FIRST MIDWEST BANCORP INC
Form 10-Q
November 10, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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FORM 10-Q

(Mark One)

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended **September 30, 2008**

or

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _________ to __________.

Commission File Number 0-10967

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FIRST MIDWEST BANCORP, INC.

(Exact name of Registrant as specified in its charter)

Delaware	36-3161078
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

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

(Address of principal executive offices) (zip code)

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

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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 [X] No [ ].

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

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

As of November 7, 2008, there were 48,589,831 shares of $.01 par value common stock outstanding.

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FIRST MIDWEST BANCORP, INC.

FORM 10-Q

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

AVAILABLE INFORMATION

We file annual, quarterly, and current reports, proxy statements, and other information with the Securities and Exchange Commission ("SEC"), and we make this information available free of charge on or through the investor relations section of our web site at *www.firstmidwest.com/aboutinvestor_overview.asp*. The following documents are also posted on our web site or are available in print upon the request of any stockholder to our Corporate Secretary:

* Certificate of Incorporation

* Company By-laws

* Charters for our Audit, Compensation, and Nominating and Corporate Governance Committees

* Related Person Transaction Policies and Procedures

* Corporate Governance Guidelines

* Code of Ethics and Standards of Conduct (the "Code"), which governs our directors, officers, and employees

* Code of Ethics for Senior Financial Officers.

Within the time period required by the SEC and the Nasdaq Stock Market, we will post on our web site any amendment to the Code and any waiver applicable to any executive officer, director, or senior financial officer (as defined in the Code). In addition, our web site includes information concerning purchases and sales of our securities by our executive officers and directors, as well as any disclosure relating to certain non-GAAP financial measures (as defined in the SEC's Regulation G) that we may make public orally, telephonically, by webcast, by broadcast, or by similar means from time to time.

Our Corporate Secretary can be contacted by writing to First Midwest Bancorp, Inc., One Pierce Place, Itasca, Illinois 60143, Attn: Corporate Secretary. The Company's Investor Relations Department can be contacted by telephone at (630) 875-7463 or by e-mail at *investor.relations@firstmidwest.com.*

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

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

Forward-looking statements are subject to known and unknown risks, uncertainties, and assumptions and may include projections relating to our future financial performance including our growth strategies and anticipated trends in our business. For a detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements, you should refer to our Annual Report on Form 10-K for the year ended December 31, 2007, including the sections entitled "Risk Factors" in Part II Item 1A of this report and "Management's Discussion and Analysis of Results of Operations," as well as our subsequent periodic and current reports filed with the SEC. These risks and uncertainties are not exhaustive however. Other sections of this report describe additional factors that could adversely impact our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risks and uncertainties emerge from time to time, and it is not possible to predict all risks and uncertainties, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. We are under no duty to update any of these forward-looking statements after the date of this report to conform our prior statements to actual results or revised expectations, and we do not intend to do so.

PART 1. FINANCIAL INFORMATION (Unaudited)

ITEM 1. FINANCIAL STATEMENTS

FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(Amounts in thousands)

	September 30, 2008	December 31, 2007
	(Unaudited)	
Assets		
Cash and due from banks	$ 126,073	$ 193,792
Federal funds sold and other short-term investments	564	1,045
Mortgages held for sale	-	394
Trading account securities	15,252	18,352
Securities available-for-sale, at fair value	2,024,881	2,080,046
Securities held-to-maturity, at amortized cost	85,982	97,671
Federal Home Loan Bank and Federal Reserve Bank stock, at cost	54,767	54,767
Loans	5,223,582	4,963,672
Reserve for loan losses	(69,811)	(61,800)
Net loans	5,153,771	4,901,872
Premises, furniture, and equipment	120,592	125,828
Accrued interest receivable	46,431	48,971
Investment in bank owned life insurance	207,390	203,535
Goodwill	262,886	262,195
Other intangible assets	22,757	26,040
Other assets	125,309	77,010
Total assets	$ 8,246,655	$ 8,091,518
Liabilities		
Demand deposits	$ 1,056,905	1,064,684
Savings deposits	758,422	798,361
NOW accounts	919,519	889,760
Money market deposits	728,021	829,226
Time deposits	2,195,417	2,196,830
Total deposits	5,658,284	5,778,861
Borrowed funds	1,554,703	1,264,228
Subordinated debt	232,442	230,082
Accrued interest payable	13,674	16,843
Other liabilities	68,643	77,529
Total liabilities	7,527,746	7,367,543
Stockholders' Equity		
Preferred stock, no par value; 1,000 shares authorized, none issued	-	-
Common stock, $.01 par value; authorized 100,000 shares; issued 61,326 shares; outstanding: September 30, 2008 - 48,590 shares	613	613

December 31, 2007 - 48,453 shares		
Additional paid-in capital	207,503	207,851
Retained earnings	875,947	844,972
Accumulated other comprehensive loss, net of tax	(51,807)	(11,727)
Treasury stock, at cost: September 30, 2008 - 12,736 shares		
December 31, 2007 - 12,873 shares	(313,347)	(317,734)
Total stockholders' equity	718,909	723,975
Total liabilities and stockholders' equity	$ 8,246,655	$ 8,091,518

See accompanying notes to unaudited consolidated financial statements.

FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME

(Amounts in thousands, except per share data)
(Unaudited)

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Interest Income				
Loans	$ 74,929	$ 93,020	$ 231,082	$ 277,372
Securities available-for-sale	25,072	25,118	75,507	78,841
Securities held-to-maturity	1,068	1,171	3,358	3,620
Federal Home Loan Bank and Federal Reserve Bank stock	329	533	999	1,704
Federal funds sold and other short-term investments	88	248	328	813
Total interest income	101,486	120,090	311,274	362,350
Interest Expense				
Deposits	25,574	41,949	87,820	125,669
Borrowed funds	9,451	13,680	30,776	43,392
Subordinated debt	3,703	3,764	11,094	11,258
Total interest expense	38,728	59,393	129,690	180,319
Net interest income	62,758	60,697	181,584	182,031
Provision for loan losses	13,029	470	27,869	5,191
Net interest income after provision for loan losses	49,729	60,227	153,715	176,840
Noninterest Income				

Service charges on deposit accounts	11,974	11,959	33,781	33,029
Trust and investment advisory fees	3,818	3,934	11,710	11,640
Other service charges, commissions, and fees	4,834	5,601	14,292	16,859
Card-based fees	4,141	4,054	12,275	11,946
Bank owned life insurance income	1,882	2,023	6,489	5,916
Securities (losses) gains, net	(1,746)	(5,165)	(1,396)	(760)
Other	(1,209)	989	(1,015)	4,088
Total noninterest income	23,694	23,395	76,136	82,718
Noninterest Expense				
Salaries and wages	20,805	21,381	59,972	64,840
Retirement and other employee benefits	6,191	5,973	19,582	19,072
Net occupancy expense	5,732	5,686	17,411	16,574
Equipment expense	2,484	2,580	7,502	7,796
Technology and related costs	1,990	1,767	5,581	5,324
Professional services	2,516	2,366	7,421	6,687
Advertising and promotions	1,133	1,950	3,883	4,503
Merchant card expense	1,949	1,842	5,375	5,120
Other expenses	5,636	6,436	20,997	18,957
Total noninterest expense	48,436	49,981	147,724	148,873
Income before income tax expense	24,987	33,641	82,127	110,685
Income tax expense	796	6,404	5,901	25,108
Net income	$ 24,191	$ 27,237	$ 76,226	$ 85,577
Per Share Data				
Basic earnings per share	$ 0.50	$ 0.55	$ 1.57	$ 1.73
Diluted earnings per share	$ 0.50	$ 0.55	$ 1.57	$ 1.71
Cash dividends per share	$ 0.310	$ 0.295	$ 0.930	$ 0.885
Weighted average shares outstanding	48,470	49,134	48,454	49,554
Weighted average diluted shares outstanding	48,556	49,447	48,573	49,915

See accompanying notes to unaudited consolidated financial statements.

FIRST MIDWEST BANCORP, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Amounts in thousands, except per share data)

(Unaudited)

	Common Shares Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Treasury Stock	Total
Balance at January 1, 2007	50,025	$ 613	$ 205,044	$ 823,787	$ (15,288)	$ (263,142)	$ 751,014
Cumulative-effect for change in accounting for purchases of life insurance policies	-	-	-	(209)	-	-	(209)
Adjusted balance at January 1, 2007	50,025	613	205,044	823,578	(15,288)	(263,142)	750,805
Comprehensive Income:							
Net income	-	-	-	85,577	-	-	85,577
Other comprehensive loss: (1)							
Unrealized losses on securities	-	-	-	-	(21,084)	-	(21,084)
Other activities	-	-	-	-	(13)	-	(13)
Total comprehensive income							64,480
Dividends declared ($0.885 per share)	-	-	-	(43,720)	-	-	(43,720)
Purchase of treasury stock	(1,470)	-	-	-	-	(52,199)	(52,199)
Share-based compensation	-	-	2,817	-	-	-	2,817

expense							
Exercise of stock options and restricted stock activity	183	-	(919)	-	-	6,751	5,832
Treasury stock (purchased for) issued to benefit plans	(3)	-	9	-	-	(96)	(87)
Balance at September 30, 2007	48,735	$ 613	$ 206,951	$ 865,435	$ (6,385)	$ (308,686)	$ 727,928
Balance at January 1, 2008	48,453	$ 613	$ 207,851	$ 844,972	$ (1,727)	$ (317,734)	$ 723,975
Comprehensive Income:							
Net income	-	-	-	76,226	-	-	76,226
Other comprehensive loss: (1)							
Unrealized losses on securities	-	-	-	-	(40,080)	-	(40,080)
Total comprehensive income							36,146
Dividends declared ($0.930 per share)	-	-	-	(45,251)	-	-	(45,251)
Purchase of treasury stock	(4)	-	-	-	-	(137)	(137)
Share-based compensation expense	-	-	2,916	-	-	-	2,916

Exercise of stock options and restricted stock activity	145	-	(3,242)	-	-	4,564	1,322
Treasury stock (purchased for) issued to benefit plans	(4)	-	(22)	-	-	(40)	(62)
Balance at September 30, 2008	48,590	$ 613	$ 207,503	$ 875,947	$ (1,807)	$ (313,347)	$ 718,909

(1) Net of taxes and reclassification adjustments.

See accompanying notes to unaudited consolidated financial statements.

FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollar amounts in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2008	2007
Net cash provided by operating activities	$ 104,949	$ 34,125
Investing Activities		
Securities available-for-sale:		
Proceeds from maturities, repayments, and calls	226,231	231,469
Proceeds from sales	226,315	335,744
Purchases	(463,298)	(83,367)
Securities held-to-maturity:		
Proceeds from maturities, repayments, and calls	40,870	30,165
Purchases	(29,117)	(31,603)
Net (increase) decrease in loans	(302,029)	66,361
Proceeds from claims on bank owned life insurance	2,634	887
Proceeds from sales of other real estate owned	3,628	3,647

Proceeds from sales of premises, furniture, and equipment	720	1,034
Purchases of premises, furniture, and equipment	(3,957)	(9,044)
Net cash (used in) provided by investing activities	(298,003)	545,293
Financing Activities		
Net decrease in deposit accounts	(120,577)	(333,041)
Net increase (decrease) in borrowed funds	290,475	(183,766)
Purchases of treasury stock	(137)	(52,199)
Proceeds from issuance of treasury stock	(62)	-
Cash dividends paid	(45,208)	(44,100)
Exercise of stock options and restricted stock activity	411	4,365
Excess tax benefit from exercise of stock options and release of restricted stock awards	(48)	346
Net cash provided by (used in) financing activities	124,854	(608,395)
Net decrease in cash and cash equivalents	(68,200)	(28,977)
Cash and cash equivalents at beginning of period	194,837	214,906
Cash and cash equivalents at end of period	$ 126,637	$ 185,929
Supplemental Disclosures:		
Noncash transfers of loans to foreclosed real estate	$ 22,261	$ 4,962
Dividends declared but unpaid	15,088	14,399

See accompanying notes to unaudited consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated interim financial statements of First Midwest Bancorp, Inc. (the "Company"), a Delaware corporation, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission for quarterly reports on Form 10-Q and do not include certain information and footnote disclosures required by U.S. generally accepted accounting principles ("GAAP") for complete annual financial statements. Accordingly, these financial statements should be read in conjunction with the Company's 2007 Annual Report on Form 10-K ("2007 10-K").

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with U.S. GAAP and reflect all adjustments that are, in the opinion of management, necessary for the fair presentation of the financial position and results of operations for the periods presented. All such adjustments are of a normal recurring nature. The results of operations for the quarter and nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

The consolidated financial statements include the accounts and results of operations of the Company and its subsidiaries after elimination of all significant intercompany accounts and transactions. Certain reclassifications have been made to prior periods to conform to the current period presentation. U.S. GAAP requires management to make certain estimates and assumptions. Although these and other estimates and assumptions are based on the best available information, actual results could be materially different from these estimates.

2. RECENT ACCOUNTING PRONOUNCEMENTS

Fair Value Measurements:

Effective January 1, 2008, the Company adopted Financial Accounting Standards Board ("FASB") Statement No. 157, *Fair Value Measurements* ("SFAS No. 157"), which, upon adoption, replaced various definitions of fair value in existing accounting literature with a single definition, established a framework for measuring fair value, and required additional disclosures about fair value measurements. SFAS No. 157 applies whenever an entity is measuring fair value under other accounting standards that require or permit fair value measurement. To clarify the application of SFAS No. 157 in inactive markets, on October 10, 2008, the FASB issued FASB Staff Position ("FSP") No. FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active.* Specifically, the FSP addresses the use of broker quotes and pricing services and how an entity's own input assumptions (such as discount rates used in cash flow projections) should be considered when measuring fair value when relevant observable market data does not exist. While SFAS No. 157 is effective for financial assets and liabilities on January 1, 2008 and for non-financial assets and liabilities on January 1, 2009, the FSP to address fair value measurements for inactive markets was effective on issuance, including prior periods for which financial statements had not been issued. The adoption of SFAS No. 157 on January 1, 2008 and the FSP during the third quarter of 2008 did not have a material impact on the Company's financial position, results of operations, or liquidity. Refer to Note 9, "Fair Value," for the Company's fair value measurement disclosures.

Fair Value Option

: Effective January 1, 2008, the Company adopted FASB Statement No. 159, *The Fair Value Option for Financial Assets and Liabilities* ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure certain financial assets and liabilities at fair value that are not currently required to be measured at fair value. The fair value option is applied on an instrument-by-instrument basis, is irrevocable and can only be applied to an entire instrument and not to specified risks, specified cash flows, or portions of that instrument. Changes in fair value (i.e. unrealized gains and losses) on items for which the fair value option has been elected will be reported in earnings at each subsequent reporting date and upfront fees and costs related to those items will be recognized in earnings as incurred and not deferred. SFAS No. 159 also requires entities to provide additional information that would help users of the financial statements understand how changes in fair values affect current-period earnings. While the Company did not elect the fair value option on the adoption date, it may elect this guidance for financial assets and liabilities in the future as permitted under the statement. Accordingly, the adoption of SFAS No. 159 on January 1, 2008 did not have an impact on the Company's financial position, results of operations, or liquidity.

Endorsement Split-Dollar Life Insurance Arrangements:

Effective January 1, 2008, the Company adopted Emerging Issues Task Force ("EITF") Issue 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* ("EITF 06-4"). The EITF is limited to the recognition of a liability and related compensation costs for endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods. The effect of initially applying the guidance would be accounted for as a cumulative-effect adjustment to beginning retained earnings with the option of retrospective application. As the Company had already

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followed the provisions of this statement, the adoption of EITF 06-4 on January 1, 2008 did not have an impact on the Company's financial position, results of operations, or liquidity.

Business Combinations:

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* ("SFAS No. 141(R)"). SFAS No. 141(R) will significantly change how entities apply the acquisition method to business combinations. The most significant changes affecting how the Company will account for business combinations under this statement include: (a) the acquisition date will be the date the acquirer obtains control; (b) all (and only) identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree will be stated at fair value on the acquisition date; (c) assets or liabilities arising from noncontractual contingencies will be measured at their acquisition date fair value only if it is more likely than not that they meet the definition of an asset or liability on the acquisition date; (d) adjustments subsequently made to the provisional amounts recorded on the acquisition date will be made retroactively during a measurement period not to exceed one year; (e) acquisition-related restructuring costs that do not meet the criteria in SFAS No.146, *Accounting for Costs Associated with Exit or Disposal Activities*, will be expensed as incurred; (f) transaction costs will be expensed as incurred, except for debt or equity issuance costs which will be accounted for in accordance with other generally accepted accounting principles; (g) reversals of deferred income tax valuation allowances and income tax contingencies will be recognized in earnings subsequent to the measurement period; and (h) the reserve for loan losses of an acquiree will not be permitted to be recognized by the acquirer. In addition, SFAS No. 141(R) will require new and modified disclosures surrounding subsequent changes to acquisition-related contingencies, contingent consideration, noncontrolling interests, acquisition-related transaction costs, fair values and cash flows not expected to be collected for acquired loans, and an enhanced goodwill rollforward. The Company will be required to prospectively apply SFAS No. 141(R) to all business combinations completed on or after January 1, 2009. Early adoption of SFAS No. 141(R) is not permitted, accordingly the Company will be required to record and disclose any business combinations in accordance with existing GAAP until January 1, 2009. The effect of these new requirements on the Company's financial position and results of operations will depend on the volume and terms of acquisitions in 2009 and beyond, but will likely increase the amount and change the timing of recognizing expenses related to acquisition activities.

Derivative Disclosures:

In March 2008, the FASB issued SFAS No. 161, *Disclosures About Derivative Instruments and Hedging Activities - an amendment of SFAS No. 133* ("SFAS No. 161"), which requires an entity to provide greater transparency about how its derivative and hedging activities affect its financial statements. SFAS No. 161 requires enhanced disclosures about: (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133; and (c) how derivative instruments and related hedged items affect an entity's financial position, results of operations, and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. Since SFAS No. 161 affects only disclosures, it will not impact the Company's financial position or results of operation upon adoption.

3. SECURITIES

Securities Portfolio

(Dollar amounts in thousands)

	September 30, 2008				December 31, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale								
U.S. Treasury	$ 902	$ 3	$ -	$ 905	$ 1,027	$ 2	$ (1)	$ 1,028
U.S. Agency	1,999	3	-	2,002	41,895	597	-	42,492
Collateralized mortgage obligations	515,376	1,798	(6,827)	510,347	534,688	2,333	(2,221)	534,800
Other mortgage-backed securities	517,139	1,970	(3,068)	516,041	417,532	5,116	(2,328)	420,320
	926,519	1,987	(45,854)	882,652	961,638	7,728	(2,531)	966,835

State and municipal								
Collateralized debt obligations	85,286	80	(14,000)	71,366	95,584	-	(13,954)	81,630
Other	50,973	26	(9,431)	41,568	35,295	34	(2,388)	32,941
Total	$ 2,098,194	$ 5,867	$ (79,180)	$ 2,024,881	$ 2,087,659	$ 15,810	$ (23,423)	$ 2,080,046

	September 30, 2008				December 31, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Held-to-Maturity								
State and municipal	$ 85,982	$ 211	$ -	$ 86,193	$ 97,671	$ 260	$ -	$ 97,931
Trading Securities				$ 15,252				$ 18,352

During the first nine months of 2008, the Company continued to closely monitor the fair value of the six asset-backed collateralized debt obligations that were subject to impairment charges in fourth quarter 2007 and recorded additional non-cash impairment charges on these securities of $2.3 million in first quarter 2008, $6.0 million in second quarter 2008, and $1.8 million in third quarter 2008. The carrying value of these securities was zero at September 30, 2008.

At September 30, 2008, gross unrealized gains in the securities available-for-sale portfolio totaled $5.9 million, and gross unrealized losses totaled $79.2 million, resulting in a net unrealized depreciation of $73.3 million. The unrealized loss on securities in an unrealized loss position for greater than 12 months totaled $50.2 million. Management does not believe any individual unrealized loss as of September 30, 2008 represented an other-than-temporary impairment. The Company has both the intent and ability to hold the securities with unrealized losses for a period of time necessary to recover the amortized cost, or to maturity.

Trading securities held by the Company represent diversified investment securities held in a grantor trust under deferred compensation arrangements in which plan participants may direct amounts earned to be invested in securities other than Company stock. Net trading (losses) gains, representing changes in fair value of the portfolio, included in other noninterest income in the Consolidated Statements of Income totaled ($1.8) million in third quarter 2008 and $226,000 in third quarter 2007. Trading (losses) gains totaled ($3.2) million for the nine months ended September 30, 2008 and $1.4 million for the nine months ended September 30, 2007.

4. LOANS

Loan Portfolio

(Dollar amounts in thousands)

	September 30, 2008	December 31, 2007
Commercial and industrial	$ 1,485,541	$ 1,347,481
Agricultural	159,217	181,358

Real estate - office, retail, and industrial	1,092,268	942,065
Real estate - residential land and development	509,974	505,194
Real estate - multifamily	204,029	178,602
Real estate - other commercial real estate	1,021,662	1,024,490
Consumer	545,040	563,741
Real estate - 1-4 family	205,851	220,741
Total loans	$ 5,223,582	$ 4,963,672

Total loans reported are net of deferred loan fees of $9.6 million as of September 30, 2008 and $8.8 million as of December 31, 2007 and include overdrawn demand deposits totaling $11.9 million as of September 30, 2008 and $11.0 million as of December 31, 2007.

The Company primarily lends to small to mid-sized businesses and consumers in the market areas in which the Company operates. Within these areas, the Company diversifies its loan portfolio by loan type, industry, and borrower.

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

5. RESERVE FOR LOAN LOSSES AND IMPAIRED LOANS

Reserve for Loan Losses

(Dollar amounts in thousands)

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Balance at beginning of period	$ 66,104	$ 62,391	$ 61,800	$ 62,370
Loans charged-off	(9,721)	(2,001)	(21,453)	(7,936)
Recoveries of loans previously charged-off	399	552	1,595	1,787
Net loans charged-off	(9,322)	(1,449)	(19,858)	(6,149)
Provision for loan losses	13,029	470	27,869	5,191
Balance at end of period	$ 69,811	$ 61,412	$ 69,811	$ 61,412

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

Impaired, Nonaccrual, and Past Due Loans

(Dollar amounts in thousands)

	September 30, 2008	December 31, 2007
Impaired loans:		
Impaired loans with valuation reserve required [(1)]	$ 12,004	$ 3,470
Impaired loans with no valuation reserve required	40,047	11,878
Total impaired loans	$ 52,051	$ 15,348
Nonperforming loans:		
Impaired loans on nonaccrual	$ 49,793	$ 15,068
Other nonaccrual loans [(2)]	3,524	3,379
Total nonaccrual loans	$ 53,317	$ 18,447
Restructured loans	2,258	280
Total nonperforming loans	$ 55,575	$ 18,727
Loans past due 90 days and still accruing interest	$ 37,316	$ 21,149
Valuation reserve related to impaired loans	4,327	1,757

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

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

The average recorded investment in impaired loans was $25.7 million for the nine months ended 2008 and $12.1 million for the nine months ended September 30, 2007. Interest income recognized on impaired loans was $53,000 for the nine months ended 2008 and $312,000 for the nine months ended September 30, 2007. Interest income recognized on impaired loans is recorded using the cash basis of accounting. As of September 30, 2008, the Company had $659,000 of additional funds committed to be advanced in connection with impaired loans.

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6. EARNINGS PER COMMON SHARE

Basic and Diluted Earnings per Share

(Amounts in thousands, except per share data)

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net income	$ 24,191	$ 27,237	$ 76,226	$ 85,577
Weighted-average common shares outstanding:				
Weighted-average common shares outstanding (basic)	48,470	49,134	48,454	49,554
Dilutive effect of stock options	29	267	64	327
Dilutive effect of non-vested restricted stock awards	57	46	55	34
Weighted-average diluted common shares outstanding	48,556	49,447	48,573	49,915

Basic earnings per share	$ 0.50	$ 0.55	$ 1.57	$ 1.73
Diluted earnings per share	0.50	0.55	1.57	1.71

7. PENSION PLAN

Net Periodic Benefit Pension Expense

(Dollar amounts in thousands)

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Components of net periodic benefit cost:				
Service cost	$ 617	$ 802	$ 2,133	$ 2,770
Interest cost	487	633	1,684	2,187
Expected return on plan assets	(609)	(792)	(2,106)	(2,735)
Recognized net actuarial loss	140	181	482	625
Amortization of prior service cost	1	1	2	3
Net periodic cost	$ 636	$ 825	$ 2,195	$ 2,850

The Company previously disclosed in Note 16 to the Consolidated Financial Statements in its 2007 10-K that it expected to contribute $5.0 million to its Pension Plan in 2008. Based on updated actuarial assumptions, the Company contributed $7.5 million to the Pension Plan in first quarter 2008.

8. COMMITMENTS, GUARANTEES, AND CONTINGENT LIABILITIES

Credit Extension Commitments and Guarantees

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

Contractual or Notional Amounts of Financial Instruments

(Dollar amounts in thousands)

	September 30, 2008	December 31, 2007
Commitments to extend credit:		
Home equity lines	$ 297,052	$ 266,582
All other commitments	1,173,668	1,135,612
Letters of credit:		
Standby	139,829	128,281
Commercial	508	427
Recourse on assets securitized	9,943	13,252

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

The maximum potential future payments guaranteed by the Company under standby letters of credit arrangements are equal to the contractual amount of the commitment. The carrying value of the Company's standby letters of credit, which is included in other liabilities in the Consolidated Statements of Condition, totaled $703,000 as of September 30, 2008 and $669,000 as of December 31, 2007. As of September 30, 2008, standby letters of credit had a remaining weighted-average term of approximately 10.8 months, with remaining actual lives ranging from less than 1 year to 6.8 years. If a commitment is funded, the Company may seek recourse through the liquidation of the underlying collateral provided including real estate, physical plant and property, marketable securities, or cash.

Pursuant to the securitization of certain 1-4 family mortgage loans in fourth quarter 2004, the Company is obligated by agreement to repurchase at recorded value any nonperforming loans, defined as loans past due greater than 90 days. During the nine-months ended September 30, 2008, the Company repurchased $686,000 of nonperforming loans and charged off $28,000 related to these loans. The aggregate outstanding balance of securitized loans subject to this recourse obligation was $9.9 million as of September 30, 2008 and $13.3 million as of December 31, 2007. Per its agreement, the Company's recourse obligations will end on November 30, 2011. The carrying value of the Company's recourse liability, which is included in other liabilities in the Consolidated Statements of Condition, totaled approximately $150,000 as of September 30, 2008 and December 31, 2007.

Legal Proceedings

At September 30, 2008, there were certain legal proceedings pending against the Company and its subsidiaries in the ordinary course of business. The Company does not believe that liabilities, individually or in the aggregate, arising from these proceedings, if any, would have a material adverse effect on the consolidated financial condition of the Company as of September 30, 2008.

9. FAIR VALUE

The Company measures, monitors, and discloses certain of its assets and liabilities on a fair value basis. Fair value is used on a recurring basis to account for trading securities, securities available-for-sale, mortgage servicing rights, derivative assets, and derivative liabilities. In addition, fair value is used on a non-recurring basis to apply lower-of-cost-or-market accounting to foreclosed real estate; evaluate assets or liabilities for impairment, including collateral-dependent impaired loans, goodwill, and other intangibles; and for disclosure purposes. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Depending on the nature of the asset or liability, the Company uses various valuation techniques (e.g.. discounted cash flow analysis) and input assumptions when estimating fair value, all of which are in accordance with SFAS No. 157.

SFAS No. 157 requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Furthermore, SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value into three broad levels based on the reliability of the input assumptions. The hierarchy gives the highest priority to level 1 measurements and the lowest priority to level 3 measurements. The three levels of the fair value hierarchy are defined as follows:

* Level 1 - Unadjusted quoted prices for identical assets or liabilities traded in active markets.

* Level 2 - Observable inputs other than level 1 prices, such as quoted prices for similar instruments; quoted prices in 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 asset or liability.

* 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.

The categorization of where an asset or liability falls within the hierarchy is based on the lowest level of input that is significant to the fair value measurement.

Valuation Methodology

The following describes the valuation methodologies used by the Company for assets and liabilities measured at fair value, including the general classification of the assets and liabilities pursuant to the valuation hierarchy.

Trading Securities

- Trading securities represent diversified investment securities held in a grantor trust under deferred compensation arrangements in which plan participants may direct amounts earned to be invested in securities other than Company common stock. Trading securities are reported at fair value, with unrealized gains and losses included in noninterest income. The fair value of trading securities is based on quoted market prices in active exchange markets and, therefore, is classified in level 1 of the valuation hierarchy.

Securities Available-for-Sale

- Substantially all available-for-sale securities are fixed income instruments that are not quoted on an exchange, but may be traded in active markets. The fair value of these securities is based on quoted market prices obtained from external pricing services or dealer market participants where trading in an active market exists. In obtaining such data from external pricing services, the Company has evaluated the methodologies used to develop the fair values in order to determine whether such valuations are representative of an exit price in the Company's principal markets. The Company's principal markets for its securities portfolio are the secondary institutional markets, with an exit price that is predominantly reflective of bid level pricing in those markets. Examples of such securities measured at fair value are U.S. Treasury and Agency securities, municipal bonds, collateralized mortgage obligations, and other mortgage-backed securities. These securities are generally classified in level 2 of the valuation hierarchy. In certain cases where there is limited activity or less transparency for inputs to the valuation, securities are classified in level 3 of the valuation hierarchy. For instance, in the valuation of certain collateralized mortgage and debt obligations and high-yield debt securities, the determination of fair value may require benchmarking to similar instruments or analyzing default and recovery rates.

For asset-backed collateralized debt obligations ("CDOs"), the Company obtained price information from third-party dealer quotes, as this level of evidence is the strongest support absent current market activity for the fair value of these securities. Due to the illiquidity in the secondary market for CDOs, especially since the disruption in the sub-prime credit markets, these fair value estimates cannot be directly corroborated by observable market data. However one can perform a reasonable analysis of cash flows and estimate attendant fair value as rating agency downgrades result in events of default of these assets in accordance with the individual trustee indentures. Therefore the asset-backed CDO securities were classified in level 3 of the valuation hierarchy.

Prior to September 30, 2008 the Company relied on third-party dealer quotes to establish fair value for trust-preferred collateralized debt obligations ("TRUPs"). These were classified in level 3 of the valuation hierarchy. Due to the illiquidity in the secondary market for TRUPs, especially since the disruption in the credit markets, the Company enhanced its understanding of the information underlying the third-party dealer quotes and determined that these dealer quotes do not reflect the best estimate of fair value. Therefore the Company, with the assistance of a structured credit valuation firm, developed a valuation model to estimate the value of these securities.

The model has been validated through back testing. It relies on independently verifiable historical balance sheet data, empirical default data, equity volatility, and current market values to estimate the likelihood any entity comprising the collateral underlying the individual TRUP will default on its trust-preferred obligation. Using simulation techniques, cash flows are then projected for each entity's obligation under the TRUP and used to estimate the ultimate cash flow to the Company. These cash flows are then modeled and assigned based upon the contractual terms of the TRUP, discounted to their present values, and used to derive the estimated fair value of the individual TRUP.

The model is dependent upon the following key assumptions based on the Company's judgment regarding how a market participant would assess these:

* Estimated default rate - Based upon historical data obtained from the Federal Deposit Insurance Corporation ("FDIC") and outside sources, a target default level was developed as of the measurement date;

* Deferral of cash flows - A deferral of cash flow by any entity within the collateral pool is assumed to be a default;

* Equity volatility - Equity volatility is used to measure market risk over the life of the underlying entity's obligation based on a 6-year historical equity volatility period.

* Discount rate - The discount rate used for valuing cash flows was derived by the Company by first establishing the implied discount rate at a time when a relatively active market existed for such securities and adjusting it for an estimate of the additional risk premium currently demanded by market participants. The Company established that an active market existed during 2006 and the implied discount rate used by the market during that period was approximately the 3-month Treasury bill rate. Since that time the spread between the 3-month Treasury bill rate and the 3-month LIBOR rate has increased between 300 and 400 basis points. Given the most recent volatility in the market, the Company used the current 3-month Treasury bill rate plus 550 basis points as an estimate of the current discount rate.

These assumptions have a direct and significant impact on the resulting fair values. For instance, for every 100 basis points added or subtracted to the discount rate, the total fair value for the 7 TRUPs increases or decreases by approximately $7.5 million, respectively (approximately 9% of the $85 million par value). If an equity volatility period of 2 years is used, the total fair value of the 7 TRUPS would decrease by approximately $14 million (approximately 16% of the $85 million par value). The Company's current fair value for these securities in total is approximately 84% of par value, with the unrealized loss recorded as a component of "Accumulated Other Comprehensive Income/(Loss)" in the Consolidated Statements of Changes in Stockholders' Equity.

Certain securities available-for-sale are carried at cost, including other miscellaneous marketable equity securities. The carrying value of these cost investments approximates fair value.

Collateral-Dependent Impaired Loans

- The carrying value of impaired loans is disclosed in Note 5, "Reserve for Loan Losses and Impaired Loans." The Company does not record loans at fair value on a recurring basis. However, from time to time, fair value adjustments are recorded on these loans to reflect (1) partial write-downs that are based on the current appraised or market-quoted value of the underlying collateral or (2) the full charge-off of the loan carrying value. In some cases, the properties for which market quotes or appraised values have been obtained are located in areas where comparable sales data is limited, outdated, or unavailable. Accordingly, fair value estimates, including those obtained from real estate brokers or other third-party consultants, for collateral-dependent impaired loans are classified in level 3 of the valuation hierarchy.

Mortgage Servicing Rights

- The Company records its mortgage servicing rights at fair value in accordance with SFAS No. 156, *Accounting for Servicing of Financial Assets, an amendment of SFAS No. 140*. Mortgage servicing rights do not trade in an active market with readily observable prices. Accordingly, the Company determines the fair value of mortgage servicing rights by estimating the present value of the future cash flows associated with the mortgage loans being serviced. Key assumptions used in measuring the fair value of mortgage servicing rights include prepayment speeds and discount rates. While market-based data is used to determine the input assumptions, the Company incorporates its own estimates of assumptions market participants would use in determining the fair value of mortgage servicing rights and classifies them in level 3 of the valuation hierarchy.

Derivative Assets and Derivative Liabilities

- The interest rate swaps entered into by the Company are executed in the dealer market and priced based on market quotes obtained from the counterparty that transacted the derivative contract. The market quotes were developed by the counterparty using market observable inputs, which primarily include the London Interbank Offered Rate ("LIBOR") for swaps. As the fair value estimates for interest rate swaps are primarily based on LIBOR, which is a market observable input, derivatives are classified in level 2 of the valuation hierarchy. For its derivative assets and liabilities, the Company also considers nonperformance risk, including the likelihood of default by itself and its counterparties, when evaluating whether the market quotes from the counterparty are representative of an exit price. The Company has a policy of executing derivative transactions only with counterparties above a certain credit rating. Credit risk is also mitigated through the pledging of collateral when certain thresholds are reached. The likelihood of the Company's default is considered remote and its credit rating has remained stable over the past recent history. For these reasons, nonperformance risk is considered extremely low and accordingly, any such credit risk adjustments to the Company's derivative assets and liabilities would be immaterial.

Assets and Liabilities Measured at Fair Value

The following table provides the hierarchy level and fair value for each major category of assets and liabilities measured at fair value at September 30, 2008.

Fair Value Measurements

(Dollar amounts in thousands)

	September 30, 2008			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets and liabilities measured at fair value on a recurring basis				
Assets:				
Trading securities	$ 15,252	$ -	$ -	$ 15,252
Securities available-for-sale (1)	-	1,936,852	88,029	2,024,881
Mortgage servicing rights (2)	-	-	1,500	1,500

Total assets	$ 15,252	$ 1,936,852	$ 89,529	$ 2,041,633