

FIRST MIDWEST BANCORP INC
Form 10-Q
May 08, 2009

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of
1934
For the quarterly period ended **March 31, 2009**

or

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

Commission File Number 0-10967

FIRST MIDWEST BANCORP, INC.

(Exact name of Registrant as specified in its charter)

Delaware

36-3161078

(State or other jurisdiction of
incorporation or organization)

(IRS Employer Identification No.)

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

(Address of principal executive offices) (zip code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (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, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Large accelerated filer Accelerated filer Non-accelerated filer .

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

As of May 8, 2009, there were 48,626,506 shares of \$.01 par value common stock outstanding.

FIRST MIDWEST BANCORP, INC.

FORM 10-Q

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First Midwest Bancorp, Inc. is a bank holding company headquartered in the Chicago suburb of Itasca, Illinois with operations throughout the greater Chicago 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 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) 875-7533 or by e-mail at investor.relations@firstmidwest.com.

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

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

Forward-looking statements are subject to known and unknown risks, uncertainties, and assumptions and may include projections relating to our future financial performance including our growth strategies and anticipated trends in our business. For a detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements, you should refer to our Annual Report on Form 10-K for the year ended December 31, 2008 and 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.

Since mid-2007, and particularly during the second half of 2008 and beginning of 2009, the financial services industry and the securities markets generally have been materially and adversely affected by significant declines in the values of nearly all asset classes and by a serious lack of liquidity. The global markets have been characterized by substantially increased volatility and short-selling and an overall loss of investor confidence, initially in financial

institutions, but more recently in companies in a number of other industries and in the broader markets. Such instability has brought a new level of risk to financial institutions in addition to the risks normally associated with competition and free market economies. The Company has attempted to list those risks elsewhere in this report and consider them as it makes disclosures regarding forward-looking statements. Nevertheless, given the uncertain economic times, new risks and uncertainties may emerge very quickly and unpredictably, and it is not possible to predict all risks and uncertainties. We cannot 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)

| | March 31, 2009 <u>(Unaudited)</u> | December 31, 2008 <u></u> |
|--|---|---------------------------------|
| Assets | | |
| Cash and due from banks | \$ 103,586 | \$ 106,082 |
| Federal funds sold and other short-term investments | 3,741 | 8,226 |
| Trading account securities | 10,885 | 12,358 |
| Securities available-for-sale, at fair value | 1,901,919 | 2,216,186 |
| Securities held-to-maturity, at amortized cost | 81,566 | 84,306 |
| Federal Home Loan Bank and Federal Reserve Bank stock, at cost | 54,768 | 54,767 |
| Loans | 5,387,128 | 5,360,063 |
| Reserve for loan losses | <u>(116,001)</u> | <u>(93,869)</u> |
| Net loans | <u>5,271,127</u> | <u>5,266,194</u> |
| Other real estate owned | 38,984 | 24,368 |
| Premises, furniture, and equipment | 117,880 | 120,035 |
| Accrued interest receivable | 40,551 | 43,247 |
| Investment in bank owned life insurance | 199,070 | 198,533 |
| Goodwill | 262,886 | 262,886 |
| Other intangible assets | 20,684 | 21,662 |
| Receivable for securities sold | 25,199 | - |
| Other assets | <u>119,730</u> | <u>109,491</u> |
| Total assets | <u>\$ 8,252,576</u> | <u>\$ 8,528,341</u> |
| Liabilities | | |
| Demand deposits | \$ 1,046,660 | \$ 1,040,763 |
| Savings deposits | 757,997 | 747,079 |
| NOW accounts | 900,988 | 915,691 |
| Money market deposits | 816,644 | 754,421 |
| Time deposits | <u>1,986,093</u> | <u>2,127,800</u> |
| Total deposits | 5,508,382 | 5,585,754 |
| Borrowed funds | 1,535,752 | 1,698,334 |

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| | | |
|--|---------------------|---------------------|
| Subordinated debt | 232,375 | 232,409 |
| Accrued interest payable | 12,927 | 10,550 |
| Payable for securities purchased | - | 17,537 |
| Other liabilities | 59,528 | 75,478 |
| Total liabilities | <u>7,348,964</u> | <u>7,620,062</u> |
| Stockholders' Equity | | |
| Preferred stock, no par value; authorized 1,000 shares, issued and outstanding: 193 shares | 189,768 | 189,617 |
| Common stock, \$.01 par value; authorized 100,000 shares; issued 61,326 shares; outstanding: March 31, 2009 - 48,628 shares December 31, 2008 - 48,630 shares | 613 | 613 |
| Additional paid-in capital | 211,325 | 210,698 |
| Retained earnings | 851,339 | 837,390 |
| Accumulated other comprehensive loss, net of tax | (37,470) | (18,042) |
| Treasury stock, at cost: March 31, 2009 - 12,698 shares December 31, 2008 - 12,696 shares | (311,963) | (311,997) |
| Total stockholders' equity | <u>903,612</u> | <u>908,279</u> |
| Total liabilities and stockholders' equity | <u>\$ 8,252,576</u> | <u>\$ 8,528,341</u> |

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 | |
|---|----------------|----------------|
| | March 31, | |
| | 2009 | 2008 |
| Interest Income | | |
| Loans | \$ 65,447 | \$ 81,334 |
| Securities available-for-sale | 24,705 | 25,590 |
| Securities held-to-maturity | 977 | 1,130 |
| Federal Home Loan Bank and Federal Reserve Bank stock | 308 | 338 |
| Federal funds sold and other short-term investments | 43 | 83 |
| Total interest income | <u>91,480</u> | <u>108,475</u> |
| Interest Expense | | |
| Deposits | 18,927 | 34,210 |
| Borrowed funds | 4,632 | 12,076 |
| Subordinated debt | 3,702 | 3,689 |
| Total interest expense | <u>27,261</u> | <u>49,975</u> |
| Net interest income | 64,219 | 58,500 |
| Provision for loan losses | | |
| | <u>48,410</u> | <u>9,060</u> |
| | 15,809 | 49,440 |

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Net interest income after provision for loan losses

| | | |
|---|-----------------|------------------|
| Noninterest Income | | |
| Service charges on deposit accounts | 9,044 | 10,422 |
| Trust and investment advisory fees | 3,329 | 3,947 |
| Other service charges, commissions, and fees | 4,006 | 5,002 |
| Card-based fees | 3,755 | 3,898 |
| Bank owned life insurance income | 541 | 2,462 |
| Securities (losses) gains, net | 8,222 | 4,968 |
| Trading (losses) gains, net | (622) | (1,420) |
| Other income | 496 | 740 |
| | <u>28,771</u> | <u>30,019</u> |
| Total noninterest income | | |
| Noninterest Expense | | |
| Salaries and wages | 17,090 | 19,024 |
| Retirement and other employee benefits | 6,221 | 7,166 |
| Net occupancy expense | 6,506 | 6,151 |
| Equipment expense | 2,331 | 2,567 |
| Technology and related costs | 2,240 | 1,771 |
| Professional services | 2,934 | 2,294 |
| Advertising and promotions | 1,082 | 1,037 |
| Merchant card expense | 1,538 | 1,646 |
| Other expenses | 8,452 | 7,687 |
| | <u>48,394</u> | <u>49,343</u> |
| Total noninterest expense | | |
| (Loss) income before income tax (benefit) expense | (3,814) | 30,116 |
| Income tax (benefit) expense | (9,541) | 5,078 |
| Net income | 5,727 | 25,038 |
| Preferred dividends | (2,563) | - |
| Net income applicable to non-vested restricted shares | (9) | (59) |
| Net income applicable to common shares | <u>\$ 3,155</u> | <u>\$ 24,979</u> |
| Per Common Share Data | | |
| Basic earnings per common share | \$ 0.07 | \$ 0.52 |
| Diluted earnings per common share | \$ 0.07 | \$ 0.51 |
| Cash dividends per common share | \$ 0.010 | \$ 0.310 |
| Weighted average common shares outstanding | 48,493 | 48,433 |
| Weighted average common diluted shares outstanding | 48,493 | 48,537 |

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)

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| | Common Shares Outstanding | Preferred Stock | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive (Loss) Income | Treasury Stock | Total |
|---|---------------------------------|--------------------|-----------------|----------------------------------|----------------------|---|-------------------|------------|
| Balance at January 1, 2008 | 48,453 | \$ - | \$ 613 | \$ 207,851 | \$ 844,972 | \$ (11,727) | \$ (317,734) | \$ 723,975 |
| Comprehensive income: | | | | | | | | |
| Net income | - | - | - | - | 25,038 | - | - | 25,038 |
| Other comprehensive income: ⁽¹⁾ | | | | | | | | |
| Unrealized gains on securities | - | - | - | - | - | 2,394 | - | 2,394 |
| Total comprehensive income | | | | | | | | 27,432 |
| Common dividends declared (\$0.310 per common share) | - | - | - | - | (15,079) | - | - | (15,079) |
| Purchase of treasury stock | (4) | - | - | - | - | - | (109) | (109) |
| Share-based compensation expense | - | - | - | 817 | - | - | - | 817 |
| Exercise of stock options and restricted stock activity | 112 | - | - | (2,660) | - | - | 3,551 | 891 |
| Treasury stock (purchased for) issued to benefit plans | - | - | - | 3 | - | - | (3) | - |
| Balance at March 31, 2008 | 48,561 | \$ - | \$ 613 | \$ 206,011 | \$ 854,931 | \$ (9,333) | \$ (314,295) | \$ 737,927 |
| | 48,630 | \$ 189,617 | \$ 613 | \$ 210,698 | \$ 837,390 | \$ (18,042) | \$ (311,997) | \$ 908,279 |
| Balance at | | | | | | | | |

January 1, 2009

| | | | | | | | | |
|--|--------|---------|-----|---------|---------|----------|-----------|---------|
| Cumulative effect of change in accounting for other-than-temporary impairment ⁽²⁾ | - | - | - | - | 11,271 | (11,271) | - | - |
| Adjusted balance at January 1, 2009 | 48,630 | 189,617 | 613 | 210,698 | 848,661 | (29,313) | (311,997) | 908,279 |
| Comprehensive income (loss): | | | | | | | | |
| Net income | - | - | - | - | 5,727 | - | - | 5,727 |
| Other comprehensive loss ⁽¹⁾ : | | | | | | | | |
| Unrealized losses on securities | - | - | - | - | - | (8,157) | - | (8,157) |
| Total comprehensive loss | | | | | | | | (2,430) |
| Common dividends declared (\$0.010 per common share) | - | - | - | - | (486) | - | - | (486) |
| Preferred dividends declared (\$12.50 per preferred share) | - | - | - | - | (2,412) | - | - | (2,412) |
| Accretion on preferred stock | - | 151 | - | - | (151) | - | - | - |
| Share-based compensation expense | - | - | - | 676 | - | - | - | 676 |
| Exercise of stock options and restricted stock activity | 1 | - | - | 11 | - | - | - | 11 |

| | | | | | | | | |
|---|--------|------------|--------|------------|------------|-------------|--------------|------------|
| Treasury stock (purchased for) issued to benefit plans | (3) | - | - | (60) | - | - | 34 | (26) |
| Balance at March 31, 2009 | 48,628 | \$ 189,768 | \$ 613 | \$ 211,325 | \$ 851,339 | \$ (37,470) | \$ (311,963) | \$ 903,612 |

(1) Net of taxes and reclassification adjustments.

For additional details of this adjustment, refer to Note 2, "Recent Accounting Pronouncements," and Note (2) 3, "Securities."

See accompanying notes to unaudited consolidated financial statements.

FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollar amounts in thousands)

(Unaudited)

| | Quarters Ended March 30, | |
|---|-----------------------------|------------|
| | 2009 | 2008 |
| Net cash provided by (used in) operating activities | \$ 1,122 | \$ (1,820) |
| Investing Activities | | |
| Securities available-for-sale: | | |
| Proceeds from maturities, repayments, and calls | 77,491 | 79,994 |
| Proceeds from sales | 334,687 | 221,076 |
| Purchases | (103,145) | (311,998) |
| Securities held-to-maturity: | | |
| Proceeds from maturities, repayments, and calls | 29,033 | 18,553 |
| Purchases | (26,279) | (16,491) |
| Net increase in loans | (68,500) | (91,358) |
| Proceeds from claims on bank owned life insurance | 4 | 2,010 |
| Proceeds from sales of other real estate owned | 125 | 621 |
| Proceeds from sales of premises, furniture, and equipment | 7 | 437 |
| Purchases of premises, furniture, and equipment | (614) | (777) |
| Net cash provided by (used in) investing activities | 242,809 | (97,953) |

| | | |
|--|-------------------|-------------------|
| Financing Activities | | |
| Net decrease in deposit accounts | (77,372) | (57,299) |
| Net (decrease) increase in borrowed funds | (162,582) | 149,498 |
| Purchases of treasury stock | - | (109) |
| Cash dividends paid | (10,952) | (15,046) |
| Exercise of stock options and restricted stock activity | (14) | 755 |
| Excess tax benefit (expense) related to share-based compensation | 8 | (18) |
| Net cash (used in) provided by financing activities | <u>(250,912)</u> | <u>77,781</u> |
| Net decrease in cash and cash equivalents | (6,981) | (21,992) |
| Cash and cash equivalents at beginning of period | <u>114,308</u> | <u>194,837</u> |
| Cash and cash equivalents at end of period | <u>\$ 107,327</u> | <u>\$ 172,845</u> |
| Supplemental Disclosures: | | |
| Non-cash transfers of loans to other real estate owned | \$ 15,157 | \$ 3,185 |
| Dividends declared but unpaid | 487 | 15,079 |

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 2008 Annual Report on Form 10-K ("2008 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 ended March 31, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009.

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 FASB Statement No. 157, *Fair Value Measurements* ("SFAS No. 157"). Upon adoption, SFAS No. 157 provided a single definition of fair value, 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 measurements. On October 10, 2008, to clarify the application of SFAS No. 157 in inactive markets, the FASB issued FASB Staff Position ("FSP") FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*. Specifically, the FSP addressed 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. On April 9, 2009, the FASB provided additional fair value measurement guidance by issuing FSP No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*. Specifically, the FSP concludes that if there has been a significant decrease in the volume and level of activity in relation to the normal market activity, transactions or quoted prices may not be the best indicator of fair value. Further analysis of the transactions or quoted prices may be needed and a significant adjustment to the transactions or quoted prices may be necessary to estimate fair value in accordance with SFAS No. 157. The FSP expands disclosures by requiring entities to disclose its inputs and valuation assumptions for both interim and annual periods. In addition, the FSP requires the SFAS No. 157 disclosures to be presented by major security type (such as commercial mortgage-backed securities or collateralized debt obligations), rather than disclosure by major category (such as trading securities and available-for-sale securities).

SFAS No. 157 was 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 estimating fair value when the volume and level of activity in the market have decreased significantly is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. Effective for first quarter 2009, the Company elected to early adopt FSP 157-4. The adoption of SFAS No. 157 on January 1, 2008, the FSP on fair value measurements in inactive markets during third quarter 2008, and the FSP on estimating fair value when volume and the level of activity have significantly decreased during first quarter 2009 did not have a material impact on the Company's financial position, results of operations, or liquidity. Refer to Note 10, "Fair Value," for the Company's fair value measurement disclosures.

Interim Period Fair Value Disclosures:

On April 9, 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments for interim reporting periods as well as in annual financial statements. The FSP is effective for interim reporting periods ending after June 15, 2009, and the Company will adopt the FSP during second quarter 2009. Since the FSP affects only disclosures, it will not impact the Company's financial position or results of operations upon adoption.

Other-Than-Temporary Impairment:

Effective January 1, 2009, the Company adopted FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, to improve the presentation and disclosure of other-than-temporary impairments on debt securities in its financial statements. Under the prior impairment guidance, an entity was required to assess whether it has the intent and ability to hold a security to recovery when determining whether the impairment is other than temporary. The FSP amends the prior guidance and once an impairment has been determined requires an entity to:

- Recognize the entire impairment as an other-than-temporary impairment against earnings if an entity intends to sell the security or if it is "more-likely-than-not" that it will be required to sell the security before recovery of its cost basis.
- Recognize only the credit loss portion of the impairment against income as an other-than-temporary impairment if the entity does not intend to sell the security and it is not likely that it will be forced to do so

before recovering its cost basis. The balance of the impairment loss would be charged to other comprehensive income.

- Recalculate any previous impairment taken and only the credit loss portion would remain, with the remainder (or liquidity portion) added back to retained earnings (with an offsetting reduction of accumulated other comprehensive income) as an after-tax cumulative adjustment.
- Expand the disclosure requirements for interim and annual periods to provide more detail on the types of available-for-sale and held-to-maturity debt securities held (by major security type, such as commercial mortgage-backed securities or collateralized debt obligations), including information about investments in an unrealized loss position for which an other-than-temporary impairment has or has not been recognized. In addition, disclose the reasons why an other-than-temporary impairment was recognized in earnings and the method and inputs used to calculate the portion of the impairment (or credit loss) recognized in earnings.

The FSP is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. As the Company elected to early adopt this FSP during first quarter 2009, it was also required to adopt FSP FAS 157-4. Refer to Note 3, "Securities," for the impact of adopting this FSP and Note 10, "Fair Value," for its fair value measurement disclosures.

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:

- The acquisition date will be the date the acquirer obtains control.
- All (and only) identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquiree will be stated at fair value on the acquisition date.
- 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.
- 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.
- 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.
- 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.
- Reversals of deferred income tax valuation allowances and income tax contingencies after the acquisition date will be recognized in earnings.
- 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 about subsequent changes to acquisition-related contingencies, contingent consideration, noncontrolling interests, acquisition-related transaction costs, fair values, cash flows not expected to be collected for acquired loans, and an enhanced goodwill rollforward.

The Company will apply SFAS No. 141(R) to all future business combinations. 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:

Effective January 1, 2009, the Company adopted FASB Statement 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: (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for under SFAS No. 133; and (iii) how derivative instruments and related hedged items affect an entity's financial position, results of operations, and cash flows. Since SFAS No. 161 affects only disclosures, it did not impact the Company's financial position or results of operations upon adoption. Refer to Note 13, "Derivative Instruments and Hedging Activities," for the Company's derivative disclosures.

Disclosures about Pension Plan Assets:

Effective January 1, 2009, the Company adopted FSP FAS 132R-1, *Disclosures about Plan Assets*. This FSP requires additional disclosures about plan assets of a defined benefit pension or other postretirement plan. The FSP has two main objectives. First, it requires additional disclosures about major categories of plan assets and concentrations of risk within plan assets. Second, it applies the requirements of SFAS No. 157 to defined benefit plans by requiring disclosure of the inputs and valuation techniques used to measure the fair value of plan assets and the effect of fair value measurements using unobservable inputs on changes in plan assets for the period. Adoption of this FSP affects disclosures only and therefore had no impact on the Company's financial position or results of operations. The adoption of this FSP will impact future annual disclosures related to the Company's defined benefit pension plan.

Earnings Per Share Under Two-Class Method:

Effective January 1, 2009, the Company adopted FSP Emerging Issues Task Force ("EITF") Issue No. 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. This FSP requires an entity to include participating share-based payment transactions, prior to vesting, in the earnings allocation in computing earnings per share. Participating share-based payment awards are those that contain nonforfeitable rights to dividends, even if granted prior to when an award vests. For the Company, participating share-based payment awards include restricted stock awards that have a right to receive dividends prior to vest. The adoption of this FSP did not have a material impact on the Company's earnings per share computations. Refer to Note 7, "Earnings Per Common Share," for the Company's earnings per share disclosures.

3. SECURITIES

As discussed in Note 2, "Recent Accounting Pronouncements," effective January 1, 2009, the Company adopted new guidance related to the recognition of other-than-temporary impairment. The effect of the adoption as of January 1, 2009 is presented in the table below.

Incremental Effect of Applying FSP FAS 115-2 and FAS 124-2 on Individual Line Items in the Consolidated Statements of Condition

(Dollar amounts in thousands)

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| | Before Application of the FSP | Adjustments | After Application of the FSP |
|--|-------------------------------------|-------------|---------------------------------|
| Securities available for sale, at amortized cost | \$ 2,219,504 | \$ 18,477 | \$ 2,237,981 |
| Unrealized (losses) on securities | (3,318) | (18,477) | (21,795) |
| Securities available for sale, at fair value | 2,216,186 | - | 2,216,186 |
| Prepaid income taxes (included in other assets) | - | (7,206) | (7,206) |
| Deferred income taxes (included in other assets) | 1,290 | 7,206 | 8,496 |
| Total assets | 8,528,341 | - | 8,528,341 |
| Retained earnings | 837,390 | 11,271 | 848,661 |
| Accumulated other comprehensive (loss) | (18,042) | (11,271) | (29,313) |
| Total stockholders' equity | 908,279 | - | 908,279 |

Securities Portfolio

(Dollar amounts in thousands)

| | March 31, 2009 | | | December 31, 2008 | | | | |
|--|---------------------|----------------------------------|--------------------|---------------------|---------------------|----------------------------------|--------------------|---------------------|
| | Amortized Cost | <u>Gross Unrealized</u> Gains | Losses | Fair Value | Amortized Cost | <u>Gross Unrealized</u> Gains | Losses | Fair Value |
| Securities Available- for-Sale | | | | | | | | |
| U.S. | | | | | | | | |
| Treasury | \$ 122 | \$ - | \$ - | \$ 122 | \$ 1,039 | \$ 2 | \$ - | \$ 1,041 |
| Collateralized mortgage obligations | 598,367 | 14,094 | (3,120) | 609,341 | 694,285 | 7,668 | (3,114) | 698,839 |
| Other mortgage- backed securities | 344,503 | 11,575 | (24) | 356,054 | 504,918 | 13,421 | (74) | 518,265 |
| State and municipal | 861,547 | 9,136 | (16,134) | 854,549 | 907,036 | 12,606 | (12,895) | 906,747 |
| Collateralized debt obligations | 75,922 | - | (41,395) | 34,527 | 78,883 | - | (36,797) | 42,086 |
| Corporate debt securities | 35,751 | - | (8,896) | 26,855 | 35,731 | 179 | (2,586) | 33,325 |
| Equity securities | 20,861 | 104 | (494) | 20,471 | 16,089 | 34 | (239) | 15,883 |
| Total | <u>\$ 1,937,073</u> | <u>\$ 34,909</u> | <u>\$ (70,063)</u> | <u>\$ 1,901,919</u> | <u>\$ 2,237,981</u> | <u>\$ 33,910</u> | <u>\$ (55,705)</u> | <u>\$ 2,216,186</u> |
| Securities Held- to-Maturity | | | | | | | | |
| State and municipal | <u>\$ 81,566</u> | <u>\$ 396</u> | <u>\$ -</u> | <u>\$ 81,962</u> | <u>\$ 84,306</u> | <u>\$ 286</u> | <u>\$ -</u> | <u>\$ 84,592</u> |

| | | |
|--------------------|------------------|------------------|
| Trading Securities | <u>\$ 10,885</u> | <u>\$ 12,358</u> |
|--------------------|------------------|------------------|

During first quarter 2008, the Company recorded an other-than-temporary impairment ("OTTI") of \$2.3 million related to an asset-backed collateralized debt obligation ("CDO"). During first quarter 2009, the Company recorded OTTI of \$2.9 million related to two trust preferred CDOs. FSP FAS 115-2 and FAS 124-2 requires that only the credit portion of an OTTI must be recognized through income beginning first quarter 2009. In deriving the credit component of the impairment on these two CDOs, the Company applied the contractual rate to cash flows. If a decline in fair value below carrying value was not attributable to credit loss and the Company did not intend to sell the security or believe it would be required to sell the security prior to recovery, the Company recorded the decline in fair value in accumulated other comprehensive income.

Changes in the amount of credit losses recognized in earnings on trust preferred CDOs are summarized in the following table.

Changes in Credit Losses Recognized in Earnings

(Dollar amounts in thousands)

| | <u>Quarter Ended March 31, 2009</u> |
|--|---|
| Balance at beginning of period | \$ 6,331 |
| Credit losses included in earnings ⁽¹⁾ : | |
| Losses recognized on securities that previously had credit losses | 2,800 |
| Losses recognized on securities that did not previously have credit losses | 138 |
| Cash collections | - |
| Changes in credit losses due to security sales | - |
| Changes in credit loss due to a change in intention to sell | - |
| Balance at end of period | <u>\$ 9,269</u> |

(1) Included in securities gains, net in the Consolidated Statements of Income.

Securities Gains (Losses)

(Dollar amounts in thousands)

| | <u>Quarters Ended March 31,</u> | |
|--|---------------------------------|-----------------|
| | <u>2009</u> | <u>2008</u> |
| Proceeds from sales | \$ 334,687 | \$ 221,076 |
| Gains (losses) on sales of securities: | | |
| Gross realized gains | \$ 11,161 | \$ 7,252 |
| Gross realized losses | <u>(1)</u> | <u>(3)</u> |
| Net realized gains on securities sales | 11,160 | 7,249 |
| Non-cash impairment charges | <u>(2,938)</u> | <u>(2,281)</u> |
| Net realized gains | <u>\$ 8,222</u> | <u>\$ 4,968</u> |
| Income tax expense on net realized gains | <u>\$ 3,207</u> | <u>\$ 1,938</u> |

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, are included in the Consolidated Statements of Income and totaled (\$622,000) in first quarter 2009 and (\$1.4 million) in first quarter 2008.

Securities In an Unrealized Loss Position

(Dollar amounts in thousands)

| | Less Than 12 Months | | 12 Months or Longer | | Total | |
|---|---------------------|-------------------|---------------------|-------------------|-------------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| As of March 31, 2009 | | | | | | |
| Collateralized mortgage obligations | \$ 17,283 | \$ 184 | \$ 24,002 | \$ 2,936 | \$ 41,285 | \$ 3,120 |
| Other mortgage-backed securities | - | - | 697 | 24 | 697 | 24 |
| State and municipal Collateralized debt obligations | 209,702 | 7,016 | 164,115 | 9,118 | 373,817 | 16,134 |
| Corporate debt securities | - | - | 34,527 | 41,395 | 34,527 | 41,395 |
| Equity securities | 23,660 | 6,146 | 3,194 | 2,750 | 26,854 | 8,896 |
| | - | - | 1,060 | 494 | 1,060 | 494 |
| Total | <u>\$ 250,645</u> | <u>\$ 13,346</u> | <u>\$ 227,595</u> | <u>\$ 56,717</u> | <u>\$ 478,240</u> | <u>\$ 70,063</u> |
| As of December 31, 2008 | | | | | | |
| Collateralized mortgage obligations | \$ 27,142 | \$ 49 | \$ 39,923 | \$ 3,065 | \$ 67,065 | \$ 3,114 |
| Other mortgage-backed securities | 113 | 1 | 6,246 | 73 | 6,359 | 74 |
| State and municipal Collateralized debt obligations | 144,997 | 5,783 | 174,141 | 7,112 | 319,138 | 12,895 |
| Corporate debt securities | - | - | 28,004 | 36,797 | 28,004 | 36,797 |
| Equity securities | 23,092 | 2,586 | - | - | 23,092 | 2,586 |
| | - | - | 1,065 | 239 | 1,065 | 239 |
| Total | <u>\$ 195,344</u> | <u>\$ 8,419</u> | <u>\$ 249,379</u> | <u>\$ 47,286</u> | <u>\$ 444,723</u> | <u>\$ 55,705</u> |

The unrealized losses on the Company's investment in collateralized mortgage obligations and other mortgage-backed securities were caused by increases in interest rates. These types of investments are either backed by U.S. Government-owned agencies or issued by U.S. Government-sponsored enterprises. Accordingly, the Company believes it will receive its contractual cash flows. The unrealized losses in the Company's investment in state and municipal securities all relate to securities with investment grade ratings and were caused not by credit risk, but by interest rate increases.

The unrealized loss on CDOs as of March 31, 2009 of \$41.4 million reflects the market's temporary negative bias toward structured investment vehicles given the current interest rate and liquidity environment. The Company does not believe this loss is an other-than-temporary impairment. The Company expects no change in its net cash flows from these investments from what was originally anticipated, and the Company has both the intent and ability to hold them until maturity or recovery and more than likely will not be forced to sell before recovering its cost basis. The

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Company's estimation of cash flows for these investments and resulting fair values were based upon its own cash flow modeling in accordance with SFAS No. 157, as described in Note 10, "Fair Value."

The unrealized losses in the Company's investment in other securities consist of unrealized losses on corporate bonds and equity securities and relate to adverse conditions in the financial markets.

Management does not believe any individual unrealized loss as of March 31, 2009 represents an other-than-temporary impairment. The declines in fair value on the Company's securities are not attributable to credit quality, but rather to changes in interest rates and temporary market movements. In addition, 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.

4. LOANS

Loan Portfolio

(Dollar amounts in thousands)

| | March 31, 2009 | December 31, 2008 |
|--|-------------------|----------------------|
| Commercial and industrial | \$ 1,508,175 | \$ 1,490,101 |
| Agricultural | 141,190 | 142,635 |
| Real estate - office, retail, and industrial | 1,211,844 | 1,127,689 |
| Real estate - residential land and development | 466,195 | 509,059 |
| Real estate - multi-family | 257,039 | 237,646 |
| Real estate - other commercial real estate | 1,073,483 | 1,106,952 |
| Consumer | 543,716 | 547,784 |
| Real estate - 1-4 family | 185,486 | 198,197 |
| Total loans | \$ 5,387,128 | \$ 5,360,063 |

Total loans reported are net of deferred loan fees of \$8.3 million as of March 31, 2009 and \$8.5 million as of December 31, 2008 and include overdrawn demand deposits totaling \$11.4 million as of March 31, 2009 and \$7.7 million as of December 31, 2008.

The Company primarily lends to small to mid-sized businesses, commercial real estate customers, 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 March 31, | |
|--------------------------|------|
| 2009 | 2008 |

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| | | |
|--|-------------------|------------------|
| Balance at beginning of period | \$ 93,869 | \$ 61,800 |
| Loans charged-off | (27,243) | (6,741) |
| Recoveries of loans previously charged-off | <u>965</u> | <u>661</u> |
| Net loans charged-off | (26,278) | (6,080) |
| Provision for loan losses | <u>48,410</u> | <u>9,060</u> |
| Balance at end of period | <u>\$ 116,001</u> | <u>\$ 64,780</u> |

Impaired, Non-accrual, and Past Due Loans

(Dollar amounts in thousands)

| | <u>March 31,</u> <u>2009</u> | <u>December</u> <u>31,</u> <u>2008</u> |
|---|---------------------------------|--|
| Impaired loans: | | |
| Impaired loans with valuation reserve required ⁽¹⁾ | \$ 14,703 | \$ 58,439 |
| Impaired loans with no valuation reserve required | <u>163,154</u> | <u>72,397</u> |
| Total impaired loans | <u>\$ 177,857</u> | <u>\$ 130,836</u> |
| Non-accrual loans: | | |
| Impaired loans on non-accrual | \$ 176,794 | \$ 123,492 |
| Other non-accrual loans ⁽²⁾ | <u>6,747</u> | <u>4,276</u> |
| Total non-accrual loans | <u>\$ 183,541</u> | <u>\$ 127,768</u> |
| Restructured loans | \$ 1,063 | \$ 7,344 |
| Loans past due 90 days or more and still accruing interest | \$ 73,929 | \$ 36,999 |
| Valuation reserve related to impaired loans | \$ 7,531 | \$ 10,177 |

(1) These impaired loans require a valuation reserve because the estimated value of the loans or related collateral 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 \$154.3 million for first quarter 2009 and \$17.9 million for first quarter 2008. Interest income recognized on impaired loans was \$19,000 for first quarter 2009 and \$37,000 for first quarter 2008. Interest income recognized on impaired loans is recorded using the cash basis of accounting. As of March 31, 2009, the Company had \$22.5 million of additional funds committed to be advanced in connection with impaired loans.

6. MATERIAL TRANSACTION AFFECTING STOCKHOLDERS' EQUITY

On March 16, 2009, the Company's Board of Directors announced a reduction in its quarterly common stock dividend from \$0.225 per share to \$0.010 per share. This reduction approximates \$42 million in retained capital over the course of a year.

The Board of Directors will continue to evaluate all aspects of the Company's capital plan each quarter, recognizing both current and anticipated conditions.

7. EARNINGS PER COMMON SHARE

Basic and Diluted Earnings per Common Share

(Amounts in thousands, except per share data)

| | Quarters Ended March 31, | |
|---|--------------------------|------------------|
| | 2009 | 2008 |
| Net income | \$ 5,727 | \$ 25,038 |
| Preferred dividends | (2,412) | - |
| Accretion on preferred stock | (151) | - |
| Net income applicable to non-vested restricted shares | (9) | (59) |
| Net income applicable to common shares | <u>\$ 3,155</u> | <u>\$ 24,979</u> |
| Weighted-average common shares outstanding: | | |
| Weighted-average common shares outstanding (basic) | 48,493 | 48,433 |
| Dilutive effect of stock options | - | 104 |
| Weighted-average diluted common shares outstanding | <u>48,493</u> | <u>48,537</u> |
| Basic earnings per common share | \$ 0.07 | \$ 0.52 |
| Diluted earnings per common share | \$ 0.07 | \$ 0.51 |

Stock options and common stock warrants for which the exercise price is greater than the average market price of the Company's common stock are antidilutive and, therefore, not included in the computation of diluted earnings per share. Antidilutive shares excluded from diluted earnings per share totaled 4,083,616 shares for first quarter 2009 and 2,175,043 shares for first quarter 2008.

8. PENSION PLAN

Net Periodic Benefit Pension Expense

(Dollar amounts in thousands)

| | Quarters Ended March 31, | |
|--|--------------------------|---------------|
| | 2009 | 2008 |
| Components of net periodic benefit cost: | | |
| Service cost | \$ 1,203 | \$ 898 |
| Interest cost | 1,195 | 709 |
| Expected return on plan assets | (1,667) | (887) |
| Recognized net actuarial loss | 193 | 203 |
| Amortization of prior service cost | 1 | 1 |
| Net periodic cost | <u>\$ 925</u> | <u>\$ 924</u> |

The Company contributed \$8.0 million to the Pension Plan in April 2009.

9. COMMITMENTS, GUARANTEES, AND CONTINGENT LIABILITIES

Credit Extension Commitments and Guarantees

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

Contractual or Notional Amounts of Financial Instruments

(Dollar amounts in thousands)

| | March 31, 2009 | December 31, 2008 |
|-------------------------------------|-------------------|----------------------|
| Commitments to extend credit: | | |
| Home equity lines | \$ 287,178 | \$ 293,221 |
| Credit card lines to businesses | 12,864 | 12,417 |
| 1-4 family real estate construction | 99,720 | 87,050 |
| Commercial real estate | 267,584 | 286,368 |
| All other commitments | 787,897 | 884,226 |
| Letters of credit: | | |
| 1-4 family real estate construction | 22,183 | 21,301 |
| Commercial real estate | 38,831 | 35,536 |
| All other | 87,690 | 86,175 |
| Recourse on assets securitized | 9,131 | 9,344 |

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.

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 unamortized fees associated with the Company's standby letters of credit, which is included in other liabilities in the Consolidated Statements of Financial Condition, totaled \$816,000 as of March 31, 2009 and \$700,000 as of December 31, 2008. The Company will amortize these amounts into income over the commitment period. As of March 31, 2009, standby letters of credit had a remaining weighted-average term of approximately 14.2 months, with remaining actual lives ranging from less than 1 year to 6.3 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 non-performing loans, defined as loans past due greater than 90 days. During 2008, the Company repurchased \$992,000 of non-performing loans and charged-off \$41,000 related to those loans. The Company was not required to repurchase any of these loans during first quarter 2009. The aggregate outstanding balance of securitized loans subject to this recourse obligation was \$9.1 million as of March 31, 2009 and \$9.3 million as of December 31, 2008. 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 Financial Condition, totaled approximately \$150,000 as of March 31, 2009 and December 31, 2008.

Legal Proceedings

As of March 31, 2009, 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 March 31, 2009.

10. 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 other real estate owned ("OREO"); 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.

The Company measures fair value in accordance with FASB Statement No. 157, *Fair Value Measurements* ("SFAS No. 157"). SFAS No. 157 was effective for the Company on January 1, 2008 for financial assets and liabilities and on January 1, 2009 for non-financial assets and liabilities. Depending upon the nature of the asset or liability, the Company uses various valuation techniques 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. 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.

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 as of March 31, 2009.

Fair Value Measurements

(Dollar amounts in thousands)

March 31, 2009

| | 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 | \$ 10,885 | \$ - | \$ - | \$ 10,885 |
| Securities available-for-sale: | | | | |
| U.S. Treasury securities | - | 122 | - | 122 |
| Collateralized mortgage obligations ⁽¹⁾ | - | 609,341 | - | 609,341 |
| Other mortgage-backed securities ⁽¹⁾ | - | 339,767 | 16,287 | 356,054 |
| State and municipal securities | - | 854,549 | - | 854,549 |
| Collateralized debt obligations | - | - | 34,527 | 34,527 |
| Corporate debt securities | - | 26,855 | - | 26,855 |
| Equity securities ⁽²⁾ | 15,727 | 4,744 | - | 20,471 |
| Total securities available-for-sale | <u>15,727</u> | <u>1,835,378</u> | <u>50,814</u> | <u>1,901,919</u> |
| Mortgage servicing rights ⁽³⁾ | <u>-</u> | <u>-</u> | <u>1,284</u> | <u>1,284</u> |
| Total assets | <u>\$ 26,612</u> | <u>\$ 1,835,378</u> | <u>\$ 52,098</u> | <u>\$ 1,914,088</u> |
| Liabilities: | | | | |
| Derivative liabilities ⁽³⁾ | <u>\$ -</u> | <u>\$ 2,380</u> | <u>\$ -</u> | <u>\$ 2,380</u> |
| Assets measured at fair value on a non-recurring basis | | | | |
| Collateral-dependent impaired loans ⁽⁴⁾ | \$ - | \$ - | \$ 65,886 | \$ 65,886 |
| Other real estate owned | - | - | 38,984 | 38,984 |
| Total assets | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 104,870</u> | <u>\$ 104,870</u> |

(1) These securities are backed by residential mortgages.

(2) Includes other miscellaneous marketable equity securities with an aggregate carrying value totaling \$2.9 million that is assumed to approximate fair value.

(3) Mortgage servicing rights are included in other assets, and derivative liabilities are included in other liabilities in the Consolidated Statements of Financial Condition.

(4) Represents the carrying value of loans for which adjustments are based on the appraised or market-quoted value of the collateral.

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.

Due to the illiquidity in the secondary market for the Company's trust-preferred CDOs, especially since the disruption in the credit markets, the Company determined that dealer quotes did 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 using discounted cash flows and has classified these investments in level 3 of the valuation hierarchy.

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 CDO will default on its trust-preferred obligation. Using simulation techniques, cash flows are then projected for each entity's obligation under the CDO and used to estimate the ultimate cash flow to the Company. These cash flows are then modeled based on the contractual terms of the CDO, discounted to their present values, and used to derive the estimated fair value of the individual CDO.

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 on 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.

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- 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. At March 31, 2009, the Company used a discount rate based on a 3-month Treasury rate plus 1,000 basis points.

Carrying Value of Level 3 Securities Available-for-Sale

(Dollar amounts in thousands)

| | Quarter Ended March 31, 2009 | | |
|---|--|---------------------------------------|------------|
| | Other Mortgage- Backed Securities | Collateralized Debt Obligations | Total |
| Balance at beginning of period | \$ 16,632 | \$ 42,086 | \$ 58,718 |
| Total losses: | | | |
| Included in earnings ⁽¹⁾ | - | (2,938) | (2,938) |
| Included in other comprehensive loss | 258 | (4,598) | (4,340) |
| Purchases, sales, issuances, and settlements | (603) | (23) | (626) |
| Balance at end of period | \$ 16,287 | \$ 34,527 | \$ 50,814 |
| Change in unrealized losses recognized in earnings relating to securities still held at the end of period | \$ - | \$ (2,938) | \$ (2,938) |

(1) Included in securities gains, net in the Consolidated Statements of Income.

In the table above, the net losses recognized in earnings represent non-cash impairment charges recognized on certain CDOs that were deemed to be other-than-temporarily impaired.

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. Mortgage servicing rights are included in other assets in the Consolidated Statements of Financial Condition. Key economic assumptions used in measuring the fair value of mortgage servicing rights include weighted-average prepayment speeds and weighted-average 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.

Carrying Value of Mortgage Servicing Rights

(Dollar amounts in thousands)

| Quarters Ended March 31, | |
|--------------------------|------|
| 2009 | 2008 |

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| | | |
|--|-----------------|-----------------|
| Balance at beginning of period | \$ 1,461 | \$ 1,877 |
| Total (losses) gains included in earnings ⁽¹⁾ : | | |
| Due to changes in valuation inputs and assumptions ⁽²⁾ | (97) | 17 |
| Other changes in fair value ⁽³⁾ | <u>(80)</u> | <u>(95)</u> |
| Balance at end of period | <u>\$ 1,284</u> | <u>\$ 1,799</u> |
| Contractual servicing fees earned during the period ⁽¹⁾ | \$ 85 | \$ 105 |

(1) Included in other service charges, commissions, and fees in the Consolidated Statements of Income.

(2) Principally reflects changes in prepayment speed assumptions.

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

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.

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.

In accordance with the provisions of SFAS No. 114, during first quarter 2009 collateral-dependent impaired loans with a carrying value of \$98.6 million, less transfers to OREO of \$10.5 million, were written down to their fair value of \$65.9 million, resulting in a provision for loan losses of \$22.2 million, which was included in earnings.

Other Real Estate Owned -

OREO includes properties acquired in partial or total satisfaction of certain loans. Properties are recorded at the lower of the recorded investment in the loans for which the properties previously served as collateral or the fair value, which represents the estimated sales price of the properties on the date acquired less estimated selling costs. Any write-downs in the carrying value of a property at the time of acquisition are charged against the reserve for loan losses. Management periodically reviews the carrying value of OREO properties. Any write-downs of the properties subsequent to acquisition, as well as gains or losses on disposition and income or expense from the operations of OREO, are recognized in operating results in the period they are realized. Fair value is generally based on third party appraisals and internal estimates and is therefore considered a Level 3 valuation.

During first quarter 2009, OREO properties with a carrying value of \$2.9 million were written down to their fair value of \$2.5 million, resulting in a charge to earnings of \$387,000.

Goodwill and Other Intangible Assets -

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Goodwill represents the excess of purchase price over the fair value of net assets acquired using the purchase method of accounting. Other intangible assets represent purchased assets that also lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset, or liability.

Goodwill and other intangible assets are subject to impairment testing, which requires a significant degree of management judgment. Goodwill is tested at least annually for impairment using the market capitalization valuation method, or more often if events or circumstances indicate that there may be impairment. Identified intangible assets that have a finite useful life are amortized over that life in a manner that reflects the estimated decline in the economic value of the identified intangible asset. Identified intangible assets that have a finite useful life are periodically reviewed to determine whether there have been any events or circumstances to indicate that the recorded amount is not recoverable from projected undiscounted net operating cash flows.

In the event fair value is determined to be less than the carrying value, goodwill and other intangible assets may be impaired. If the testing resulted in impairment, the Company would classify goodwill and other intangible assets subjected to nonrecurring fair value adjustments as Level 3. Additional information regarding goodwill, other intangible assets, and impairment policies can be found in Note 7 of "Notes to Consolidated Financial Statements" in Item 8 of the Company's 2008 10-K.

11. INCOME TAXES

The Company's provision for income taxes includes both federal and state income tax expense. Following is an analysis of the provision for income taxes and the effective income tax rates for the periods presented.

| | Quarter Ended March 31, | |
|---|----------------------------|-----------|
| | 2009 | 2008 |
| (Loss) income before income tax (benefit) expense | \$ (3,814) | \$ 30,116 |
| Income tax (benefit) expense | (9,541) | 5,078 |
| Effective income tax rate | N/M | 16.9% |

N/M - Not meaningful.

Federal income tax expense, and the related effective tax rate, is primarily influenced by the amount of tax-exempt income derived from investment securities and bank owned life insurance ("BOLI") in relation to pre-tax income. State income tax expense, and the related effective tax rate, is influenced by the amount of state tax-exempt income in relation to pre-tax income, and state tax rules relating to consolidated/combined reporting and sourcing of income and expense.

The decrease in tax expense from 2008 to 2009 was primarily attributable to the decrease in pre-tax income. In 2009, federal tax-exempt income exceeded pre-tax income resulting in the recording of federal tax benefits. State income tax expense increased from 2008 to 2009 as a result of changes in Illinois sourcing rules. This increase was more than offset by the recording of additional benefits totaling \$4.1 million with respect to certain previously identified uncertain tax positions under FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FASB Statement No. 109, *Accounting for Income Taxes* ("FIN 48") as a result of certain developments in pending tax audits.

12. ASSETS HELD FOR SALE

As of March 31, 2009, the Company held nine parcels of vacant land for sale. The total carrying value of \$1.6 million as of March 31, 2009 is included in premises, furniture, and equipment in the Consolidated Statements of Financial Condition. The Company had no assets classified as held for sale as of December 31, 2008. During first quarter 2009, the Company reviewed all of its vacant properties that are potentially marketable, and elected to place the nine parcels on the market. The estimated fair value of these parcels is greater than the book value as of March 31, 2009. Therefore, no impairment loss was required to be recognized during the quarter related to these properties.

13. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

Accounting Policy for Derivative Financial Instruments

In the ordinary course of business, the Company enters into derivative transactions as part of its overall interest rate risk management strategy to minimize significant unplanned fluctuations in earnings and cash flows caused by interest rate volatility. All derivative instruments are recorded at fair value as either other assets or other liabilities. Subsequent changes in a derivative's fair value are recognized in earnings unless specific hedge accounting criteria are met.

On the date the Company enters into a derivative contract, it designates the derivative instrument as either a fair value hedge, cash flow hedge, or as a non-hedge derivative instrument. Derivative instruments designated in a hedge relationship to mitigate exposure to changes in the fair value of an asset or liability attributable to a particular risk, such as interest rate risk, are considered to be fair value hedges. Derivative instruments designated in a hedge relationship to mitigate exposure to variability in expected future cash flows to be received or paid related to an asset or liability or other types of forecasted transactions are considered to be cash flow hedges. The Company formally documents all relationships between hedging instruments and hedged items as well as its risk management objective and strategy for undertaking each hedge transaction.

For effective derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative instrument, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, are recognized in current earnings during the period of the change in fair values. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income. The unrealized gain or loss is reclassified into earnings in the same period or periods during which the hedged transaction affects earnings (for example, when a hedged item is terminated or redesignated). For all hedge relationships, derivative gains and losses not effective in hedging the change in fair value or expected cash flows of the hedged item are recognized immediately in current earnings during the period of change.

At the hedge's inception and at least quarterly thereafter, a formal assessment is performed to determine whether changes in the fair values or cash flows of the derivative instruments have been highly effective in offsetting changes in the fair values or cash flows of the hedged item and whether they are expected to be highly effective in the future. If a derivative instrument designated as a hedge is terminated or ceases to be highly effective, hedge accounting is discontinued prospectively and the gain or loss is amortized to earnings. For fair value hedges, the gain or loss is amortized over the remaining life of the hedged asset or liability. For cash flow hedges, the gain or loss is amortized over the same period(s) that the forecasted hedged transactions impact earnings. If the hedged item is disposed of, or the forecasted transaction is no longer probable, any fair value adjustments are included in the gain or loss from the disposition of the hedged item. In the case of a forecasted transaction that is no longer probable, the gain or loss is included in earnings immediately.

Hedging Strategy

The Company maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings and cash flows caused by interest rate volatility. The Company usually designates derivative instruments used to manage interest rate risk into hedge relationships with the specific assets, liabilities, or cash flows being hedged. Some derivative instruments used for interest rate risk management may not be designated as part of a hedge relationship if the derivative instrument has been moved out of a hedge relationship because the hedge was deemed not effective or if operational or cost constraints make it prohibitive to apply hedge accounting.

Management uses derivative instruments to protect against the risk of interest rate movements on the value of certain assets and liabilities and on future cash flows. The derivative instruments the Company primarily uses are interest rate swaps with indices that relate to the pricing of specific assets and liabilities. The nature and volume of the derivative instruments used to manage interest rate risk depend on the level and type of assets and liabilities held and the risk management strategies for the current and anticipated interest rate environment.

As with any financial instrument, derivative instruments have inherent risks, primarily market and credit risk. Market risk is the adverse effect a change in interest rates, currency, equity prices, or implied volatility has on the value of a financial instrument. Market risk associated with changes in interest rates is managed by establishing and monitoring limits as to the degree of risk that may be undertaken as part of the Company's overall market risk monitoring process, which includes the use of net interest income and economic value of equity simulation methodologies. This process is carried out by the Company's Asset Liability Management Committee. See further discussion of this process in Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," of this Form 10-Q.

Fair Value Hedges

- During 2008 and 2009, the Company hedged the fair value of fixed rate commercial real estate loans through the use of pay fixed, receive variable interest rate swaps. In 2008, the Company also hedged the fair value of fixed rate, junior subordinated debentures through the use of pay variable, receive fixed interest rate swaps. The Company recognized ineffectiveness on its fair value hedges of \$5,000 during first quarter 2009, which is included in other noninterest income in the Consolidated Statements of Income. No gains or losses were recognized related to components of derivative instruments that were excluded from the assessment of hedge ineffectiveness during 2008 or 2009.

Derivative contracts are valued using observable market prices, if available, or cash flow projection models acquired from third parties. Pricing models used for valuing derivative instruments are regularly validated by testing through comparison with other third parties. The valuations and expected lives presented in the following table are based on yield curves, forward yield curves, and implied volatilities that were observable in the cash and derivatives markets on March 31, 2009 and December 31, 2008.

Other Derivative Activities

- The Company had no other derivative instruments as of March 31, 2009 or December 31, 2008. The Company does not enter into derivative transactions for purely speculative purposes.

Interest Rate Derivatives Portfolio

(Dollar amounts in thousands)

| | <u>March 31,</u> <u>2009</u> | <u>December 31,</u> <u>2008</u> |
|---|---------------------------------|------------------------------------|
| Fair Value Hedges | | |
| Related to fixed rate commercial loans | | |
| Notional amount outstanding | \$ 19,741 | \$ 19,982 |
| Weighted-average interest rate received | 2.42% | 3.16% |

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| | | |
|--------------------------------------|------------|------------|
| Weighted-average interest rate paid | 6.39% | 6.39% |
| Weighted-average maturity (in years) | 8.52 | 8.76 |
| Derivative liability fair value | \$ (2,380) | \$ (2,628) |

| | <u>Quarters Ended March 31,</u> | |
|--|---------------------------------|--------------|
| | <u>2009</u> | <u>2008</u> |
| Gains (losses) on hedged items recognized in noninterest income: | | |
| Gains (losses) on swaps | \$ 248 | \$ (430) |
| (Losses) gains on loans | <u>(253)</u> | <u>440</u> |
| Net hedge ineffectiveness | <u>\$ (5)</u> | <u>\$ 10</u> |
| Gains recognized in net interest income ^{(1) (2)} | \$ 40 | \$ 6 |

(1)The gain represents the fair value adjustments on discontinued fair value hedges in connection with our subordinated fixed rate debt that are being amortized through earnings over the remaining life of the hedged item (debt).

(2)In addition to these amounts, interest accruals on fair value hedges are also reported in net interest income.

Credit Risk

Credit risk occurs when the counterparty to a derivative contract with an unrealized gain fails to perform according to the terms of the agreement. Credit risk is managed by limiting the aggregate amount of net unrealized gains in agreements outstanding, monitoring the size and the maturity structure of the derivatives, applying uniform credit standards maintained for all activities with credit risk, and collateralizing gains. The Company maintains a policy limiting credit exposure to any one counterparty to not more than 2.5% of stockholders' equity. In addition, the Company has established bilateral collateral agreements with its major derivative dealer counterparties that provide for exchanges of marketable securities or cash to collateralize either party's net gains above an agreed-upon minimum threshold. On March 31, 2009, these collateral agreements covered 100% of the fair value of the Company's interest rate swaps outstanding. Net losses with counterparties must be collateralized with either cash or U.S. Government and U.S. Government-sponsored agency securities. As of March 31, 2009 and December 31, 2008, the Company pledged cash of \$2.7 million to collateralize net losses with counterparties. No other collateral was required to be pledged as of March 31, 2009 or December 31, 2008.

As of March 31, 2009 and December 31, 2008, all of the Company's derivative instruments contain provisions that require the Company's debt to remain above a certain credit rating by each of the major credit rating agencies. If the Company's debt were to fall below that credit rating, it would be in violation of those provisions, and the counterparties to the derivative instruments could terminate the swap transaction and demand cash settlement of the derivative instrument.

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

The discussion presented below provides an analysis of our results of operations and financial condition for the quarters ended March 31, 2009 and 2008. When we use the terms "First Midwest," the "Company," "we," "us," and "our," we mean First Midwest Bancorp, Inc., a Delaware Corporation, and its consolidated subsidiaries. When we use the term the "Bank," we are referring to our wholly-owned banking subsidiary, First Midwest Bank. Management's discussion and analysis should be read in conjunction with the consolidated financial statements and accompanying notes presented elsewhere in this report, as well as in our 2008 Annual Report on Form 10-K ("2008 10-K"). Results of operations for the quarter ended March 31, 2009 are not necessarily indicative of results to be expected for the year ending December 31, 2009. Unless otherwise stated, all earnings per common share data included in this section and

throughout the remainder of this discussion are presented on a diluted basis.

PERFORMANCE OVERVIEW

General Overview

Our banking network provides a full range of business and retail banking and trust and advisory services through 97 banking branches, one operational facility, and one dedicated lending office primarily in suburban metropolitan Chicago. The primary sources of our revenue are net interest income and fees from financial services provided to customers. Business volumes tend to be influenced by overall economic factors including market interest rates, business spending, consumer confidence, and competitive conditions within the marketplace.

First Quarter 2009 vs. 2008

Table 1
Selected Financial Data ⁽¹⁾

(Dollar amounts in thousands, except per share data)

| | Quarters Ended March 31, | | % Change |
|--|-----------------------------|------------|----------|
| | 2009 | 2008 | |
| Operating Results | | | |
| Interest income | \$ 91,480 | \$ 108,475 | (15.7) |
| Interest expense | 27,261 | 49,975 | (45.5) |
| Net interest income | 64,219 | 58,500 | 9.8 |
| Fee-based revenues | 20,134 | 23,269 | (13.5) |
| Other noninterest income | 415 | 1,782 | (76.7) |
| Noninterest expense | (48,394) | (49,343) | (1.9) |
| Pre-tax earnings, excluding provision for loan losses and market-related losses ⁽²⁾ | 36,374 | 34,208 | 6.3 |
| Provision for loan losses | (48,410) | (9,060) | 434.3 |
| Gains on securities sales, net | 11,160 | 7,249 | 54.0 |
| Securities impairment losses | (2,938) | (2,281) | 28.8 |
| (Loss) income before income tax benefit (expense) | (3,814) | 30,116 | (112.7) |
| Income tax benefit (expense) | 9,541 | (5,078) | (287.9) |
| Net income | 5,727 | 25,038 | (77.1) |
| Preferred dividends | (2,563) | - | - |
| Net income applicable to non-vested restricted shares | (9) | (59) | (84.7) |
| Net income applicable to common shares | \$ 3,155 | \$ 24,979 | (87.4) |
| Diluted earnings per common share | \$ 0.07 | \$ 0.51 | (86.3) |
| Performance Ratios | | | |
| Return on average common equity | 1.78% | 13.72% | |
| Return on average assets | 0.15% | 1.24% | |
| Net interest margin - tax equivalent | 3.67% | 3.53% | |

Efficiency ratio 52.33% 54.02%

| | March 31, 2009 | December 31, 2008 | March 31, 2008 | 3/31/09 \$ Change From 12/31/08 | 3/31/08 |
|---------------------------------|-------------------|----------------------|-------------------|------------------------------------|-------------|
| Balance Sheet Highlights | | | | | |
| Total assets | \$ 8,252,576 | \$ 8,528,341 | \$ 8,315,368 | \$ (275,765) | \$ (62,792) |
| Total loans | 5,387,128 | 5,360,063 | 5,045,765 | 27,065 | 341,363 |
| Total deposits | 5,508,382 | 5,585,754 | 5,721,562 | (77,372) | (213,180) |

(1) All ratios are presented on an annualized basis.

(2) The company's accounting and reporting policies conform to U.S. generally accepted accounting principles ("GAAP") and general practice within the banking industry. As a supplement to GAAP, the Company has provided this non-GAAP performance result. The Company believes that this non-GAAP financial measure is useful because it allows investors to assess the Company's operating performance. Although this non-GAAP financial measure is intended to enhance investors' understanding of the Company's business and performance, this non-GAAP financial measure should not be considered an alternative to GAAP.

We recorded a loss before taxes of \$3.8 million for first quarter 2009, as compared to income of \$30.1 million for first quarter 2008, with the difference largely due to higher provision for loan losses. Provision for loan losses for first quarter 2009 was \$48.4 million as contrasted to \$9.1 million for first quarter 2008. Excluding the provision for loan losses and net securities gains from each period, income before taxes was \$36.4 million for first quarter 2009 and \$34.2 million for first quarter 2008.

For a discussion of the Company's loan portfolio and credit quality, see the section titled "Loan Portfolio and Credit Quality" elsewhere in this report. For a discussion of net securities gains and impairment losses, see the section titled "Investment Portfolio Management."

Our first quarter operating results reflect both the impact of current economic conditions on our credit costs as well as the implementation of planned initiatives designed to respond to those conditions. Operating performance for the quarter, excluding credit costs, was up from a year ago as we profited from stronger net interest margins, the stability of our core funding base, targeted loan growth, and lower operating expenses. During the quarter, we made the difficult decision to reduce our dividend and took advantage of improvement in the debt security markets to reduce the size of our securities portfolio. In combination, these actions helped further our objectives of enhancing our tangible capital position and improving our overall liquidity.

Net interest margin for first quarter 2009 of 3.67% declined 4 basis points from fourth quarter 2008 but was up 14 basis points from first quarter 2008. While partly due to improved loan pricing, it also reflects our stable, solid customer deposit base. As of March 31, 2009, our loan-to-deposit ratio is 97.8%, with nearly two-thirds of our customer deposits consisting of demand, NOW, money market, and savings core transactional accounts.

Our total noninterest income decreased \$1.2 million, or 4.2%, for first quarter 2009 compared to first quarter 2008. Fee-based revenues decreased 13.5% for first quarter 2009 from first quarter 2008. This decrease largely stems from the impact of lower transaction volumes caused by reduced consumer spending on overdraft fees as well as card-based fees. Further, trust and investment advisory fees declined 15.7% as compared to first quarter 2008, resulting from the adverse impact of lower asset values on revenues.

For first quarter 2009, noninterest expense declined by 1.9% compared to first quarter 2008, largely due to a \$2.9 million decline in salaries and benefits expense resulting from a 3.6% reduction in FTEs. This reduction substantially

offset a \$2.1 million increase in FDIC insurance premiums and a \$1.4 million increase in legal and operating costs associated with credit remediation and other real estate owned. Operating efficiency for the first quarter 2009 improved to 52.33% for first quarter 2009, compared to 54.02% for first quarter 2008.

Outstanding loans totaled \$5.4 billion as of March 31, 2009, an annualized increase of 2.0% from December 31, 2008. The increase since December 2008 was led by growth in commercial and industrial loans and commercial real estate, specifically office, retail, and industrial, and multi-family lending. These increases were partially offset by a decline in residential land and development loans.

Non-performing loans as of March 31, 2009 were \$258.5 million compared to \$172.1 million at December 31, 2008, with residential land and development loans comprising half of the March 31, 2009 total. Non-accrual loans at March 31, 2009 totaled \$183.5 million compared to \$127.8 million at December 31, 2008, while loans 90 days or more past due and still accruing totaled \$73.9 million, up from \$37.0 million at December 31, 2008.

We increased our reserve for loan losses to \$116.0 million as of March 31, 2009, up \$22.1 million from December 31, 2008. The reserve for loan losses to loans was 2.15% as of March 31, 2009, up from 1.75% as of December 31, 2008. Total loans charged-off, net of recoveries, in first quarter 2009 were 1.98% of average loans.

Total average deposits for first quarter 2009 decreased 3.7% from first quarter 2008 and 2.3% from fourth quarter 2008 due primarily to a decline in time deposits. The Company's average core transactional deposits declined 0.4% from fourth quarter 2008. Traditionally, we would have expected to see a greater decline in average core transactional deposits in the first quarter due to normal seasonal declines in public funds balances.

EARNINGS PERFORMANCE

Net Interest Income

Net interest income equals the difference between interest income plus fees earned on interest-earning assets and interest expense incurred on interest-bearing liabilities. The level of interest rates and the volume and mix of interest-earning assets and interest-bearing liabilities impact net interest income. Net interest margin represents net interest income as a percentage of total average interest-earning assets. The accounting policies underlying the recognition of interest income on loans, securities, and other interest-earning assets are included in the "Notes to Consolidated Financial Statements" contained in our 2008 10-K.

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

Table 2
Effect of Tax-Equivalent Adjustment

(Dollar amounts in thousands)

| | Quarters Ended March 31, | | |
|----------------------------|--------------------------|-----------|----------|
| | 2009 | 2008 | % Change |
| Net interest income (GAAP) | \$ 64,219 | \$ 58,500 | 9.8 |

| | | | |
|------------------------------------|------------------|------------------|--------------|
| Tax-equivalent adjustment | <u>5,428</u> | <u>5,554</u> | <u>(2.3)</u> |
| Tax-equivalent net interest income | <u>\$ 69,647</u> | <u>\$ 64,054</u> | <u>8.7</u> |

Table 3 summarizes changes in our average interest-earning assets and interest-bearing liabilities as well as interest income and interest expense related to each category of assets and funding sources and the average interest rates earned and paid on each. The table also shows the trend in net interest margin on a quarterly basis for 2009 and 2008, including the tax-equivalent yields on interest-earning assets and rates paid on interest-bearing liabilities. Table 3 also details increases in income and expense for each of the major categories of interest-earning assets and analyzes the extent to which such variances are attributable to volume and rate changes. Interest income and yields are presented on a tax-equivalent basis assuming a federal income tax rate of 35%, which includes the tax-equivalent adjustment as presented in Table 2 above.

Net interest margin for first quarter 2009 of 3.67% declined 4 basis points from fourth quarter 2008 but was up 14 basis points from first quarter 2008. While partly due to improved loan pricing, it also reflects our stable, solid customer deposit base. As of March 31, 2009, our loan-to-deposit ratio is 97.8%, with nearly two-thirds of our customer deposits consisting of demand, NOW, money market, and savings core transactional accounts.

First quarter 2009 net interest margin reflects our strong core deposit base and our ability to effectively manage our cost of funds. With approximately one-half of our loan portfolio tied to floating indices, the 275 basis point decline in the Federal Reserve's federal funds during the period March through December 2008 resulted in a decline of 158 basis points in average loan yields from first quarter 2008. This negative impact was offset by a shift to less expensive wholesale borrowing from money market and time deposits, a widening of loan spreads, and expanded spreads on our investment portfolio as the interest rate yield curve steepened.

As shown in Table 3, first quarter 2009 tax-equivalent interest income declined \$17.1 million compared to first quarter 2008. The increase in interest-earning assets increased interest income by \$7.6 million, while a decline in the average rate earned on interest-earning assets reduced interest income by \$24.7 million. First quarter 2009 interest expense declined \$22.7 million compared to first quarter 2008. The increase in interest-bearing liabilities increased interest expense by \$3.9 million, but the shift to less expensive wholesale borrowing, coupled with an overall decrease in the average rate paid on interest-bearing liabilities reduced interest expense by \$26.6 million.

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

Table 3
Net Interest Income and Margin Analysis

(Dollar amounts in thousands)

| Quarters Ended March 31, | | | | | | Attribution of Change | |
|--------------------------|----------|-----------------------|--------------------|----------|-----------------------|------------------------|----------------|
| 2009 | | | 2008 | | | in Net Interest Income | |
| Average Balance | Interest | Yield/ Rate (%) | Average Balance | Interest | Yield/ Rate (%) | Volume | Yield/ Rate |
| | | | | | | | |

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Assets:

Federal funds
sold and other
short-term
investments

\$ 4,487 \$ 3 0.27 \$ 2,072 \$ 21 4.08 \$ (108) \$ 90 \$

Trading account
securities

12,434 40 1.29 18,604 62 1.33 (20) (2)

Securities
available-for-sale
(2)

2,109,477 29,376 5.57 2,089,135 30,359 5.81 300 (1,283)

Securities
held-to-maturity

82,969 1,413 6.81 95,747 1,601 6.69 (219) 31

Federal Home
Loan Bank and
Federal Reserve
Bank stock

54,768 308 2.25 54,767 338 2.47 - (30)

Loans (2):

Commercial and
industrial

1,488,508 17,114 4.66 1,356,868 22,249 6.59 2,469 (7,604)

Agricultural

139,947 1,293 3.75 180,088 2,544 5.68 (490) (761)

Commercial real
estate

3,010,167 37,928 5.11 2,698,459 44,111 6.57 6,280 (12,463)

Consumer

547,876 6,555 4.85 556,252 9,189 6.64 (136) (2,498)

Real estate - 1-4
family

192,407 2,878 6.07 227,100 3,555 6.30 (524) (153)

Total loans

5,378,905 65,768 4.96 5,018,767 81,648 6.54 7,599 (23,479)

Total
interest-earning
assets (2)

7,643,040 96,908 5.12 7,279,092 114,029 6.29 7,552 (24,673)

Cash and due
from banks

113,673 129,431

Reserve for loan
losses

(100,756) (62,431)

Other assets

772,922 724,632

Total assets

\$ 8,428,879 \$ 8,070,724

Liabilities and Stockholders'

Equity:

Savings deposits

\$ 748,350 847 0.46 \$ 814,764 2,671 1.32 (202) (1,622)

NOW accounts

893,687 969 0.44 880,505 2,812 1.28 43 (1,886)

Money market
deposits

768,202 2,104 1.11 822,154 4,532 2.22 (280) (2,148)

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| | | | | | | | | |
|--|---------------------|------------------|-------------|---------------------|------------------|-------------|-----------------|-----------------|
| Time deposits | 2,069,671 | 15,007 | 2.94 | 2,175,183 | 24,195 | 4.47 | (1,124) | (8,064) |
| Borrowed funds | 1,694,928 | 4,632 | 1.11 | 1,307,398 | 12,076 | 3.71 | 5,411 | (12,855) |
| Subordinated debt | <u>232,391</u> | <u>3,702</u> | <u>6.46</u> | <u>230,458</u> | <u>3,689</u> | <u>6.44</u> | <u>31</u> | <u>(18)</u> |
| Total interest-bearing liabilities | <u>6,407,229</u> | <u>27,261</u> | <u>1.73</u> | <u>6,230,462</u> | <u>49,975</u> | <u>3.23</u> | <u>3,879</u> | <u>(26,593)</u> |
| Demand deposits | 1,028,617 | | | 1,025,320 | | | | |
| Other liabilities | 79,224 | | | 82,484 | | | | |
| Stockholders' equity - common | 720,809 | | | 732,458 | | | | |
| Stockholders' equity - preferred | <u>193,000</u> | | | <u>-</u> | | | | |
| Total liabilities and stockholders' equity | <u>\$ 8,428,879</u> | | | <u>\$ 8,070,724</u> | | | | |
| Net interest income/margin ⁽²⁾ | | <u>\$ 69,647</u> | <u>3.67</u> | | <u>\$ 64,054</u> | <u>3.53</u> | <u>\$ 3,673</u> | <u>\$ 1,920</u> |

Quarterly Net Interest Margin Trend

| | 2009 | | 2008 | | |
|--|-------|--------|-------|--------|-------|
| | First | Fourth | Third | Second | First |
| Yield on interest-earning assets | 5.12% | 5.43% | 5.69% | 5.81% | 6.29% |
| Rates paid on interest-bearing liabilities | 1.73% | 2.03% | 2.40% | 2.61% | 3.23% |
| Net interest margin ⁽²⁾ | 3.67% | 3.71% | 3.63% | 3.58% | 3.53% |

(1) For purposes of this table, changes which are not due solely to volume changes or rate changes are allocated to such categories on the basis of the percentage relationship of each to the sum of the two.

(2) Interest income and yields are presented on a tax-equivalent basis, assuming a federal income tax rate of 35%.

Noninterest Income

Table 4
Noninterest Income Analysis

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(Dollar amounts in thousands)

| | Quarters Ended March 31, | | |
|--|--------------------------|------------------|---------------|
| | 2009 | 2008 | % Change |
| Service charges on deposit accounts | \$ 9,044 | \$ 10,422 | (13.2) |
| Trust and investment advisory fees | 3,329 | 3,947 | (15.7) |
| Other service charges, commissions, and fees | 4,006 | 5,002 | (19.9) |
| Card-based fees | <u>3,755</u> | <u>3,898</u> | <u>(3.7)</u> |
| Subtotal fee-based revenues | 20,134 | 23,269 | (13.5) |
| Bank owned life insurance ("BOLI") income | 541 | 2,462 | (78.0) |
| Other income | <u>496</u> | <u>740</u> | <u>(33.0)</u> |
| Subtotal operating revenues | 21,171 | 26,471 | (20.0) |
| Trading (losses) gains, net | (622) | (1,420) | (56.2) |
| Gains on securities sales, net | 11,160 | 7,249 | 54.0 |
| Securities impairment losses | <u>(2,938)</u> | <u>(2,281)</u> | <u>28.8</u> |
| Total noninterest income | <u>\$ 28,771</u> | <u>\$ 30,019</u> | <u>(4.2)</u> |

Our total noninterest income decreased \$1.2 million, or 4.2%, for first quarter 2009 compared to first quarter 2008. Fee-based revenues decreased 13.5% for first quarter 2009 from first quarter 2008. This decrease largely stems from the impact of lower transaction volumes caused by reduced consumer spending on overdraft fees as well as card-based fees. Further, trust and investment advisory fees declined 15.7% as compared to first quarter 2008, resulting from the adverse impact of lower asset values on revenues.

Other service charges, commissions, and fees declined 19.9% for first quarter 2009 compared to first quarter 2008 primarily due to a \$501,000 decline in commissions received from the sale of third-party annuity and investment products as compared to first quarter 2008.

BOLI income represents benefit payments received and the change in cash surrender value ("CSV") of the policies, net of premiums paid. The change in CSV is attributable to earnings or losses credited to policies, based on investments made by the insurer. In comparison to first quarter 2008, bank-owned life insurance income declined \$1.9 million for first quarter 2009. In the current environment, management elected to accept lower market returns in order to reduce its risk to market volatility through investment in shorter-duration, lower yielding money market instruments. The tax-equivalent yield on BOLI was 1.69% for first quarter 2009 compared to 6.99% for first quarter 2008. See the section titled "Investment in Bank Owned Life Insurance" for a discussion of our investment in BOLI.

Other income, which consists primarily of safe deposit box rentals and miscellaneous recoveries, declined for 33.0% for first quarter 2009 as compared to first quarter 2008.

Trading (losses) gains result from the change in fair value of trading securities. Such change is substantially offset by an adjustment to salaries and benefits expense. Our 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 stock.

We recognized a net securities gain and securities impairment losses for each period presented. For a discussion of these items, see the section titled "Investment Portfolio Management."

Noninterest Expense

Table 5
Noninterest Expense Analysis

(Dollar amounts in thousands)

| | Quarters Ended March 31, | | |
|--|--------------------------|-----------|----------|
| | 2009 | 2008 | % Change |
| Compensation expense: | | | |
| Salaries and wages | \$ 17,090 | \$ 19,024 | (10.2) |
| Retirement and other employee benefits | 6,221 | 7,166 | (13.2) |
| Total compensation expense | 23,311 | 26,190 | (11.0) |
| Net occupancy expense | 6,506 | 6,151 | 5.8 |
| Professional services | 2,934 | 2,294 | 27.9 |
| Federal Deposit Insurance Corporation ("FDIC") insurance | 2,361 | 252 | 836.9 |
| Equipment expense | 2,331 | 2,567 | (9.2) |
| Technology and related costs | 2,240 | 1,771 | 26.5 |
| Advertising and promotions | 1,082 | 1,037 | 4.3 |
| Merchant card expense | 1,538 | 1,646 | (6.6) |
| Other real estate owned ("OREO") expense, net | 1,004 | 318 | 215.7 |
| Other expenses | 5,087 | 7,117 | (28.5) |
| Total noninterest expense | \$ 48,394 | \$ 49,343 | (1.9) |
| Full-time equivalent ("FTE") employees | 1,767 | 1,833 | (3.6) |
| Efficiency ratio | 52.33% | 54.02% | |

For first quarter 2009, noninterest expense declined by 1.9% compared to first quarter 2008, largely due to a \$2.9 million decline in salaries and benefits expense resulting from a 3.6% reduction in FTEs. This reduction substantially offset a \$2.1 million increase in FDIC insurance premiums and a \$1.4 million increase in legal and operating costs associated with credit remediation and OREO.

Salaries and wages decreased in first quarter 2009 compared to first quarter 2008 as annual general merit increases were more than offset by targeted staff reductions and declines in incentive compensation and share-based compensation expense.

Of the \$469,000 increase in technology and related costs from first quarter 2008 to first quarter 2009, \$253,000 was due to a new voice over internet protocol (VoIP), which is a used for the delivery of voice communications over

IP networks such as the Internet. This investment in technology positions us for the future by providing us with a much more cost-effective means of communicating and transferring data. This cost also provides a savings in telephone expense, which is included in other expenses. The remaining variance in technology and related costs resulted from standard contractual increases.

The increase in professional services was due primarily to increased costs associated with credit remediation and OREO.

OREO expense increased in first quarter 2009 compared to first quarter 2008 as the balance of OREO properties increased from \$8.6 million at March 31, 2008 to \$39.0 million at March 31, 2009.

The decline in other expenses was spread over various noninterest expense categories including freight and expense, telephone, and supplies and printing.

The efficiency ratio expresses noninterest expense as a percentage of tax-equivalent net interest income plus total fees and other income. Operating efficiency for first quarter 2009 improved to 52.33%, compared to 54.02% for first quarter 2008.

Income Taxes

Our accounting policies underlying the recognition of income taxes in the Consolidated Statements of Financial Condition and Income are included in Notes 1 and 15 to the Consolidated Financial Statements of our 2008 10-K.

Income tax (benefit) expense totaled (\$9.5 million) for first quarter 2009 compared to \$5.1 million for first quarter 2008.

Federal income tax expense and the related effective tax rate are primarily influenced by the amount of tax-exempt income derived from investment securities and BOLI in relation to pre-tax income. State income tax expense and the related effective tax rate are influenced by the amount of state tax-exempt income in relation to pre-tax income, and state tax rules relating to consolidated/combined reporting and sourcing of income and expense.

The decrease in tax expense from 2008 to 2009 was primarily attributable to the decrease in pre-tax income. In 2009, federal tax-exempt income exceeded pre-tax income resulting in the recording of federal tax benefits. State income tax expense increased from 2008 to 2009 as a result of changes in Illinois sourcing rules. This increase was more than offset by the recording of additional benefits totaling \$4.1 million with respect to certain previously identified uncertain tax positions under Financial Accounting Standards Board ("FASB") Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, Accounting for Income Taxes* ("FIN 48") as a result of certain developments in pending tax audits.

FINANCIAL CONDITION

Investment Portfolio Management

We manage our investment portfolio to maximize the return on invested funds within acceptable risk guidelines, to meet pledging and liquidity requirements, and to adjust balance sheet interest rate sensitivity to insulate net interest income against the impact of changes in interest rates.

We adjust the size and composition of our securities portfolio according to a number of factors, including expected loan growth, anticipated changes in collateralized public funds on account, the interest rate environment, and the related value of various segments of the securities markets. The following provides a valuation summary of our investment portfolio.

Table 6
Investment Portfolio Valuation Summary

(Dollar amounts in thousands)

| | As of March 31, 2009 | | | As of December 31, 2008 | | |
|--------------------|----------------------|----------------|------------|-------------------------|----------------|------------|
| | Fair Value | Amortized Cost | % of Total | Fair Value | Amortized Cost | % of Total |
| Available-for-Sale | \$ 122 | \$ 122 | - | \$ 1,041 | \$ 1,039 | 0.1 |

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| | | | | | | |
|-------------------------------------|---------------------|------------------|--------------|------------------|------------------|--------------|
| U.S. Treasury securities | | | | | | |
| Collateralized mortgage obligations | 609,341 | 598,367 | 29.6 | 698,839 | 694,285 | 29.9 |
| Other mortgage-backed securities | 356,054 | 344,503 | 17.1 | 518,265 | 504,918 | 21.7 |
| State and municipal securities | 854,549 | 861,547 | 42.7 | 906,747 | 907,036 | 39.1 |
| Collateralized debt obligations | 34,527 | 75,922 | 3.8 | 42,086 | 78,883 | 3.4 |
| Corporate debt securities | 26,855 | 35,751 | 1.8 | 33,325 | 35,731 | 1.5 |
| Equity securities | 20,471 | 20,861 | 1.0 | 15,883 | 16,089 | 0.7 |
| Total available-for-sale | <u>1,901,919</u> | <u>1,937,073</u> | <u>96.0</u> | <u>2,216,186</u> | <u>2,237,981</u> | <u>96.4</u> |
| Held-to-Maturity | | | | | | |
| State and municipal securities | <u>81,962</u> | <u>81,566</u> | <u>4.0</u> | <u>84,592</u> | <u>84,306</u> | <u>3.6</u> |
| Total securities | <u>\$ 1,983,881</u> | <u>2,018,639</u> | <u>100.0</u> | <u>2,300,778</u> | <u>2,322,287</u> | <u>100.0</u> |

| | At March 31, 2009 | | | At December 31, 2008 | | |
|-------------------------------------|---------------------------|---------------------|-------------------|---------------------------|---------------------|-------------------|
| | Effective Duration (1) | Average Life (2) | Yield to Maturity | Effective Duration (1) | Average Life (2) | Yield to Maturity |
| Available-for-Sale | | | | | | |
| U.S. Treasury securities | 1.35% | 1.50 | 1.26% | 1.35% | 1.50 | 0.89% |
| Collateralized mortgage obligations | 0.48% | 1.59 | 5.18% | 1.25% | 1.80 | 5.25% |
| Other mortgage-backed securities | 0.87% | 1.71 | 5.33% | 1.75% | 1.95 | 5.52% |
| State and municipal securities | 5.31% | 7.81 | 6.16% | 5.26% | 7.61 | 6.15% |
| Collateralized debt obligations | 0.25% | 5.70 | 3.06% | 0.25% | 5.84 | 3.26% |
| Other securities | <u>5.30%</u> | <u>12.19</u> | <u>4.27%</u> | <u>6.03%</u> | <u>12.61</u> | <u>5.06%</u> |
| Total available-for-sale | <u>2.80%</u> | <u>4.77</u> | <u>5.53%</u> | <u>3.07%</u> | <u>4.51</u> | <u>5.62%</u> |
| Held-to-Maturity | | | | | | |
| State and municipal securities | <u>6.17%</u> | <u>9.39</u> | <u>7.04%</u> | <u>7.00%</u> | <u>9.26</u> | <u>7.10%</u> |
| Total securities | <u>2.94%</u> | <u>4.96</u> | <u>5.59%</u> | <u>3.21%</u> | <u>4.69</u> | <u>5.67%</u> |

(1) The effective duration of the securities portfolio represents the estimated percentage change in the fair value of the securities portfolio given a 100 basis point change up or down in the level of interest rates. This measure is used as a gauge of the portfolio's price volatility at a single point in time and is not intended to be a precise predictor of future fair values, as such values will be influenced by a number of factors.

(2) Average life is presented in years and represents the weighted-average time to receive all future cash flows, using the dollar amount of

principal paydowns, including estimated principal prepayments, as the weighting factor.

As of March 31, 2009, our securities portfolio totaled \$2.0 billion, decreasing 13.8% from December 31, 2008. Net securities gains were \$8.2 million for first quarter 2009 compared to \$5.0 million for first quarter 2008. During first quarter 2009, we took advantage of opportunities in the market to sell \$323.5 million of mortgage-backed and municipal securities for a gain of \$11.1 million. This was partially offset by impairment charges totaling \$2.9 million associated with two trust-preferred collateralized debt obligations ("CDOs"). We elected early adoption of FASB Staff Position ("FSP") FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*. As a consequence, estimated credit losses were recognized on these two CDOs during the quarter, and a cumulative adjustment of \$11.3 million was recorded to retained earnings, representing the estimated liquidity components of previously recorded other-than-temporary impairments associated with its CDOs.

Our investments in collateralized debt obligations are trust preferred debt securities supported by the credit of the underlying banks and insurance companies. The unrealized loss on these securities as of March 31, 2009 of \$41.4 million reflects the market's temporary negative bias toward structured investment vehicles given the current interest rate and liquidity environment. We do not believe this loss is an other-than-temporary impairment. We expect no change in our net cash flows from these investments from what was originally anticipated, and we have both the intent and ability to hold them until maturity or recovery. Our estimation of cash flows for these investments and resulting fair values were based upon our own cash flow modeling in accordance with FASB No. 157, *Fair Value Measurements*, as described in Note 9 of "Notes to Consolidated Financial Statements".

State and municipal securities have an unrealized loss of \$7.0 million at March 31, 2009 compared to an unrealized gain of \$18.3 million at December 31, 2008. During first quarter 2009, we sold \$30.4 million in municipal securities at a gain of \$1.2 million. The adverse change in fair value of municipal securities is due to the uncertainty in the marketplace and the significant lack of liquidity for these debt securities. These securities continue to carry investment grade ratings with the bulk of them supported by the general revenues of the issuing governmental entity. We do not believe the unrealized loss on any of these is other than temporary.

Other securities include corporate bonds and other miscellaneous equity securities. We do not believe the unrealized loss on any of these is other than temporary.

LOAN PORTFOLIO AND CREDIT QUALITY

Portfolio Composition

Table 7
Loan Portfolio

(Dollar amounts in thousands)

| | March 31, 2009 | % of Total | December 31, 2008 | % of Total | Annualized % Change |
|--------------------------------|-------------------|---------------|----------------------|---------------|------------------------|
| Commercial and industrial | \$ 1,508,175 | 28.0 | \$ 1,490,101 | 27.8 | 4.8 |
| Agricultural | 141,190 | 2.6 | 142,635 | 2.7 | (4.0) |
| Commercial real estate: | | | | | |
| Office, retail, and industrial | 1,211,844 | 22.5 | 1,127,689 | 21.0 | 30.0 |

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| | | | | | |
|---|---------------------|--------------|---------------------|--------------|--------------|
| Residential land and development | 466,195 | 8.7 | 509,059 | 9.5 | (33.6) |
| Multi-family | 257,039 | 4.8 | 237,646 | 4.4 | 32.8 |
| Other commercial real estate | 1,073,483 | 19.9 | 1,106,952 | 20.7 | (12.0) |
| Total commercial real estate | 3,008,561 | 55.9 | 2,981,346 | 55.6 | 3.6 |
| Subtotal - corporate loans | 4,657,926 | 86.5 | 4,614,082 | 86.1 | 4.0 |
| Direct installment | 53,631 | 1.0 | 58,135 | 1.1 | (30.8) |
| Home equity | 480,283 | 8.9 | 477,105 | 8.9 | 2.8 |
| Indirect installment | 9,802 | 0.2 | 12,544 | 0.2 | (87.6) |
| Real estate - 1-4 family | 185,486 | 3.4 | 198,197 | 3.7 | (25.6) |
| Subtotal - consumer loans | 729,202 | 13.5 | 745,981 | 13.9 | (8.8) |
| Total loans | \$ 5,387,128 | 100.0 | \$ 5,360,063 | 100.0 | 2.0 |
| Consumer loans excluding indirect installment | \$ 719,400 | | \$ 733,437 | | (7.6) |
| Total loans excluding indirect installment | \$ 5,377,326 | | \$ 5,347,519 | | 2.4 |

Outstanding loans totaled \$5.4 billion as of March 31, 2009, an annualized increase of 2.0% from December 31, 2008. The increase since December 2008 was led by growth in commercial and industrial loans and commercial real estate, specifically office, retail, and industrial, and multi-family lending. These increases were partially offset by a decline in residential land and development loans.

Table 8
Commercial Real Estate Loan Detail by Product Type

(Dollar amounts in thousands)

| | <u>March 31, 2009</u> | <u>% of Total</u> | <u>December 31, 2008</u> | <u>% of Total</u> | <u>Annualized % Change</u> |
|---|-----------------------|-------------------|--------------------------|-------------------|----------------------------|
| Office, retail, and industrial | | | | | |
| Office | \$ 404,857 | 33.4 | \$ 373,242 | 33.1 | 34.0 |
| Retail | 338,858 | 28.0 | 313,286 | 27.8 | 32.8 |
| Industrial | 468,129 | 38.6 | 441,161 | 39.1 | 24.4 |
| Total office, retail, and industrial | \$ 1,211,844 | 100.0 | \$ 1,127,689 | 100.0 | 30.0 |
| Residential land and development Structures | \$ 133,497 | 28.6 | \$ 185,929 | 36.5 | (112.8) |

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| | | | | | |
|--|--------------|-------|--------------|-------|---------|
| Land | 332,698 | 71.4 | 323,130 | 63.5 | 12.0 |
| Total residential land and development | \$ 466,195 | 100.0 | \$ 509,059 | 100.0 | (33.6) |
| Multi-family | | | | | |
| | \$ 257,039 | 100.0 | \$ 237,646 | 100.0 | (56.0) |
| Other commercial real estate | | | | | |
| Commercial land | \$ 258,869 | 24.1 | \$ 280,120 | 25.3 | (30.4) |
| 1-5 family investors | 189,901 | 17.7 | 193,227 | 17.5 | (6.8) |
| Service stations and truck stops | 145,571 | 13.6 | 146,891 | 13.3 | (3.6) |
| Warehouses and storage | 89,541 | 8.3 | 85,276 | 7.7 | 20.0 |
| Hotels | 80,365 | 7.5 | 79,186 | 7.2 | 6.0 |
| Restaurants | 49,897 | 4.7 | 48,106 | 4.3 | 14.8 |
| Medical | 37,929 | 3.5 | 42,269 | 3.8 | (41.2) |
| Automobile dealers | 37,627 | 3.5 | 38,505 | 3.5 | (9.2) |
| Mobile home parks | 21,559 | 2.0 | 36,790 | 3.3 | (165.6) |
| Recreational | 12,587 | 1.2 | 14,515 | 1.3 | (53.2) |
| Religious | 11,121 | 1.0 | 11,224 | 1.0 | (3.6) |
| Other | 138,516 | 12.9 | 130,843 | 11.8 | 23.6 |
| Total other commercial real estate | \$ 1,073,483 | 100.0 | \$ 1,106,952 | 100.0 | (12.0) |

Non-performing Assets

Generally loans are placed on non-accrual status if principal or interest payments become 90 days or more past due and/or management deems the collectibility of the principal and/or interest to be in question. Loans to customers whose financial condition has deteriorated are considered for non-accrual status whether or not the loan is 90 days or more past due. For consumer loans, losses are automatically recognized and recorded when the loan reaches 120 days past due.

Once interest accruals are discontinued, accrued but uncollected interest is charged to current year operations. 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. Classification of a loan as non-accrual does not preclude the ultimate collection of loan principal or interest.

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. Given the deterioration in the economy, especially as it relates to real estate values, we are proactively working with our borrowers to restructure loans where appropriate and expect the number and amount of restructured loans to increase significantly in 2009. We do not accrue interest on any restructured loan until such time as we believe all principal and interest under its modified terms are reasonably assured. Until such time, these loans continue to be reported as non-accrual loans. Restructured loans that are accruing interest are not reported as non-accruing but continue to be separately reported as restructured until after the year in which the restructuring occurred, providing the loan was restructured at market rate and terms.

OREO represents property acquired as the result of borrower defaults on loans. OREO are recorded at estimated fair value, less estimated selling costs. Write-downs occurring at foreclosure are charged against the reserve for loan losses. On an ongoing basis, the book values of these properties are adjusted based upon new appraisals and/or market indications. Write-downs are recorded for subsequent declines in value and are included in other noninterest expense along with other expenses related to maintaining the properties. We are actively marketing properties acquired through foreclosure. Given current economic conditions and the uncertainty regarding the real estate market, the time involved to sell these properties may extend resulting in higher levels of OREO and associated maintenance costs in 2009.

90 days or more past due loans are loans for which principal or interest payments become 90 days or more past due but that still accrue interest since they are loans that are well secured and in the process of collection.

The following table breaks down our loan portfolio between performing and non-performing status.

Table 9
Loan Portfolio by Performing/Non-Performing Status

(Dollar amounts in thousands)

| | Total Loans | Current | Past Due | | Non-accrual | Restructured (still accruing) |
|-------------------------------------|----------------|--------------|------------------------|---------------------|-------------|-------------------------------------|
| | | | 30-89 Days Past Due | 90 Days Past Due | | |
| As of March 31, 2009 | | | | | | |
| Commercial and industrial | \$ 1,508,175 | \$ 1,448,291 | \$ 10,431 | \$ 16,208 | \$ 33,245 | \$ - |
| Agricultural | 141,190 | 139,439 | - | 1,751 | - | - |
| Commercial real estate: | | | | | | |
| Office, retail, and industrial | 1,211,844 | 1,179,959 | 6,305 | 12,719 | 12,769 | 92 |
| Residential land and development | 466,195 | 332,247 | 5,589 | 20,593 | 107,766 | - |
| Multi-family | 257,039 | 243,841 | 2,853 | 3,356 | 6,989 | - |
| Other commercial real estate | 1,073,483 | 1,032,315 | 16,214 | 8,900 | 16,025 | 29 |
| Total commercial real estate | 3,008,561 | 2,788,362 | 30,961 | 45,568 | 143,549 | 121 |
| Total corporate loans | 4,657,926 | 4,376,092 | 41,392 | 63,527 | 176,794 | 121 |
| Direct installment | 53,631 | 48,646 | 1,962 | 2,938 | 85 | - |
| Home equity | 480,283 | 463,947 | 6,041 | 5,174 | 4,833 | 288 |
| Indirect installment | 9,802 | 9,267 | 450 | 12 | 73 | - |
| Real estate - 1-4 family | 185,486 | 176,332 | 4,466 | 2,278 | 1,756 | 654 |
| Total consumer loans | 729,202 | 698,192 | 12,919 | 10,402 | 6,747 | 942 |
| Total loans | \$ 5,387,128 | \$ 5,074,284 | \$ 54,311 | \$ 73,929 | \$ 183,541 | \$ 1,063 |
| As of December 31, 2008 | | | | | | |
| Commercial and industrial | \$ 1,490,101 | \$ 1,428,778 | \$ 36,820 | \$ 6,818 | \$ 15,586 | \$ 2,099 |
| Agricultural | 142,635 | 138,336 | 2,548 | 1,751 | - | - |
| Commercial real estate: | | | | | | |
| Office, retail, and | 1,127,689 | 1,098,151 | 23,419 | 3,214 | 2,533 | 372 |

| | | | | | | |
|----------------------------------|---------------------|---------------------|-------------------|------------------|-------------------|-----------------|
| industrial | | | | | | |
| Residential land and development | 509,059 | 384,006 | 19,504 | 8,489 | 97,060 | - |
| Multi-family | 237,646 | 228,500 | 4,406 | 1,881 | 1,387 | 1,472 |
| Other commercial real estate | <u>1,106,952</u> | <u>1,074,945</u> | <u>15,352</u> | <u>6,586</u> | <u>6,926</u> | <u>3,143</u> |
| Total commercial real estate | <u>2,981,346</u> | <u>2,785,602</u> | <u>62,681</u> | <u>20,170</u> | <u>107,906</u> | <u>4,987</u> |
| Total corporate loans | <u>4,614,082</u> | <u>4,352,716</u> | <u>102,049</u> | <u>28,739</u> | <u>123,492</u> | <u>7,086</u> |
| Direct installment | 58,135 | 54,412 | 2,700 | 956 | 67 | - |
| Home equity | 477,105 | 463,317 | 6,471 | 3,944 | 3,254 | 119 |
| Indirect installment | 12,544 | 11,792 | 577 | 77 | 98 | - |
| Real estate - 1-4 family | <u>198,197</u> | <u>189,509</u> | <u>4,409</u> | <u>3,283</u> | <u>857</u> | <u>139</u> |
| Total consumer loans | <u>745,981</u> | <u>719,030</u> | <u>14,157</u> | <u>8,260</u> | <u>4,276</u> | <u>258</u> |
| Total loans | <u>\$ 5,360,063</u> | <u>\$ 5,071,746</u> | <u>\$ 116,206</u> | <u>\$ 36,999</u> | <u>\$ 127,768</u> | <u>\$ 7,344</u> |

The following table provides a comparison of our non-performing assets and past due loans to prior periods.

Table 10
Non-performing Assets and Past Due Loans

(Dollar amounts in thousands)

| | 2009 | | 2008 | | |
|---|----------------|--------------------|----------------|---------------|---------------|
| | March 31 | % of Loan Category | December 31 | September 30 | March 31 |
| Non-accrual loans: | | | | | |
| Commercial and industrial | \$ 33,245 | 2.20 | \$ 15,586 | \$ 13,961 | \$ 6,770 |
| Agricultural | - | 0.00 | - | - | - |
| Office, retail, and industrial | 12,769 | 1.05 | 2,533 | 1,195 | 730 |
| Residential land and development | 107,766 | 23.12 | 97,060 | 28,335 | 4,081 |
| Multi-family | 6,989 | 2.72 | 1,387 | 2,827 | 1,361 |
| Other commercial real estate | 16,025 | 1.49 | 6,926 | 1,845 | 255 |
| Consumer | 4,991 | 0.92 | 3,419 | 4,359 | 2,967 |
| Real estate - 1-4 family | <u>1,756</u> | <u>0.95</u> | <u>857</u> | <u>795</u> | <u>909</u> |
| Total non-accrual loans | <u>183,541</u> | | <u>127,768</u> | <u>53,317</u> | <u>17,073</u> |
| Restructured loans (still accruing interest) | 1,063 | | 7,344 | 3,731 | 1,942 |
| 90 days or more past due loans (still accruing interest): | | | | | |
| Commercial and industrial | 16,208 | 1.07 | 6,818 | 4,006 | 3,926 |
| Agricultural | 1,751 | 1.24 | 1,751 | 1,751 | - |
| Office, retail, and industrial | 12,719 | 1.05 | 3,214 | 4,838 | 2,182 |
| Residential land and development | 20,593 | 4.42 | 8,489 | 17,615 | 17,438 |
| Multi-family | 3,356 | 1.31 | 1,881 | 1,216 | 2,332 |

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| | | | | | |
|--|-------------------|------|-------------------|-------------------|-------------------|
| Other commercial real estate | 8,900 | 0.83 | 6,586 | 2,469 | 2,451 |
| Consumer | 8,124 | 1.49 | 4,977 | 3,062 | 3,255 |
| Real estate - 1-4 family | <u>2,278</u> | 1.23 | <u>3,283</u> | <u>2,359</u> | <u>1,895</u> |
| Total 90 days or more past due loans | <u>73,929</u> | | <u>36,999</u> | <u>37,316</u> | <u>33,479</u> |
| Total non-performing loans | <u>\$ 258,533</u> | | <u>\$ 172,111</u> | <u>\$ 94,364</u> | <u>\$ 52,494</u> |
| Other real estate owned ("OREO") | \$ 38,984 | | \$ 24,368 | \$ 23,697 | \$ 8,607 |
| 30-89 days past due loans (still accruing interest): | | | | | |
| Commercial and industrial | \$ 10,431 | 0.69 | \$ 36,820 | \$ 19,658 | \$ 22,465 |
| Agricultural | - | 0.00 | 2,548 | - | - |
| Office, retail, and industrial | 6,305 | 0.52 | 23,419 | 14,530 | 7,236 |
| Residential land and development | 5,589 | 1.20 | 19,504 | 43,592 | 35,903 |
| Multi-family | 2,853 | 1.11 | 4,406 | 3,186 | 17,591 |
| Other commercial real estate | 16,214 | 1.51 | 15,352 | 12,257 | 23,924 |
| Consumer | 8,453 | 1.55 | 9,748 | 8,583 | 7,109 |
| Real estate - 1-4 family | <u>4,466</u> | 2.41 | <u>4,409</u> | <u>2,963</u> | <u>2,203</u> |
| Total 30-89 days past due loans | <u>\$ 54,311</u> | | <u>\$ 116,206</u> | <u>\$ 104,769</u> | <u>\$ 116,431</u> |
| Non-accrual loans to total loans | 3.41% | | 2.38% | 1.02% | 0.34% |
| Non-performing loans to total loans | 4.80% | | 3.21% | 1.81% | 1.04% |

N/A - Not applicable.

Non-performing asset levels are elevated from year-end as we work through a longer and more challenging remediation cycle for real estate and construction-related credits. Recognizing this, and reflective of current conditions, we have increased our level of loan loss provisioning, bringing our level of reserves to 2.15% of total loans, 1.7 times the level existent a year ago.

Credit quality trends for the quarter were negatively impacted by continued housing market stress, particularly in the residential land and development segments of the loan portfolio. We are aggressively engaged with our builder/developer clients to determine the best solutions to maximize value for the entire segment. In future quarters, the migration of troubled loans from performing to non-performing and, in some cases, to OREO and finally to cash repayment will vary depending upon the adopted solution. We have both realigned and increased our credit remediation staffing in response to deteriorating credit trends both in this segment and overall.

Non-performing loans as of March 31, 2009 were \$258.5 million compared to \$172.1 million at December 31, 2008, with residential land and development loans comprising 49.6% of the March 31, 2009 total. Non-accrual loans at March 31, 2009 totaled \$183.5 million compared to \$127.8 million at December 31, 2008, while loans 90 days or more past due and still accruing totaled \$73.9 million, up from \$37.0 million at December 31, 2008. Restructured loans totaled \$1.1 million at March 31, 2009, a decline of \$6.3 million from December 31, 2008.

Non-accrual loans at March 31, 2009 increased \$55.8 million from December 31, 2008, with increases in all major categories of loans. Non-accrual residential land and development total of \$107.8 million is comprised of 45 relationships, with 13 accounting for 59.6% of the total and reflects the deterioration of economic conditions and, specifically, the impact of slowing market conditions on residential developers. The balances remaining for each loan are supported by recent appraisals on the underlying collateral.

Also included in non-accrual loans are \$7.7 million in loans for which the original terms have been modified in favor of the borrower or either principal or interest has been forgiven due to deterioration in the borrower's financial condition. Until such time as we believe all principal and interest under the modified terms are reasonably assured, these loans will continue to be reported as non-accrual loans.

Loans past due 90 days or more and still accruing increased \$36.9 million from December 31, 2008 to March 31, 2009. The increase in the 90 days or more past due loans from December 31, 2008 was due primarily to commercial and industrial and residential land and development loans.

As of March 31, 2009, loans 30-89 days past due totaled \$54.3 million, a decline of \$61.9 million from December 31, 2008. The decline reflects the benefits derived from expanded resources focused on the early remediation of potential problem loans as well as the migration of certain loans to other problem categories.

OREO was \$39.0 million as of March 31, 2009 as compared to \$24.4 million as of December 31, 2008. All properties are recorded at current appraised values, less estimated selling costs.

The pressure on housing sales and the resulting impact on our residential land and development portfolio, coupled with the current lack of marketability for real estate acquired through foreclosure, could result in an increase in non-performing assets. The trend of any increase and the ultimate level of non-performing assets will largely depend upon the timing and ability to convert assets acquired to cash.

In anticipation of continued economic weakness, we have substantially realigned our credit remediation staffing to proactively deal with potential credit issues.

Our disclosure with respect to impaired loans is contained in Note 5 of "Notes to Consolidated Financial Statements".

Reserve for Loan Losses

The reserve for loan losses is a reserve established through a provision for probable loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The reserve, in the judgment of management, is necessary to provide for estimated loan losses and risks inherent in the loan portfolio. The reserve for loan losses consists of three components: (i) specific reserves established for expected losses on individual loans for which the recorded investment in the loan exceeds the value of the loan; (ii) reserves based on historical loan loss experience for each loan category; and (iii) reserves based on general, current economic conditions as well as specific economic factors believed to be relevant to the markets in which we operate. Management evaluates the sufficiency of the reserve for loan losses based on the combined total of the specific, historical loss, and general components. Management believes that the reserve for loan losses of \$116.0 million is adequate to absorb credit losses inherent in the loan portfolio as of March 31, 2009.

Portions of the reserve may be allocated for specific credits. However, the entire reserve is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the reserve is dependent upon a variety of factors beyond the Company's control, including the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

For a summary of the changes in the reserve for loan losses during the quarters ended March 2009 and 2008, refer to Note 5 of "Notes to Consolidated Financial Statements."

Table 11
Reserve for Loan Losses

(Dollar amounts in thousands)

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| | 2009 | | 2008 | | |
|--|------------|-------------|--------------|-----------|-----------|
| | March 31 | December 31 | September 30 | June 30 | March 31 |
| For the period ended | | | | | |
| Reserve for loan losses | \$ 116,001 | \$ 93,869 | \$ 69,811 | \$ 66,104 | \$ 64,780 |
| Total loans | 5,387,128 | 5,360,063 | 5,223,582 | 5,182,355 | 5,045,765 |
| Reserve for loan losses to loans | 2.15% | 1.75% | 1.34% | 1.28% | 1.28% |
| Reserve for loan losses to non-accrual loans | 63% | 73% | 131% | 262% | 379% |
| For the quarter ended | | | | | |
| Provision for loan losses | \$ 48,410 | \$ 42,385 | \$ 13,029 | \$ 5,780 | \$ 9,060 |
| Net loans charged-off | 26,278 | 18,327 | 9,322 | 4,456 | 6,080 |
| Net loans charged-off to average loans, annualized | 1.98% | 1.38% | 0.71% | 0.35% | 0.49% |

We increased our reserve for loan losses to \$116.0 million as of March 31, 2009, up \$22.1 million from December 31, 2008. The reserve for loan losses to loans was 2.15% as of March 31, 2009, up from 1.75% as of December 31, 2008. Total loans charged-off, net of recoveries, in first quarter 2009 were 1.98% of average loans.

During first quarter 2009, net charge-offs totaled \$26.3 million as compared to \$6.1 million in first quarter 2008, with commercial and industrial and residential land and development loans accounting for substantially all of the increase. Provision for losses for first quarter 2009 totaled \$48.4 million and exceeded net charge-offs by 84.2%.

The accounting policies underlying the establishment and maintenance of the reserve for loan losses are discussed in Notes 1 and 5 to the Consolidated Financial Statements of our 2008 10-K.

INVESTMENT IN BANK OWNED LIFE INSURANCE

We purchase life insurance policies on the lives of certain directors and officers and are the sole owner and beneficiary of the policies. We invest in these policies, known as BOLI, to provide an efficient form of funding for long-term retirement and other employee benefit costs. Therefore, our BOLI policies are intended to be long-term investments to provide funding for long-term liabilities. We record these BOLI policies as a separate line item in the Consolidated Statements of Financial Condition at each policy's respective CSV, with changes recorded in noninterest income in the Consolidated Statements of Income.

As of March 31, 2009, the CSV of BOLI assets totaled \$199.1 million, up \$537,000 from December 31, 2008. The 0.3% increase stemmed from gains in certain underlying investment funds.

Of our total BOLI portfolio as of March 31, 2009, 23.7% is in general account life insurance distributed between 10 insurance carriers, all of whom carry investment grade ratings. This general account life insurance typically includes a feature guaranteeing minimum returns. The remaining 76.3% is in separate account life insurance, which is managed by third party investment advisors under pre-determined investment guidelines. Stable value protection is a feature available with respect to separate account life insurance policies that is designed to protect, within limits, a policy's CSV from market fluctuations on underlying investments. Our entire separate account portfolio has stable value protection, purchased from a highly rated financial institution. To the extent fair values on individual contracts fall below 80%, the CSV of the specific contracts may be reduced or the underlying assets transferred to short-duration investments, resulting in lower earnings.

In comparison to first quarter 2008, bank-owned life insurance income declined \$1.9 million for first quarter 2009. In the current environment, management elected to accept lower market returns in order to reduce its risk to market volatility through investment in shorter-duration, lower yielding money market instruments.

FUNDING AND LIQUIDITY MANAGEMENT

The following table provides a comparison of average funding sources for the quarters March 31, 2009, December 31, 2008, and March 31, 2008. We believe that average balances, rather than period-end balances, are more meaningful in analyzing funding sources because of the inherent fluctuations that may occur on a monthly basis within most funding categories.

Table 12
Funding Sources - Average Balances

(Dollar amounts in thousands)

| | Quarters Ended | | | % Change | |
|---|-------------------|----------------------|-------------------|-----------------------------|-----------------------------|
| | March 31, 2009 | December 31, 2008 | March 31, 2008 | 03/31/09 vs. 12/31/08 | 03/31/09 vs. 03/31/08 |
| Demand deposits | \$ 1,028,617 | \$ 1,043,596 | \$ 1,025,320 | (1.4) | 0.3 |
| Savings deposits | 748,350 | 748,065 | 814,764 | 0.0 | (8.2) |
| NOW accounts | 893,687 | 923,643 | 880,505 | (3.2) | 1.5 |
| Money market accounts | 768,202 | 737,658 | 822,154 | 4.1 | (6.6) |
| Transactional deposits | 3,438,856 | 3,452,962 | 3,542,743 | (0.4) | (2.9) |
| Time deposits | 1,949,942 | 2,006,080 | 2,122,249 | (2.8) | (8.1) |
| Brokered deposits | 119,729 | 176,526 | 52,934 | (32.2) | 126.2 |
| Total time deposits | 2,069,671 | 2,182,606 | 2,175,183 | (5.2) | (4.9) |
| Total deposits | 5,508,527 | 5,635,568 | 5,717,926 | (2.3) | (3.7) |
| Repurchase agreements | 444,011 | 487,937 | 364,914 | (9.0) | 21.7 |
| Federal funds purchased | 338,570 | 328,146 | 288,640 | 3.2 | 17.3 |
| Federal Home Loan Bank ("FHLB") advances | 294,014 | 513,802 | 635,163 | (42.8) | (53.7) |
| Federal term auction facilities | 618,333 | 308,152 | 18,681 | 100.7 | 3210.0 |
| Total borrowed funds | 1,694,928 | 1,638,037 | 1,307,398 | 3.5 | 29.6 |
| Subordinated debt | 232,391 | 232,425 | 230,458 | 0.0 | 0.8 |
| Total funding sources | \$ 7,435,846 | \$ 7,506,030 | \$ 7,255,782 | (0.9) | 2.5 |
| Average interest rate paid on borrowed funds | 1.11% | 1.56% | 3.71% | | |
| Weighted-average maturity of FHLB advances | 6.2 months | 5.4 months | 5.7 months | | |

| | | | |
|---|-------|-------|-------|
| Weighted-average interest rate of FHLB advances | 3.60% | 2.68% | 3.50% |
|---|-------|-------|-------|

N/M - Not meaningful.

Total average deposits for first quarter 2009 decreased 3.7% from first quarter 2008 and 2.3% from fourth quarter due primarily to a decline in time deposits. Our average core transactional deposits declined 0.4% from fourth quarter 2008. Traditionally, we would have expected to see a greater decline in average core transactional deposits in the first quarter due to normal seasonal declines in public funds balances.

Securities sold under agreements to repurchase, federal funds purchased, and term auction facilities generally mature within 1 to 90 days from the transaction date.

MANAGEMENT OF CAPITAL

Our solid capital base and ability to generate strong core earnings continue to serve as an advantage as we navigate the difficulties of the current credit cycle. This advantage enables First Midwest to continue to meet the financial needs of our customers and communities and leaves our shareholders and us better positioned to benefit as conditions improve.

Capital Measurements

The Federal Reserve Board ("FRB"), the primary regulator of the Company and the Bank, establishes minimum capital requirements that must be met by member institutions. We have managed our capital ratios to consistently maintain such measurements in excess of the FRB minimum levels to be considered "well-capitalized," which is the highest capital category established.

Capital resources of financial institutions are also regularly measured by tangible equity ratios. Tangible common equity equals total shareholders' equity as defined by GAAP less goodwill and other intangible assets and preferred equity, which does not benefit common shareholders. Tangible assets equals total assets as defined by GAAP less goodwill and other intangible assets. The tangible equity ratios are a valuable indicator of a financial institution's capital strength since they eliminate intangible assets from shareholders' equity and retain the effect accumulated other comprehensive income (loss) in shareholders' equity.

The following table presents our consolidated measures of capital as of the dates presented and the capital guidelines established by the FRB to be categorized as "well-capitalized."

Table 13
Capital Measurements

(Dollar amounts in thousands)

| | March 31, | December 31, | Regulatory Minimum For | Excess Over |
|----------------------------|-----------|--------------|------------------------|-------------------|
| | 2009 | 2008 | "Well-Capitalized" | Required Minimums |
| Regulatory capital ratios: | | | | at March 31, 2009 |
| | | | | |

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| | | | | | | |
|--|--------|--------|--------|--------------------|------|------------|
| Total capital to risk-weighted assets | 14.62% | 11.63% | 14.36% | 10.00% | 46% | \$ 305,161 |
| Tier 1 capital to risk-weighted assets | 11.85% | 9.08% | 11.60% | 6.00% | 98% | 386,344 |
| Tier 1 leverage to average assets | 9.60% | 7.51% | 9.41% | 5.00% | 92 % | 374,812 |
| Regulatory capital ratios, excluding preferred equity ⁽¹⁾ : | | | | | | |
| Total capital to risk-weighted assets | 11.70% | 11.63% | 11.44% | 10.00% | 17% | \$ 112,161 |
| Tier 1 capital to risk-weighted assets | 8.93% | 9.08% | 8.68% | 6.00% | 49% | 193,344 |
| Tier 1 leverage to average assets | 7.23% | 7.51% | 7.04% | 5.00% | 45% | 181,812 |
| Tangible equity ratios: | | | | | | |
| Tangible common equity to tangible assets | 5.36% | 5.62% | 5.23% | N/A ⁽²⁾ | | |
| Tangible common equity, excluding other comprehensive loss, to tangible assets | 5.83% | 5.73% | 5.45% | N/A ⁽²⁾ | | |
| Tangible common equity to risk-weighted assets | 6.47% | 6.99% | 6.53% | N/A ⁽²⁾ | | |

(1) These ratios exclude the impact of \$193.0 million in preferred shares issued to the U.S. Treasury in December 2008 as part of its Capital Purchase Plan ("CPP"). For additional discussion of the preferred share issuance and the CPP, refer to Note 12 to the Consolidated Financial Statements of our 2008 Form 10-K.

(2) Ratio is not subject to formal FRB regulatory guidance.

Regulatory and tangible common equity ratios were improved in comparison to December 31, 2008, with such improvement driven by retention of earnings and a decline in total assets, with the decline primarily due to a reduction in the size of the investment securities portfolio. All regulatory mandated ratios for characterization as "well capitalized" were significantly exceeded as of March 31, 2009.

Dividends

Our Board of Directors periodically reviews our dividend payout ratio to ensure that it is consistent with internal capital guidelines, industry standards, and peer group practices.

As part of a larger commitment to grow the tangible common equity component of total capital, on March 16, 2009 our Board of Directors announced a reduction in our quarterly dividend from \$0.225 per share to \$0.01 per share. This reduction equates to approximately \$42 million in retained capital over the course of a year.

Since we elected to participate in the Capital Purchase Program, our ability to increase quarterly common stock dividends above \$0.310 per share will be subject to the applicable restrictions of this program for three years following the sale of the preferred stock.

CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements are prepared in accordance with GAAP and are consistent with predominant practices in the financial services industry. Critical accounting policies are those policies that management believes are the most important to our financial position and results of operations. Application of critical accounting policies requires management to make estimates, assumptions, and judgments based on information available at the date of the financial statements that affect the amounts reported in the financial statements and accompanying notes. Future changes in information may affect these estimates, assumptions, and judgments, which, in turn, may affect amounts reported in the financial statements.

We have numerous accounting policies, of which the most significant are presented in Note 1, "Summary of Significant Accounting Policies," to the Consolidated Financial Statements of our 2008 10-K. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has determined that our accounting policies with respect to the reserve for loan losses, evaluation of impairment of securities, and income taxes are the accounting areas requiring subjective or complex judgments that are most important to our financial position and results of operations, and, as such, are considered to be critical accounting policies, as discussed in our 2008 10-K.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss arising from adverse changes in the fair value of financial instruments due to changes in interest rates, exchange rates, and equity prices. Interest rate risk is our primary market risk and is the result of repricing, basis, and option risk. A description and analysis of our interest rate risk management policies is included in Item 7A, "Quantitative and Qualitative Disclosures about Market Risk," contained in our 2008 10-K.

We seek to achieve consistent growth in net interest income and net income while managing volatility that arises from shifts in interest rates. The Bank's Asset and Liability Management Committee ("ALCO") oversees financial risk management by developing programs to measure and manage interest rate risks within authorized limits set by the Bank's Board of Directors. ALCO also approves the Bank's asset/liability management policies, oversees the formulation and implementation of strategies to improve balance sheet positioning and earnings, and reviews the Bank's interest rate sensitivity position. Management uses net interest income and economic value of equity simulation modeling tools to analyze and capture short-term and long-term interest rate exposures.

Net Interest Income Sensitivity

The analysis of net interest income sensitivities assesses the magnitude of changes in net interest income resulting from changes in interest rates over a 12-month horizon using multiple rate scenarios. These scenarios include, but are not limited to, a "most likely" forecast, a flat to inverted or unchanged rate environment, a gradual increase and decrease of 200 basis points that occur in equal steps over a six-month time horizon, and immediate increases and decreases of 200 and 300 basis points.

This simulation analysis is based on actual cash flows and repricing characteristics for balance sheet and off-balance sheet instruments and incorporates market-based assumptions regarding the effect of changing interest rates on the prepayment rates of certain assets and liabilities. This simulation analysis includes management's projections for activity levels in each of the product lines we offer. The analysis also incorporates assumptions based on the historical behavior of deposit rates and balances in relation to interest rates. Because these assumptions are inherently uncertain, the simulation analysis cannot definitively measure net interest income or predict the impact of the fluctuation in interest rates on net interest income. Actual results may differ from simulated results due to timing, magnitude, and

frequency of interest rate changes as well as changes in market conditions and management strategies.

We monitor and manage interest rate risk within approved policy limits. Our current interest rate risk policy limits are determined by measuring the change in net interest income over a 12-month horizon assuming a 200 basis point gradual increase and decrease in all interest rates compared to net interest income in an unchanging interest rate environment. Current policy limits this exposure to plus or minus 8% of the anticipated level of net interest income over the corresponding 12-month horizon assuming no change in current interest rates. As of March 31, 2009 and December 31, 2008, the percent change expected assuming a gradual decrease in interest rates was outside of policy. However, given the current market conditions as of March 31, 2009 and December 31, 2008, the Bank's Board of Directors temporarily authorized operations outside of policy limits.

Analysis of Net Interest Income Sensitivity

(Dollar amounts in thousands)

| | Gradual Change in Rates ⁽¹⁾ | | Immediate Change in Rates | | | |
|--------------------|--|-------------|---------------------------|-------------|---------------------|-------------|
| | -200 | +200 | -200 | +200 | -300 ⁽²⁾ | +300 |
| March 31, 2009: | | | | | | |
| Dollar change | \$ (24,027) | \$ (17,960) | \$ (35,635) | \$ (21,110) | \$ N/M | \$ (27,302) |
| Percent change | -9.0% | -6.7% | -13.4% | -7.9% | N/M | -10.2% |
| December 31, 2008: | | | | | | |
| Dollar change | \$ (28,797) | \$ (21,942) | \$ (43,001) | \$ (24,416) | \$ N/M | \$ (30,604) |
| Percent change | -10.4% | -7.9% | -15.5% | -8.8 | N/M | -11.0 |

Reflects an assumed uniform change in interest rates across all terms that occurs in equal steps over a (1) six-month horizon.

N/M - Due to the low level of interest rates as of March 31, 2009 and December 31, 2008, in management's judgment, an assumed 300 basis point drop in interest rates was deemed not meaningful in (2) the existent interest rate environment.

Overall, the change in interest rate risk volatility from the prior quarter under both rising and declining interest rate assumptions is less negative. The security sales during the first quarter reduced the volume of longer dated assets, and allowed for a reduction in shorter-term liabilities, thus improving the interest rate risk volatility under both rising and falling interest rates.

Economic Value of Equity

In addition to the simulation analysis, management uses an economic value of equity sensitivity technique to understand the risk in both shorter- and longer-term positions and to study the impact of longer-term cash flows on earnings and capital. In determining the economic value of equity, we discount present values of expected cash flows on all assets, liabilities, and off-balance sheet contracts under different interest rate scenarios. The discounted present value of all cash flows represents our economic value of equity. Economic value of equity does not represent the true fair value of asset, liability, or derivative positions because certain factors are not considered, such as credit risk, liquidity risk, and the impact of future changes to the balance sheet. Our policy guidelines call for preventative measures to be taken in the event that an immediate increase or decrease in interest rates of 200 basis points is estimated to reduce the economic value of equity by more than 20%.

Analysis of Economic Value of Equity

(Dollar amounts in thousands)

| | Immediate Change in Rates | |
|--------------------|---------------------------|-------------|
| | -200 | +200 |
| March 9, 2009: | | |
| Dollar change | \$ (106,728) | \$ (19,139) |
| Percent change | -8.3% | -1.5% |
| December 31, 2008: | | |
| Dollar change | \$ (89,123) | \$ (54,136) |
| Percent change | -6.8% | -4.1% |

As of March 31, 2009, the estimated sensitivity of the economic value of equity to changes in interest rates reflected less negative exposure to higher interest rates and a more negative exposure to lower interest rates compared to that existing at December 31, 2008. The changes from year-end 2008 are driven by the sale of longer-dated securities. These sales helped to reduce price volatility in a rising interest rate environment, but in a declining interest rate environment, the benefit from positive price volatility is lower.

ITEM 4. CONTROLS AND PROCEDURES

At the end of the period covered by this report, (the "Evaluation Date"), the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's President and Chief Executive Officer and its Executive Vice President and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15 of the Securities and Exchange Act of 1934 (the "Exchange Act"). Based on that evaluation, the President and Chief Executive Officer and Executive Vice President and Chief Financial Officer concluded that as of the Evaluation Date, the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms. There were no changes in the Company's internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company disclosed any material pending litigation matters relating to the Company in Item 3 of Part I of its Annual Report on Form 10-K for the year ended December 31, 2008. For the quarter ended March 31, 2009, there were no material developments with regard to any previously disclosed matters, and no other matters were reported during the period, although there were certain legal proceedings pending against the Company and its subsidiaries in the ordinary course of business at March 31, 2009. Based on presently available information, the Company believes that any liabilities arising from these proceedings would not have a material adverse effect on the consolidated financial position of the Company.

ITEM 1A. RISK FACTORS

The Company provided a discussion of certain risks and uncertainties faced by the Company in its Annual Report on Form 10-K for the year ended December 31, 2008. However, these factors may not be the only risks or uncertainties

the Company faces. Additional risks that the Company does not yet know of or that it currently thinks are immaterial may also impair its business operations.

Based on currently available information, the Company has not identified any new or material changes in the Company's risk factors as previously disclosed.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

| <u>Exhibit Number</u> | <u>Description of Documents</u> | <u>Sequential Page #</u> |
|---------------------------|---|------------------------------|
| 3.1 | Restated Certificate of Incorporation is incorporated herein by reference to Exhibit 3 to the Quarterly Report on Form 10-K dated December 31, 2008. | |
| 3.2 | Restated Bylaws of the Company is incorporated herein by reference to Exhibit 3 to the Current Report on Form 10-K dated December 31, 2008. | |
| 11 | Statement re: <u>Computation of Per Share Earnings</u> - The computation of basic and diluted earnings per share is included in <u>Note 7</u> of the Company's Notes to Consolidated Financial Statements included in "ITEM 1. FINANCIAL STATEMENTS" of this document. | |
| 15 | Acknowledgment of Independent Registered Public Accounting Firm. | |
| 31.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | |
| 31.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of | |

- 32.1 ⁽¹⁾ the Sarbanes-Oxley Act of 2002.
Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 ⁽¹⁾ Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99 Report of Independent Registered Public Accounting Firm.

(1) Furnished, not filed

SIGNATURES

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

First Midwest Bancorp, Inc.

/s/ PAUL F. CLEMENS

Paul F. Clemens

Executive Vice President, Chief Financial
Officer, and Principal Accounting Officer*

Date: May 8, 2009

* Duly authorized to sign on behalf of the Registrant.