
Southern region	137,148	5.8	%	133,097	6.9	%
Total all regions	\$2,376,683	100.0	%	\$ 1,939,501	100.0	%

Loans are geographically dispersed among these regions located in central and southwestern Illinois. While these regions have experienced some economic stress during 2018 and 2017, 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 June 30, 2018 and December 31, 2017, the Company did have industry loan concentrations in excess of 25% of total risk-based capital in the following industries (dollars in thousands):

	June 30, 2018			December 31, 2017		
	Principal balance	% Outstanding Loans	%	Principal balance	% Outstanding Loans	%
Other grain farming	\$172,331	7.25	%	\$170,758	8.80	%
Lessors of non-residential buildings	189,740	7.98	%	185,967	9.59	%
Lessors of residential buildings & dwellings	130,016	5.47	%	131,756	6.79	%
Hotels and motels	121,052	5.09	%	131,702	6.79	%
Other Gambling Industries	95,407	4.01	%	95,713	4.93	%

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

The following table presents the balance of loans outstanding as of June 30, 2018, by contractual maturities (in thousands):

	Maturity (1)			Total
	One year or less(2)	Over 1 through 5 years	Over 5 years	
Construction and land development	\$71,002	\$5,645	\$11,834	\$88,481
Agricultural real estate	11,012	48,883	124,992	184,887
1-4 Family residential properties	32,190	84,066	262,317	378,573
Multifamily residential properties	16,463	51,782	37,703	105,948
Commercial real estate	75,866	322,140	405,356	803,362
Loans secured by real estate	206,533	512,516	842,202	1,561,251
Agricultural loans	86,478	24,409	2,646	113,533
Commercial and industrial loans	179,346	272,382	50,483	502,211
Consumer loans	5,588	46,324	7,178	59,090
All other loans	29,278	37,530	73,790	140,598
Total loans	\$507,223	\$893,161	\$976,299	\$2,376,683

(1) Based upon remaining contractual maturity.

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

As of June 30, 2018, loans with maturities over one year consisted of approximately \$1.5 billion in fixed rate loans and approximately \$383 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 at June 30, 2018 and December 31, 2017 (in thousands):

	June 30, 2018	December 31, 2017		
Nonaccrual loans	\$21,650	\$ 16,659		
Restructured loans which are performing in accordance with revised terms	3,079	854		
Total nonperforming loans	24,729	17,513		
Repossessed assets	2,508	2,834		
Total nonperforming loans and repossessed assets	\$27,237	\$ 20,347		
Nonperforming loans to loans, before allowance for loan losses	1.04	% 0.90	%	
Nonperforming loans and repossessed assets to loans, before allowance for loan losses	1.15	% 1.05	%	

The \$4,991,000 increase in nonaccrual loans during 2018 resulted from the net of \$6,754,000 of loans put on nonaccrual status including \$2,242,000 acquired from First Bank offset by \$2,338,000 of loans becoming current or paid-off, \$133,000 of loans transferred to other real estate and \$533,000 of loans charged off.

The following table summarizes the composition of nonaccrual loans (in thousands):

	June 30, 2018		December 31, 2017		
	Balance	% of Total	Balance	% of Total	
Construction and land development	\$58	0.3 %	\$—	— %	
Agricultural real estate	235	1.1 %	291	1.7 %	
1-4 Family residential properties	4,323	20.0 %	2,687	16.1 %	
Multifamily Residential properties	301	1.4 %	368	2.2 %	
Commercial real estate	7,909	36.5 %	5,596	33.6 %	
Loans secured by real estate	12,826	59.3 %	8,942	53.6 %	
Agricultural loans	1,109	5.1 %	757	4.5 %	
Commercial and industrial loans	7,365	34.0 %	6,658	40.1 %	
Consumer loans	329	1.5 %	302	1.8 %	
All Other Loans	21	0.1 %	—	— %	
Total loans	\$21,650	100.0 %	\$ 16,659	100.0 %	

Interest income that would have been reported if nonaccrual and restructured loans had been performing totaled \$758,000 and \$140,000 for the six months ended June 30, 2018 and 2017, respectively.

The \$326,000 decrease in repossessed assets during the first six months of 2018 resulted from the net of \$625,000 of assets acquired from First Bank, \$217,000 of additional assets repossessed, \$12,000 of write downs and \$1,156,000 of

repossessed assets sold.

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The following table summarizes the composition of repossessed assets (in thousands):

	June 30, 2018		December 31, 2017	
	Balance	% of Total	Balance	% of Total
Construction and land development	\$1,920	76.6 %	\$1,781	62.7 %
1-4 family residential properties	520	20.7 %	413	14.6 %
Commercial real estate	—	— %	560	19.8 %
Total real estate	2,440	97.3 %	2,754	97.1 %
Commercial & industrial loans	—	— %	44	1.6 %
Consumer loans	68	2.7 %	36	1.3 %
Total repossessed collateral	\$2,508	100.0 %	\$2,834	100.0 %

Repossessed assets sold during the first six months of 2018 resulted in net losses of \$11,000, of which \$23,000 of net losses was related to real estate asset sales and \$12,000 of net gains was related to other repossessed assets.

Repossessed assets sold during the same period in 2017 resulted in net gains of \$4,000, all of \$9,000 of net losses was related to real estate asset sales and \$13,000 of net gains was related to other repossessed assets.

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. Factors considered by management in evaluating the overall adequacy of the allowance include a migration analysis of the historical net loan losses by loan segment, 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.

Management reviews economic factors including 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, 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 June 30, 2018, the Company's loan portfolio included \$299.0 million of loans to borrowers whose businesses are directly related to agriculture. Of this amount, \$172.3 million was concentrated in other grain farming. Total loans to borrowers whose businesses are directly related to agriculture increased \$85.24 million from \$213.8 million at December 31, 2017 while loans concentrated in other grain farming increased \$1.5 million from \$170.8 million at December 31, 2017. 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 \$121.1 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 \$189.7 million of loans to lessors of non-residential buildings, \$130.0 million of loans to lessors of residential buildings and dwellings, and \$95.4 million of loans to other gambling industries.

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. The board of directors and management review the status of problem loans each month and formally determine a best estimate of the allowance for loan losses on a quarterly basis. 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 as of June 30, 2018 and 2017, and of changes in the allowance for the three and six month periods ended June 30, 2018 and 2017, is as follows (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,		
	2018	2017	2018	2017	
Average loans outstanding, net of unearned income	\$2,244,639	\$1,805,619	\$2,101,194	\$1,815,417	
Allowance-beginning of period	20,771	17,846	19,977	16,753	
Charge-offs:					
Real estate-mortgage	588	162	780	351	
Commercial, financial & agricultural	3	1,421	151	1,893	
Installment	43	50	83	72	
Other	85	85	181	165	
Total charge-offs	719	1,718	1,195	2,481	
Recoveries:					
Real estate-mortgage	55	161	56	171	
Commercial, financial & agricultural	(2)	37	121	51	
Installment	11	6	35	10	
Other	52	37	119	143	
Total recoveries	116	241	331	375	
Net charge-offs (recoveries)	603	1,477	864	2,106	
Provision for loan losses	1,877	1,840	2,932	3,562	
Allowance-end of period	\$22,045	\$18,209	\$22,045	\$18,209	
Ratio of annualized net charge-offs to average loans	0.11	% 0.33	% 0.08	% 0.46	%
Ratio of allowance for loan losses to loans outstanding (less unearned interest at end of period)	0.93	% 1.00	% 0.93	% 1.00	%
Ratio of allowance for loan losses to nonperforming loans	89	% 106	% 89	% 106	%

The ratio of allowance for loan losses to loans outstanding was 0.93% as of June 30, 2018 compared to 1.00% as of June 30, 2017. The ratio of the allowance for loan losses to nonperforming loans is 89% as of June 30, 2018 compared to 106% as of June 30, 2017. The decrease in this ratio is primarily due to an increase in loan balances and the increase in nonperforming loans to \$24.7 million at June 30, 2018 from \$17.1 million at June 30, 2017 including \$6.6

million in non-performing loans acquired from First Bank.

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During the first six months of 2018, the Company had net charge-offs of \$864,000 compared to net charge-offs of \$2,106,000 in 2017. During the first six months of 2018, there were significant charge offs of two commercial loans to a single borrower of \$126,000 and charge offs of two residential real estate loans to two borrowers of \$376,000. During the first six months of 2017, there were charge offs of commercial real estate loans to two borrowers of \$215,000, charge offs of two agricultural loans to one borrower of \$662,000, and charge offs of five commercial operating loans to two borrowers of \$1,052,000.

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 six months ended June 30, 2018 and 2017 and for the year ended December 31, 2017 (dollars in thousands):

	Six months ended June 30, 2018		Six months ended June 30, 2017		Year ended December 31, 2017	
	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate
Demand deposits:						
Non-interest-bearing	\$486,930	— %	\$438,839	— %	\$438,575	— %
Interest-bearing	1,116,810	0.20 %	1,128,273	0.14 %	1,119,835	0.16 %
Savings	381,356	0.15 %	369,180	0.13 %	367,261	0.13 %
Time deposits	400,679	0.76 %	367,484	0.43 %	348,278	0.49 %
Total average deposits	\$2,385,775	0.25 %	\$2,303,776	0.16 %	\$2,273,949	0.18 %

The following table sets forth the high and low month-end balances for the six months ended June 30, 2018 and 2017 and for the year ended December 31, 2017 (in thousands):

	Six months ended June 30, 2018	Six months ended June 30, 2017	Year ended December 31, 2017
High month-end balances of total deposits	\$2,670,864	\$2,331,084	\$2,331,084
Low month-end balances of total deposits	2,208,941	2,282,214	2,217,477

During the first six months of 2018, the average balance of deposits increased by \$111.8 million from the average balance for the year ended December 31, 2017. Average non-interest bearing deposits increased by \$48.4 million, average interest-bearing balances decreased by \$3.0 million, savings account balances increased \$14.1 million and balances of time deposits increased \$52.4 million. The increases were primarily due to the result of deposit balances acquired in the acquisition of First Bank during the second quarter of 2018.

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 at June 30, 2018 and December 31, 2017 (in thousands):

	June 30, 2018	December 31, 2017
3 months or less	\$51,229	\$ 31,467
Over 3 through 6 months	76,406	34,194
Over 6 through 12 months	69,585	54,607

Over 12 months	66,357	46,805
Total	\$263,577	\$ 167,073

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Repurchase Agreements and Other Borrowings

Securities sold under agreements to repurchase are short-term obligations of First Mid Bank. These obligations are collateralized with certain government securities that are direct obligations of the United States or one of its agencies. These retail repurchase agreements are offered 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 of June 30, 2018 and December 31, 2017 is presented below (dollars in thousands):

	June 30, 2018	December 31, 2017		
Securities sold under agreements to repurchase	\$ 141,662	\$ 155,388		
Federal Home Loan Bank advances:				
Fixed term – due in one year or less	14,000	—		
Fixed term – due after one year	81,708	60,038		
Debt:				
Debt due after one year	9,375	10,313		
Junior subordinated debentures	28,792	24,000		
Total	\$ 275,537	\$ 249,739		
Average interest rate at end of period	1.26	%	1.00	%
Maximum outstanding at any month-end:				
Securities sold under agreements to repurchase	\$ 178,587	\$ 163,626		
Federal funds purchased	11,750	20,000		
Federal Home Loan Bank advances:				
FHLB-Overnight	30,000	30,000		
Fixed term – due in one year or less	14,000	5,000		
Fixed term – due after one year	86,016	60,061		
Debt:				
Debt due in one year or less	—	4,000		
Debt due after one year	10,313	14,063		
Junior subordinated debentures	30,221	24,000		
Averages for the period (YTD):				
Securities sold under agreements to repurchase	\$ 155,023	\$ 144,674		
Federal funds purchased	3,510	3,996		
Federal Home Loan Bank advances:				
FHLB-overnight	14,740	8,598		
Fixed term – due in one year or less	4,663	2,356		
Fixed term – due after one year	64,345	46,452		
Debt:				
Loans due in one year or less	—	658		
Loans due after one year	9,836	12,632		
Junior subordinated debentures	25,862	23,956		
Total	\$ 277,979	\$ 243,322		
Average interest rate during the period	1.23	%	1.02	%

Securities sold under agreements to repurchase decreased \$13.7 million during the first six months of 2018 primarily due to the seasonal declines in balances and cash flow needs of various customers. FHLB advances represent borrowings by First Mid Bank and First Bank to economically fund loan demand.

At June 30, 2018 the fixed term advances consisted of \$96 million as follows:

\$5 million advance with a 3-month maturity, at 2.11%, due August 23, 2018
 \$5 million advance with a 6-month maturity, at 2.10%, due October 16, 2018
 \$10 million advance with a 3-year maturity, at 1.42%, due November 5, 2018
 \$5 million advance with a 1.5-year maturity, at 1.49%, due December 28, 2018
 \$4 million advance with a 3-year maturity, at 1.72% due April 12, 2019
 \$5 million advance with a 2-year maturity, at 1.56%, due June 28, 2019
 \$5 million advance with a 15-month maturity, at 2.63%, due September 27, 2019
 \$2 million advance with a 5-year maturity, at 1.89%, due October 17, 2019
 \$5 million advance with a 1.5-year maturity, at 2.67%, due December 27, 2019
 \$5 million advance with a 2.5-year maturity, at 1.67%, due January 31, 2020
 \$5 million advance with a 4-year maturity, at 1.79%, due April 30, 2020
 \$5 million advance with a 2-year maturity, at 2.75%, due June 26, 2020
 \$5 million advance with a 3-year maturity, at 1.75%, due July 31, 2020
 \$5 million advance with a 6-year maturity, at 2.30%, due August 24, 2020
 \$5 million advance with a 3.5-year maturity, at 1.83%, due February 1, 2021
 \$5 million advance with a 5-year maturity, at 1.85%, due April 12, 2021
 \$5 million advance with a 7-year maturity, at 2.55%, due October 1, 2021
 \$5 million advance with a 5-year maturity, at 2.71%, due March 21, 2022
 \$5 million advance with a 8-year maturity, at 2.40%, due January 9, 2023

The Company is party to a revolving credit agreement with The Northern Trust Company in the amount of \$10 million. The balance on this line of credit was \$0 as of June 30, 2018. This loan was renewed on April 13, 2018 for one year as a revolving credit agreement with a maximum available balance of \$10 million. The interest rate is floating at 2.25% over the federal funds rate (4.16% at June 30, 2018). The loan is secured by all of the stock of First Mid Bank. The Company and First Mid Bank were in compliance with the then existing covenants at June 30, 2018 and 2017 and December 31, 2017.

On September 7, 2016, the Company entered into a credit agreement with The Northern Trust Company in the amount of \$15 million as a fixed-rate note with a maturity date of September 7, 2020. This credit agreement was amended and restated on April 13, 2018. The interest rate is floating at 2.25% over the federal funds rate (4.16% at June 30, 2018) and interest and principal payments are due quarterly. As of June 30, 2018, the balance due was \$9.4 million. The loan is secured by all of the stock of First Mid Bank. The Company used the proceeds of this note to fund the cash portion of the acquisition price of First Clover Leaf. The Company and First Mid Bank were in compliance with the then existing covenants at June 30, 2018 and December 31, 2017.

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 (4.01% and 4.21% at June 30, 2018 and December 31, 2017), 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, 3.94% and 3.19% at June 30, 2018 and December 31, 2017, respectively). The net proceeds to the Company were used for general corporate purposes, including the Company’s acquisition of Mansfield Bancorp, Inc. in 2006.

On September 8, 2016, the Company assumed the trust preferred securities of Clover Leaf Statutory Trust I (“CLST I”), a statutory business trust that was a wholly owned unconsolidated subsidiary of First Clover Financial. The \$4,000,000 of trust preferred securities and an additional \$124,000 additional investment in common equity of CLST I, is invested in junior subordinated debentures issued to CLST I. The subordinated debentures mature in 2025, bear interest at three-month LIBOR plus 185 basis points (4.19% and 3.44% at June 30, 2018 and December 31, 2017, respectively) and resets quarterly.

On May 1, 2018, the Company assumed the trust preferred securities of FBTC Statutory Trust I (“FBTCST I”), a statutory business trust that was a wholly owned unconsolidated subsidiary of First BancTrust Corporation. The \$6,000,000 of trust preferred securities and an additional \$186,000 additional investment in common equity of FBTCST I is invested in junior subordinated debentures issued to FBTCST I. The subordinated debentures mature in 2035, bear interest at three-month LIBOR plus 170 basis points (4.04% and 3.29% at June 30, 2018 and December 31, 2017, respectively) and resets quarterly.

The trust preferred securities issued by Trust I, Trust II, CLST I and FBTCST I 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. Similarly, the final rule implementing the Basel III reforms allows holding companies with less than \$15 billion in consolidated assets as of December 31, 2009 to continue to count toward Tier 1 capital any trust preferred securities issued before May 19, 2010. New issuances of trust preferred securities, however would not count as Tier 1 regulatory capital.

In addition to requirements of the Dodd-Frank Act discussed above, the act also required the federal banking agencies to adopt rules that prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (defined as hedge funds and private equity funds). This rule is generally referred to as the “Volcker Rule.” On December 10, 2013, the federal banking agencies issued final rules to implement the prohibitions required by the Volcker Rule. Following the publication of the final rule, and in reaction to concerns in the banking industry regarding the adverse impact the final rule’s treatment of certain collateralized debt instruments has on community banks, the federal banking agencies approved an interim final rule to permit banking entities to retain interests in certain collateralized debt obligations backed primarily by trust preferred securities.

Under the interim final rule, the agencies permit the retention of an interest in or sponsorship of covered funds by banking entities under \$15 billion in assets if (1) the collateralized debt obligation was established and issued prior to May 19, 2010, (2) the banking entity reasonably believes that the offering proceeds received by the collateralized debt obligation were invested primarily in qualifying trust preferred collateral, and (3) the banking entity's interests in the collateralized debt obligation was acquired on or prior to December 10, 2013. Although the Volcker Rule impacts many large banking entities, the Company does not currently anticipate that the Volcker Rule will have a material effect on the operations of the Company or First Mid Bank.

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 June 30, 2018 (dollars in thousands):

	Rate Sensitive Within						Total	Fair Value
	1 year	1-2 years	2-3 years	3-4 years	4-5 years	Thereafter		
Interest-earning assets:								
Federal funds sold and other interest-bearing deposits	\$38,658	\$—	\$—	\$—	\$—	\$—	\$38,658	\$38,658
Certificates of deposit investments	1,490	490	950	—	—	—	2,930	2,930
Taxable investment securities	341	1	16,476	31,315	27,070	435,244	510,447	508,588
Nontaxable investment securities	—	923	2,849	5,786	2,375	163,306	175,239	175,240
Loans	880,537	281,769	350,053	273,919	270,514	319,891	2,376,683	2,323,768
Total	\$921,026	\$283,183	\$370,328	\$311,020	\$299,959	\$918,441	\$3,103,957	\$3,049,184
Interest-bearing liabilities:								
Savings and NOW accounts	\$296,671	\$102,242	\$102,242	\$102,242	\$102,242	\$481,008	\$1,186,647	\$1,186,647
Money market accounts	314,067	19,028	19,028	19,028	19,028	44,380	434,559	434,559
Other time deposits	364,682	85,932	40,077	17,822	13,419	1,609	523,541	521,119
Short-term borrowings/debt	141,662	—	—	—	—	—	141,662	141,645
Long-term borrowings/debt	72,154	26,900	19,865	9,956	5,000	—	133,875	128,279
Total	\$1,189,236	\$234,102	\$181,212	\$149,048	\$139,689	\$526,997	\$2,420,284	\$2,412,249
Rate sensitive assets – rate	\$(268,210)	\$49,081	\$189,116	\$161,972	\$160,270	\$391,444	\$683,673	

sensitive liabilities							
Cumulative GAP	(268,210)	(219,129)	(30,013)	131,959	292,229	683,673	
Cumulative amounts as % of total Rate sensitive assets	(8.6)	% 1.6	% 6.1	% 5.2	% 5.2	% 12.6	%
Cumulative Ratio	(8.6)	% (7.1)	% (1.0)	% 4.3	% 9.4	% 22.0	%

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The static GAP analysis shows that at June 30, 2018, 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 and First 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 June 30, 2018, the Company's stockholders' equity increased \$103 million, or 34%, to \$411 million from \$308 million as of December 31, 2017. During the first six months of 2018, net income contributed \$18.4 million to equity before the payment of dividends to stockholders, stock issued in the acquisition for First Bank contributed \$61.4 million and stock issued following the capital raise, net of direct issuance costs, contributed \$34 million. The change in market value of available-for-sale investment securities decreased stockholders' equity by \$7.0 million, net of tax.

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 and First 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 regulatory capital standards to ensure capital adequacy require the the Company and its subsidiary bank to maintain a minimum capital amounts and ratios (set forth in the table below). Management believes that, as of June 30, 2018 and December 31, 2017, the Company, First Mid Bank, and First Bank met all capital adequacy requirements.

To be categorized as well-capitalized, total risk-based capital, Tier 1 risk-based capital, common equity Tier 1 risk-based capital and Tier 1 leverage ratios must be maintained as set forth in the following table (dollars in thousands):

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	Actual		Required Minimum For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
June 30, 2018						
Total Capital (to risk-weighted assets)						
Company	\$377,616	13.97%	\$266,848	> 9.875%	N/A	N/A
First Mid Bank	290,953	12.55	228,997	> 9.875	\$231,895	> 10.00%
First Bank & Trust	44,809	11.98	36,945	> 9.875	37,413	> 10.00%
Tier 1 Capital (to risk-weighted assets)						
Company	355,572	13.16	212,803	> 7.875	N/A	N/A
First Mid Bank	269,228	11.61	182,618	> 7.875	185,516	> 8.00
First Bank & Trust	44,490	11.89	29,463	> 7.875	29,930	> 8.00
Common Equity Tier 1 Capital (to risk-weighted assets)						
Company	325,572	12.05	172,269	> 6.375	N/A	N/A
First Mid Bank	269,228	11.61	147,833	> 6.375	150,732	> 6.50
First Bank & Trust	44,490	11.89	23,851	> 6.375	24,318	> 6.50
Tier 1 Capital (to average assets)						
Company	355,572	10.99	129,362	> 4.00	N/A	N/A
First Mid Bank	269,228	9.71	110,939	> 4.00	138,673	> 5.00
First Bank & Trust	44,490	9.80	18,156	> 4.00	22,696	> 5.00
December 31, 2017						
Total Capital (to risk-weighted assets)						
Company	\$290,843	12.70%	\$211,848	> 9.25%	N/A	N/A
First Mid Bank	282,621	12.39	211,064	> 9.25	\$228,177	> 10.00%
Tier 1 Capital (to risk-weighted assets)						
Company	270,866	11.83	166,043	> 7.25	N/A	N/A
First Mid Bank	262,644	11.51	165,428	> 7.25	182,542	> 8.00
Common Equity Tier 1 Capital (to risk-weighted assets)						
Company	246,866	10.78	131,690	> 5.75	N/A	N/A
First Mid Bank	262,644	11.51	131,202	> 5.75	148,315	> 6.50
Tier 1 Capital (to average assets)						
Company	270,866	9.91	109,381	> 4.00	N/A	N/A
First Mid Bank	262,644	9.63	109,113	> 4.00	136,392	> 5.00

The Company's risk-weighted assets, capital and capital ratios for June 30, 2018 are computed in accordance with Basel III capital rules which were effective January 1, 2015. Prior periods are computed following previous rules. See heading "Basel III" in the Overview section of this report for a more detailed description of the Basel III rules. As of June 30, 2018, both the Company, First Mid Bank, and First Bank had capital ratios above the required minimums for regulatory capital adequacy, and First Mid Bank had capital ratios that qualified it for treatment as well-capitalized under the regulatory framework for prompt corrective action with respect to banks.

Stock Plans

Participants may purchase Company stock under the following four plans of the Company: the Deferred Compensation Plan, the First Retirement and Savings Plan, the Dividend Reinvestment Plan, and the Stock Incentive

Plan. For more detailed information on these plans, refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

At the Annual Meeting of Stockholders held April 26, 2017, the stockholders approved the 2017 Stock Incentive Plan ("SI Plan"). The SI Plan was implemented to succeed the Company's 2007 Stock Incentive Plan, which had a ten-year term. 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.

A maximum of 149,983 shares of common stock may be issued under the SI Plan. There were no stock options granted in 2017 or 2016. The Company awarded 13,250 restricted stock awards during 2018 and 15,450 and 18,391 as stock unit awards during 2018 and 2017, respectively.

Employee Stock Purchase Plan

At the Annual Meeting of Stockholders held April 25, 2018, the stockholders approved the First Mid-Illinois Bancshares, Inc. Employee Stock Purchase Plan ("ESPP"). The ESPP is intended to promote the interests of the Company by providing eligible employees with the opportunity to purchase shares of common stock of the Company at a 5% discount through payroll deductions. The ESPP is also intended to qualify as an employee stock purchase plan under Section 423 of the Internal Revenue Code. A maximum of 600,000 shares of common stock may be issued under the ESPP.

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 \$76.7 million of the Company's common stock. The repurchase programs approved by the Board of Directors are as follows:

- On August 5, 1998, repurchases of up to 3%, or \$2 million, of the Company's common stock.
- In March 2000, repurchases up to an additional 5%, or \$4.2 million of the Company's common stock.
- In September 2001, repurchases of \$3 million of additional shares of the Company's common stock.
- In August 2002, repurchases of \$5 million of additional shares of the Company's common stock.
- In September 2003, repurchases of \$10 million of additional shares of the Company's common stock.
- On April 27, 2004, repurchases of \$5 million of additional shares of the Company's common stock.
- On August 23, 2005, repurchases of \$5 million of additional shares of the Company's common stock.
- On August 22, 2006, repurchases of \$5 million of additional shares of the Company's common stock.
- On February 27, 2007, repurchases of \$5 million of additional shares of the Company's common stock.
- On November 13, 2007, repurchases of \$5 million of additional shares of the Company's common stock.
- On December 16, 2008, repurchases of \$2.5 million of additional shares of the Company's common stock.
- On May 26, 2009, repurchases of \$5 million of additional shares of the Company's common stock.
- On February 22, 2011, repurchases of \$5 million of additional shares of the Company's common stock.
- On November 13, 2012, repurchases of \$5 million of additional shares of the Company's common stock.
- On November 19, 2013, repurchases of \$5 million additional shares of the Company's common stock.
- On October 28, 2014, repurchases of \$5 million additional shares of the Company's common stock.

During the six months ended June 30, 2018, the Company repurchased 2,588 shares at \$95,109. These shares were a result of of cancellation of shares withheld in conjunction with vested options of one First Bank employee. The shares were withheld to cover payroll taxes. Since 1998, the Company has repurchased a total of 2,063,727 shares at a total price of approximately \$70.3 million. As of June 30, 2018, the Company is authorized per all repurchase programs to purchase \$6.3 million in additional shares.

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, deposits of the State of Illinois, 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 the sources include:

First Mid Bank has \$35 million available in overnight federal fund lines, including \$10 million from U.S. Bank, N.A., \$10 million from Wells Fargo Bank, N.A. and \$15 million from The Northern Trust Company. Availability of the funds is subject to 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 June 30, 2018, First Mid Bank met these regulatory requirements.

First Mid Bank and First 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 June 30, 2018, the excess collateral at the FHLB would support approximately \$195.0 million of additional advances for First Mid Bank and First Bank.

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 June 30, 2018, the Company had a revolving credit agreement in the amount of \$10 million with The Northern Trust Company with an outstanding balance of \$0 and \$10 million in available funds. This loan was renewed on April 13, 2018 for one year as a revolving credit agreement. The interest rate is floating at 2.25% over the federal funds rate. The loan is secured by all of the stock of First Mid Bank, including requirements for operating and capital ratios. The Company and its subsidiary bank were in compliance with the then existing covenants at June 30, 2018 and 2017 and December 31, 2017.

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 June 30, 2018 (in thousands):

	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Time deposits	\$523,541	\$364,682	\$126,009	\$31,241	\$1,609
Debt	40,181	3,750	5,625	—	30,806
Other borrowings	237,662	175,662	47,000	15,000	—
Operating leases	43,956	2,611	4,074	3,798	33,473

Supplemental retirement 565	100	120	100	245
	\$845,905	\$546,805	\$182,828	\$50,139
				\$66,133

For the six months ended June 30, 2018, net cash of \$18.0 million and \$31.2 million was provided from operating activities and financing activities, respectively, and \$52.5 million was used in investing activities. In total, cash and cash equivalents decreased by \$3.3 million since year-end 2017.

Off-Balance Sheet Arrangements

First Mid Bank and First 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 June 30, 2018 and December 31, 2017 were as follows (in thousands):

	June 30, 2018	December 31, 2017
Unused commitments and lines of credit:		
Commercial real estate	\$64,091	\$ 73,268
Commercial operating	256,440	223,960
Home equity	45,943	38,318
Other	103,043	69,333
Total	\$469,517	\$ 404,879
Standby letters of credit	\$42,524	\$ 10,626

The increase in 2018 is primarily due to the acquisition of First Bank. 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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There has been no material change in the market risk faced by the Company since December 31, 2017. For information regarding the Company's market risk, refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

ITEM 4. CONTROLS AND PROCEDURES

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's "disclosure controls and procedures" (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of the end of the period covered by this report. Based on such evaluation, such officers have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective. Further, there have been no changes in the Company's internal control over financial reporting during the last fiscal quarter that have materially affected or that are reasonably likely to affect materially the Company's internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

On February 13, 2018, an alleged class action complaint was filed by a purported stockholder of First Bank in the United States District Court for the District of Delaware captioned Parshall v. First BancTrust Corporation (Case No. 1:18-cv-00218) against the Company, Merger Sub, First Bank and members of First Bank’s board of directors (the “Lawsuit”). The Lawsuit related to the Agreement and Plan of Merger, dated as of December 11, 2017 (as amended by the First Amendment to Agreement and Plan of Merger entered into as of January 18, 2018), among the Company, Merger Sub and First Bank and the merger contemplated thereby (the “Merger”). Among other things, the Lawsuit alleged that the Registration Statement on Form S-4 filed with the SEC by the Company on January 22, 2018 failed to disclose allegedly material information relating to the Company’s and First Bank’s financial projections, the analyses performed by First Bank’s financial advisor, and alleged potential conflicts of interest of First Bank’s officers, directors and financial advisor. The plaintiff sought, among other relief, to enjoin the Merger from proceeding. The Company believes that the factual allegations in the Lawsuit were without merit.

On March 9, 2018, in order to moot plaintiff’s disclosure claims, reduce the expenses, burdens, risks and uncertainties inherent in litigation and avoid the risk of delaying or adversely affecting the Merger, in exchange for the plaintiff agreeing to withdraw the Lawsuit and dismiss his claims with prejudice, the Company and First Bank made additional supplemental disclosures to the proxy statement/prospectus related to the Merger that was first mailed to stockholders of First Bank on or about February 9, 2018. The agreement between the parties did not release or otherwise prejudice any potential claims of any member of the putative class other than the plaintiff and did not constitute any admission by any of the defendants as to the merits of any claims. In addition, in connection with the mootness of the disclosure claims, the parties contemplate that plaintiff’s counsel will seek an award of attorneys’ fees and expenses.

From time to time the Company and its subsidiaries may be involved in litigation that the Company believes is a type common to our industry. None of any such existing claims are believed to be individually material at this time to the Company, although the outcome of any such existing claims cannot be predicted with certainty.

ITEM 1A. RISK FACTORS

Various risks and uncertainties, some of which are difficult to predict and beyond the Company’s control, could negatively impact the Company. As a financial institution, the Company is exposed to interest rate risk, liquidity risk, credit risk, operational risk, risks from economic or market conditions, and general business risks among others. Adverse experience with these or other risks could have a material impact on the Company’s financial condition and results of operations, as well as the value of its common stock. See the risk factors and “Supervision and Regulation” described in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the

				Plans or Programs
April 1, 2018 - April 30, 2018	0	\$0.00	0	\$ 6,375,000
May 1, 2018 - May 31, 2018	2,588	\$36.75	2,588	\$ 6,280,000
June 1, 2018 - June 30, 2018	0	\$0.00	0	\$ 6,280,000
Total	2,588	\$0.00	2,588	\$ 6,280,000

See heading "Stock Repurchase Program" for more information regarding stock purchases.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. 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 that immediately precedes the exhibits filed.

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Exhibit Index to Quarterly Report on Form 10-Q

Exhibit Number	Description and Filing or Incorporation Reference
2.1	<u>Agreement and Plan of Merger by and among First Mid-Illinois Bancshares, Inc., Project Almond Merger Sub LLC and SCB Bancorp, Inc., dated June 12, 2018 (incorporated by reference to Exhibit 2.1 to First Mid-Illinois Bancshares, Inc.'s current report on Form 8-K/A filed with SEC on June 13, 2018)</u>
3.1	<u>Amendment to Restated Certificate of Incorporation, dated April 26, 2018 (incorporated by reference to Exhibit 3.1 to First Mid-Illinois Bancshares, Inc.'s current report on Form 8-K filed with the SEC on April 26, 2018)</u>
3.2	<u>Restated Certificate of Incorporation, dated April 26, 2018 (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 April 26, 2018)</u>
10.3	<u>Fifth Amended and Restated Credit Agreement by and between First Mid-Illinois Bancshares, Inc. and The Northern Trust Company, dated as of April 13, 2018 (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 13, 2018)</u>
11.1	<u>Statement re: Computation of Earnings Per Share (Filed herewith on page 11)</u>
31.1	<u>Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	<u>Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002</u>
32.1	<u>Certification pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002</u>
32.2	<u>Certification pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002</u>
101	The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2018, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets at June 30, 2018 and December 31, 2017, (ii) the Consolidated Statements of Income for the three and six months ended June 30, 2018 and 2017, (iii) the Consolidated Statements of Cash Flows for the six months ended June 30, 2018 and 2017, and (iv) the Notes to Consolidated Financial Statements.

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: August 6, 2018
Joseph R. Dively
President and Chief Executive Officer

Matthew K. Smith
Chief Financial Officer