

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

FIRST MID ILLINOIS BANCSHARES INC
Form 10-Q
November 08, 2006

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

FORM 10-Q

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

For the quarterly period ended September 30, 2006
Or

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

For the transition period from _____ to _____

Commission file number 0-13368

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

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

1515 Charleston Avenue,
Mattoon, Illinois 61938
(Address of principal executive offices) (Zip Code)

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

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

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

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 Act). Yes No

As of November 8, 2006, 4,320,846 common shares, \$4.00 par value, were outstanding.

PART I

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

ITEM 1. FINANCIAL STATEMENTS

Consolidated Balance Sheets (In thousands, except share data)	Unaudited) September 30, 2006	December 31, 2005
	-----	-----
Assets		
Cash and due from banks:		
Non-interest bearing	\$ 17,688	\$ 19,131
Interest bearing	276	426
Federal funds sold	200	-
	-----	-----
Cash and cash equivalents	18,164	19,557
Investment securities:		
Available-for-sale, at fair value	197,815	155,841
Held-to-maturity, at amortized cost (estimated fair value of \$1,365 and \$1,442 at September 30, 2006 and December 31, 2005, respectively)	1,343	1,412
Loans held for sale	1,202	1,778
Loans	725,752	636,355
Less allowance for loan losses	(5,976)	(4,648)
	-----	-----
Net loans	719,776	631,707
Interest receivable	8,341	6,410
Premises and equipment, net	16,536	15,168
Goodwill, net	17,363	9,034
Intangible assets, net	5,364	2,778
Other assets	7,582	6,888
	-----	-----
Total assets	\$993,486	\$850,573
	=====	=====
Liabilities and Stockholders' Equity		
Deposits:		
Non-interest bearing	\$111,750	\$ 95,305
Interest bearing	679,004	553,764
	-----	-----
Total deposits	790,754	649,069
Securities sold under agreements to repurchase	55,031	67,380
Interest payable	2,521	1,717
Other borrowings	44,200	44,500
Junior subordinated debentures	20,620	10,310
Other liabilities	4,630	5,271
	-----	-----
Total liabilities	917,756	778,247
	-----	-----
Stockholders' Equity		
Common stock, \$4 par value; authorized 18,000,000 shares; issued 5,688,404 shares in 2006 and 5,633,621 shares in 2005	22,753	22,534
Additional paid-in capital	21,109	19,439
Retained earnings	67,098	60,867
Deferred compensation	2,610	2,440
Accumulated other comprehensive loss	(152)	(739)
Less treasury stock at cost, 1,369,808 shares in 2006 and 1,241,359 shares in 2005	(37,688)	(32,215)
	-----	-----
Total stockholders' equity	75,730	72,326
	-----	-----
Total liabilities and stockholders' equity	\$993,486	\$850,573
	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

Consolidated Statements of Income (unaudited)
(In thousands, except per share data)

	Three months ended 2006	September 30, 2005	Nine mon 200
Interest income:			
Interest and fees on loans	\$12,369	\$ 9,822	
Interest on investment securities	2,353	1,495	
Interest on federal funds sold	78	99	
Interest on deposits with other financial institutions	4	17	
Total interest income	14,804	11,433	
Interest expense:			
Interest on deposits	5,261	3,167	
Interest on securities sold under agreements to repurchase	654	378	
Interest on other borrowings	620	471	
Interest on subordinated debentures	426	168	
Total interest expense	6,961	4,184	
Net interest income	7,843	7,249	
Provision for loan losses	171	213	
Net interest income after provision for loan losses	7,672	7,036	
Other income:			
Trust revenues	592	548	
Brokerage commissions	122	72	
Insurance commissions	361	352	
Service charges	1,413	1,233	
Securities gains, net	67	61	
Mortgage banking revenue, net	127	284	
Other	686	587	
Total other income	3,368	3,137	
Other expense:			
Salaries and employee benefits	4,036	3,343	
Net occupancy and equipment expense	1,236	1,119	
Amortization of intangible assets	216	143	
Stationery and supplies	165	114	
Legal and professional	374	342	
Marketing and promotion	240	198	
Other	1,106	1,134	
Total other expense	7,373	6,393	
Income before income taxes	3,667	3,780	
Income taxes	1,234	1,335	
Net income	\$ 2,433	\$ 2,445	
Per share data:			
Basic earnings per share	\$ 0.56	\$ 0.55	
Diluted earnings per share	\$ 0.55	\$ 0.54	
Cash dividends per share	-	-	

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

See accompanying notes to unaudited condensed consolidated financial statements.

Consolidated Statements of Cash Flows (unaudited) (In thousands)	Nine months ended Septe 2006		20
	-----	-----	-----
Cash flows from operating activities:			
Net income		\$ 7,359	
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses		575	
Depreciation, amortization and accretion, net		1,220	
		135	
Stock-based compensation expense			
Gains on sale of securities, net		(66)	
Losses on sale of other real property owned, net		30	
Gains on sale of loans held for sale, net		(341)	
Origination of loans held for sale		(23,829)	
Proceeds from sale of loans held for sale		24,746	
Increase in other assets		(2,307)	
Increase (decrease) in other liabilities		680	
		-----	-----
Net cash provided by operating activities		8,202	
		-----	-----
Cash flows from investing activities:			
Proceeds from sales of securities available-for-sale		12,989	
Proceeds from maturities of securities available-for-sale		47,750	
Proceeds from maturities of securities held-to-maturity		120	
Purchases of securities available-for-sale		(48,479)	
Purchases of securities held-to-maturity		-	
Net increase in loans		(34,279)	
Purchases of premises and equipment		(1,096)	
Proceeds from sales of other real property owned		324	
Payment related to acquisition, net of cash and cash equivalents acquired		(12,062)	
		-----	-----
Net cash used in investing activities		(34,733)	
		-----	-----
Cash flows from financing activities:			
Net increase in deposits		33,571	
Decrease in federal funds purchased		(800)	
Decrease in repurchase agreements		(12,349)	
Proceeds from short term FHLB advances		75,600	
Proceeds from long term FHLB advances		15,000	
Repayment of short term FHLB advances		(99,600)	
Proceeds from short term debt		500	
Proceeds from long term debt		15,000	
Repayment of short term debt		(6,000)	
Issuance of junior subordinated debentures		10,310	
Proceeds from issuance of common stock		723	
Purchase of treasury stock		(5,303)	
Dividends paid on common stock		(1,514)	
		-----	-----
Net cash provided by financing activities		25,138	
		-----	-----
Decrease in cash and cash equivalents		(1,393)	
Cash and cash equivalents at beginning of period		19,557	

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

Cash and cash equivalents at end of period	\$18,164

Supplemental disclosures of cash flow information	
Cash paid during the period for:	
Interest	\$16,762
Income taxes	3,860
Supplemental disclosures of noncash investing and financing activities	
Loans transferred to real estate owned	487
Dividends reinvested in common stock	757
Net tax benefit related to option and deferred compensation plans	273

See accompanying notes to unaudited condensed consolidated financial statements.

Notes to Consolidated Financial Statements
(unaudited)

Basis of Accounting and Consolidation

The unaudited condensed consolidated financial statements include the accounts of First Mid-Illinois Bancshares, Inc. ("Company") and the following current and former wholly-owned subsidiaries: Mid-Illinois Data Services, Inc. ("MIDS"), The Checkley Agency, Inc. ("Checkley"), Mansfield Bancorp, Inc. ("Mansfield") and its wholly-owned subsidiary Peoples State Bank of Mansfield ("Peoples State Bank") and First Mid-Illinois Bank & Trust, N.A. ("First Mid Bank"). Mansfield was merged with and into Peoples State Bank on September 7, 2006, and Peoples State Bank was merged with and into First Mid Bank on September 8, 2006. All significant intercompany balances and transactions have been eliminated in consolidation. The financial information reflects all adjustments which, in the opinion of management, are necessary for a fair presentation of the results of the interim periods ended September 30, 2006 and 2005, and all such adjustments are of a normal recurring nature. Certain amounts in the prior year's consolidated financial statements have been reclassified to conform to the September 30, 2006 presentation and there was no impact on net income or stockholders' equity. The results of the interim period ended September 30, 2006 are not necessarily indicative of the results expected for the year ending December 31, 2006. The Company operates as a one-segment entity for financial reporting purposes.

The 2005 year-end consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles.

The unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X and do not include all of the information required by U.S. generally accepted accounting principles for complete financial statements and related footnote disclosures although the Company believes that the disclosures made are adequate to make the information not misleading. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2005 Annual Report on Form 10-K.

Website

The Company maintains a website at www.firstmid.com. All periodic and current reports of the Company and amendments to these reports filed with the Securities

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

and Exchange Commission ("SEC") can be accessed, free of charge, through this website as soon as reasonably practicable after these materials are filed with the SEC.

Comprehensive Income

The Company's comprehensive income for the three and nine-month periods ended September 30, 2006 and 2005 was as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Net income	\$2,433	\$2,445	\$7,359	\$7,242
Other comprehensive income (loss):				
Unrealized gains (losses) during the period	2,445	(272)	1,028	(906)
Less realized gains during the period	(67)	(61)	(66)	(315)
Tax effect	(927)	129	(375)	476
Total other comprehensive income (loss)	1,451	(204)	587	(745)
Comprehensive income	\$3,884	\$2,241	\$7,946	\$6,497

New Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 155 (FAS 155), "Accounting for Certain Hybrid Financial Instruments: an amendment of FASB Statements No. 133 and 140." FAS 155 permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and amends Statement 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. FAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company does not expect the adoption of FAS 155 to have a material effect on the results of operations or the statement of condition.

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156 (FAS 156), "Accounting for Servicing of Financial Assets: an amendment of FASB Statement No. 140." FAS 140 establishes, among other things, the accounting for all separately recognized servicing assets and servicing liabilities. This Statement amends FAS 140 to require that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. This Statement permits, but does not require, the subsequent measurement of separately recognized servicing assets and servicing

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

liabilities at fair value. Under this Statement, an entity can elect subsequent fair value measurement to account for its separately recognized servicing assets and servicing liabilities. Adoption of this Statement is required as of the beginning of the first fiscal year that begins after September 15, 2006. The Company does not expect the adoption of FAS 156 to have a material effect on the results of operations or the statement of condition.

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement 109," which provides guidance on the measurement, recognition, and disclosure of tax positions taken or expected to be taken in a tax return. The Interpretation also provides guidance on derecognition, classification, interest and penalties, and disclosure. FIN 48 prescribes that a tax position should only be recognized if it is more-likely-than-not that the position will be sustained upon examination by the appropriate taxing authority. A tax position that meets this threshold is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. The cumulative effect of applying the provisions of FIN 48 is to be reported as an adjustment to the beginning balance of retained earnings in the period of adoption. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently assessing the impact, if any, that the adoption of this Interpretation will have on its financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (FAS 157), "Fair Value Measurements," which provides enhanced guidance for using fair value to measure assets and liabilities. FAS 157 establishes a common definition of fair value, provides a framework for measuring fair value under U.S. Generally Accepted Accounting Principles and expands disclosures requirements about fair value measurements. FAS 157 is effective for financial statements issued in fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the impact, if any, the adoption of FAS 157 will have on its financial reporting and disclosures.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158 (FAS 158), "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans--an amendment of FASB Statements No. 87, 88, 106, and 132(R)," which requires recognition of a net liability or asset to report the funded status of defined benefit pension and other postretirement plans on the balance sheet and recognition (as a component of other comprehensive income) of changes in the funded status in the year in which the changes occur. Additionally, FAS 158 requires measurement of a plan's assets and obligations as of the balance sheet date and additional disclosures in the notes to the financial statements. The recognition and disclosure provisions of FAS 158 are effective for fiscal years ending after December 15, 2006, while the requirement to measure a plan's assets and obligations as of the balance sheet date is effective for fiscal years ending after December 15, 2008. The Company is currently evaluating the impact the adoption of FAS 158 will have on its financial reporting and disclosures.

Earnings Per Share

Basic earnings per share ("EPS") is calculated as net income divided by the weighted average number of common shares outstanding. Diluted EPS is computed using the weighted average number of common shares outstanding, increased by the assumed conversion of the Company's stock options, unless anti-dilutive. The components of basic and diluted earnings per common share for the three and nine-month periods ended September 30, 2006 and 2005 were as follows:

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

	Three months ended September 30,		Nine Se
	2006	2005	2006
Basic Earnings per Share:			
Net income	\$2,433,000	\$2,445,000	\$7,359,
Weighted average common shares outstanding	4,324,250	4,411,723	4,348,
Basic earnings per common share	\$.56	\$.55	\$1
Diluted Earnings per Share:			
Weighted average common shares outstanding	4,324,250	4,411,723	4,348,
Assumed conversion of stock options	78,911	126,819	87,
Diluted weighted average common shares outstanding	4,403,161	4,538,542	4,436,
Diluted earnings per common share	\$.55	\$.54	\$1

Acquisition

On May 1, 2006, the Company completed the acquisition, for \$24 million in cash, of all of the outstanding common stock of Mansfield and its wholly-owned subsidiary, People State Bank, located in Mansfield, Mahomet and Weldon, Illinois, in order to expand its market presence in this area. The Company financed the purchase price through a dividend of \$5 million from First Mid Bank, an issuance of \$10 million of trust preferred securities and a \$9.5 million draw on the Company's line of credit with The Northern Trust Company. Following the completion of the acquisition during the third quarter of 2006, Mansfield merged with and into Peoples State Bank and Peoples State Bank merged with and into First Mid Bank. Following the completion of these mergers, Mansfield and Peoples ceased to exist and Peoples' operations were merged into First Mid Bank's.

The transaction has been accounted for as a purchase, and the results of operations of Mansfield and Peoples since the acquisition date have been included in the consolidated financial statements. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of this transaction (in thousands):

Cash and cash equivalents	\$12,193
Investment securities	52,740
Loans	55,770
Less allowance for loan losses	(1,405)
Premises and equipment	1,465
Goodwill	8,328
Core deposit intangibles	3,132
Other asset	1,637
Total assets acquired	133,860
Deposits	108,114
Deferred income taxes	869
Other liabilities	622

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

Total liabilities assumed	109,605

Net assets acquired	\$24,255
	=====

Transaction costs related to the completion of the transaction were approximately \$255,000. The fair value of deposits acquired in the transaction exceeded the book value, resulting in a core deposit intangible asset of \$3,132,000, which is being amortized over 10 years. The total fair value of the assets and liabilities acquired exceeded the book value, resulting in goodwill of \$8,328,000, which is not subject to amortization. The core deposit intangibles and goodwill are not deductible for tax purposes.

The following unaudited pro forma condensed combined financial information presents the results of operations of the Company, including the effects of the purchase accounting adjustments, issuance of trust preferred securities and bank loan, had the acquisition taken place at the beginning of each period (in thousands):

	For the nine months ended September 30, 2006	For the nine months ended September 30, 2005
	-----	-----
Net interest income	\$23,710	\$23,963
Provision for loan losses	615	630
Non-interest income	10,049	10,046
Non-interest expense	21,855	21,458
	-----	-----
Income before income taxes	11,289	11,921
Income tax expense	3,892	4,073
	-----	-----
Net income	\$ 7,397	\$ 7,848
	=====	=====
 Earnings per share		
Basic	\$1.70	\$1.77
Diluted	\$ 1.67	\$1.72
Basic weighted average shares outstanding	4,348,668	4,431,175
Diluted weighted average shares outstanding	4,436,047	4,556,239

The unaudited pro forma condensed combined financial statements do not reflect any anticipated cost savings and revenue enhancements. Additionally, the income statement for the first nine months of 2006 includes merger-related expenses. Accordingly, the pro forma results of operations of the Company as of and after the merger may not be indicative of the results that actually would have occurred if the merger had been in effect during the periods presented or of the results that may be attained in the future.

Goodwill and Intangible Assets

The Company has goodwill from business combinations, intangible assets from branch acquisitions, identifiable intangible assets assigned to core deposit relationships and customer lists of Checkley, and intangible assets arising from the rights to service mortgage loans for others.

The following table presents gross carrying value and accumulated amortization by major intangible asset class as of September 30, 2006 and December 31, 2005 (in thousands):

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

	September 30, 2006		December 31, 2005	
	Gross Carrying Value	Accumulated Amortization	Gross Carrying Value	Accumulated Amortization
Goodwill not subject to amortization (effective 1/1/02)	\$21,123	\$3,760	\$12,794	\$3,760
Intangibles from branch acquisition	3,015	1,910	3,015	1,760
Core deposit intangibles	5,937	2,693	2,805	2,440
Mortgage servicing rights	608	608	608	608
Customer list intangibles	1,904	889	1,904	746
	\$32,587	\$9,860	\$21,126	\$9,314

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

Purchase price	\$24,000
Less: Mansfield equity	(14,927)
	9,073
Direct acquisition costs 255 Less purchase accounting adjustments:	
Investments	\$983
Fixed assets	69
Existing goodwill	211
Core deposit intangible	(3,132)
	(1,869)
Deferred taxes on purchase accounting adjustments	869
Resulting goodwill from Mansfield acquisition	\$8,328

Total amortization expense for the nine months ended September 30, 2006 and 2005 was as follows (in thousands):

	September 30, 2006	2005
Intangibles from branch acquisition	\$151	\$151
Core deposit intangibles	251	121
Mortgage servicing rights	-	15
Customer list intangibles	143	143
	\$545	\$430

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

Aggregate amortization expense:	
For period 01/01/06-9/30/06	\$545

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

Estimated amortization expense:

For period 10/01/06-12/31/06	\$216
For year ended 12/31/07	\$812
For year ended 12/31/08	\$791
For year ended 12/31/09	\$761
For year ended 12/31/10	\$731
For year ended 12/31/11	\$731

In accordance with the provisions of SFAS 142, the Company performed testing of goodwill for impairment as of September 30, 2006, and determined that, as of that date, goodwill was not impaired. Management also concluded that the remaining amounts and amortization periods were appropriate for all intangible assets.

Stock Incentive Plan

Prior to January 1, 2006, the Company accounted for its Stock Incentive Plan ("Plan") under the recognition and measurement provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"), and related Interpretations, as permitted by Financial Accounting Standards Board ("FASB") Statement No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"). No stock option compensation cost was recognized in the Statement of Income as all options granted had an exercise price equal to the market value of the underlying common stock on the grant date.

In December 2004, the FASB issued Statement No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123R"), which requires the cost resulting from stock options be measured at fair value and recognized in earnings. This Statement replaces SFAS No. 123 and supercedes APB No. 25 which permitted the recognition of compensation expense using the intrinsic value method.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS 123R using the modified prospective application method. Under this method, the Statement applies to new awards and to awards modified, repurchased or cancelled after the effective date. Additionally, compensation cost for a portion of awards for which requisite services have not been rendered that are outstanding as of the effective date shall be recognized as the requisite service is rendered or after the effective date. As a result of this adoption, the Company's income before income taxes and net income for the nine months ended September 30, 2006 have included stock option compensation cost of \$135,000 and \$129,000, respectively, which represents \$.03 impact on basic and diluted earnings per share for the period. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 on stock-based employee compensation for the three and nine-month periods ended September 30, 2005.

	Three months ended September 30, 2005	Nine months ended September 30, 2005
	-----	-----
Net income, as reported	\$2,445	\$7,242
Stock based compensation expense determined under fair value based method, net of related tax effect	(68)	(249)
	-----	-----
Pro forma net income	\$2,377	\$6,993
	=====	=====
Basic Earnings Per Share:		
As reported	\$.55	\$ 1.63

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

Pro forma	\$.54	\$ 1.58
Diluted Earnings Per Share:		
As reported	\$.54	\$ 1.59
Pro forma	\$.52	\$ 1.53

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

The following discussion and analysis is intended to provide a better understanding of the consolidated financial condition and results of operations of the Company and its subsidiaries as of, and for the periods ended, September 30, 2006 and 2005. This discussion and analysis should be read in conjunction with the consolidated financial statements, related notes and selected financial data appearing elsewhere in this report.

Forward-Looking Statements

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, such as discussions of the Company's pricing and fee trends, credit quality and outlook, liquidity, new business results, expansion plans, anticipated expenses and planned schedules. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and is including this statement for purposes of these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are identified by use of the words "believe", "expect", "intend", "anticipate", "estimate", "project", or similar expressions. Actual results could differ materially from the results indicated by these statements because the realization of those results is subject to many uncertainties including: changes in interest rates, general economic conditions, legislative/regulatory changes, monetary and fiscal policies of the U.S. government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area and accounting principles, policies and guidelines. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Further information concerning the Company and its business, including additional factors that could materially affect the Company's financial results, is included in the Company's 2005 Annual Report on Form 10-K under the headings "Item 1. Business" and "Item 1A. Risk Factors."

New Accounting Standards Adopted During 2006

Prior to January 1, 2006, the Company accounted for its Stock Incentive Plan ("Plan") under the recognition and measurement provisions of APB No. 25, and related Interpretations, as permitted by SFAS No. 123. No stock option compensation cost was recognized in the Statement of Income as all options granted had an exercise price equal to the market value of the underlying common stock on the grant date.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS 123R using the modified prospective application method. Under this method, the Statement applies to new awards and to awards modified,

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

repurchased or cancelled after the effective date. Additionally, compensation cost for a portion of awards for which requisite services have not been rendered that are outstanding as of the effective date shall be recognized as the requisite service is rendered or after the effective date. As a result of this adoption, the Company's income before income taxes and net income for the three months ended September 30, 2006 have included stock option compensation cost of \$43,000 and \$41,000, respectively, which represents \$.01 impact on basic and diluted earnings per share for the period. The Company's income before income taxes and net income for the nine months ended September 30, 2006 have included stock option compensation cost of \$135,000 and \$129,000, respectively, which represents \$.03 impact on basic and diluted earnings per share for the period. As of September 30, 2006, there was approximately \$159,000 of total unrecognized compensation cost related to nonvested options under the Plan. The Company expects to recognize that cost over a weighted average period of less than four years.

Overview

This overview of management's discussion and analysis highlights selected information in this document and may not contain all of the information that is important to you. For a more complete understanding of trends, events, commitments, uncertainties, liquidity, capital resources, and critical accounting estimates, you should carefully read this entire document. These have an impact on the Company's financial condition and results of operations.

Net income was \$7,359,000 and \$7,242,000 and diluted earnings per share was \$1.66 and \$1.59 for the nine months ended September 30, 2006 and 2005. The following table shows the Company's annualized performance ratios for the nine months ended September 30, 2006 and 2005, compared to the performance ratios for the year ended December 31, 2005:

	Nine months ended		Year ended
	September 30, 2006	September 30, 2005	December 31, 2005
Return on average assets	1.06%	1.17%	1.18%
Return on average equity	13.25%	13.59%	13.64%
Average equity to average assets	8.01%	8.58%	8.64%

Total assets at September 30, 2006 and December 31, 2005 were \$993.5 million and \$850.6 million, respectively. The increase in net assets was due to assets acquired of \$133.9 million in the acquisition of Mansfield. Total assets excluding acquired assets increased as the result of an increase in loan balances, primarily residential and commercial real estate. Net loan balances were \$719.8 million at September 30, 2006, an increase of \$88.1 million, or 13.9%, from \$631.7 million at December 31, 2005. Total deposit balances increased to \$790.8 million at September 30, 2006 from \$649.1 million at December 31, 2005.

Net interest margin, defined as net interest income divided by average interest-earning assets, was 3.52% for the nine months ended September 30, 2006, down from 3.69% for the same period in 2005. The decrease in the net interest margin is attributable to a greater increase in borrowing and deposit rates compared to the increase in interest-earning asset rates. Net interest income before the provision for loan losses was \$22.7 million with growth in average earning assets of \$84.1 million for the nine months ended September 30, 2006 compared to net interest income of \$21.5 million for the same period in 2005.

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

Noninterest income increased \$443,000, or 4.7%, to \$9.8 million for the nine months ended September 30, 2006 compared to \$9.4 million for the nine months ended September 30, 2005. In addition to increased income due to the acquisition of Mansfield, the primary reason for this increase was an increase in ATM and bankcard service fees, service charges for overdrafts and brokerage commissions during the first nine months of 2006 compared to the same period in 2005.

Noninterest expense increased 9.1%, or \$1.7 million, to \$20.9 million for the nine months ended September 30, 2006 compared to \$19.2 million during the same period in 2005. In addition to increases in noninterest expense due to the acquisition of Mansfield, the primary factor in the expense increase was increased salaries and benefits expense that resulted from merit increases for continuing employees, additional compensation expense recorded in accordance with the provisions of SFAS 123R, and an increase in occupancy expense for a new office location for Checkley.

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

	Change in Net Income 2006 versus 2005	
	Three months ended September 30	Nine months ended September 30
	-----	-----
Net interest income	\$ 594	\$1,202
Provision for loan losses	42	(25)
Other income, including securities transactions	231	443
Other expenses	(980)	(1,754)
Income taxes	101	251
	-----	-----
Increase (decrease) in net income	\$ (12)	\$117
	=====	=====

Credit quality is an area of importance to the Company. Total nonperforming loans were \$3.6 million at September 30, 2006, compared to \$3.3 million at September 30, 2005 and \$3.5 million at December 31, 2005. The Company's provision for loan loss for the nine months ended September 30, 2006 and 2005 was \$575,000 and \$550,000, respectively. At September 30, 2006, the composition of the loan portfolio remained similar to the same period last year. During the nine months ended September 30, 2006, net charge-offs were .13% of average loans compared to .11% for the same period in 2005. Loans secured by both commercial and residential real estate comprised 70% and 72% of the loan portfolio as of September 30, 2006 and 2005, respectively.

The Company's capital position remains strong and the Company has consistently maintained regulatory capital ratios above the "well-capitalized" standards. The Company's Tier 1 capital to risk weighted assets ratio calculated under the regulatory risk-based capital requirements at September 30, 2006 and 2005 was 9.98% and 11.07%, respectively. The Company's total capital to risk weighted assets ratio calculated under the regulatory risk-based capital requirements at September 30, 2006 and 2005 was 10.80% and 11.81%, respectively.

The Company's liquidity position remains sufficient to fund operations and meet the requirements of borrowers, depositors, and creditors. The Company maintains

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

various sources of liquidity to fund its cash needs. See discussion under the heading "Liquidity" for a full listing of sources and anticipated significant contractual obligations. The Company enters into financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include lines of credit, letters of credit and other commitments to extend credit. The total outstanding commitments at September 30, 2006 and 2005 were \$125.7 million and \$117.2 million, respectively. This increase is primarily attributable to the Mansfield acquisition.

Critical Accounting Policies

The Company has established various accounting policies that govern the application of U.S. generally accepted accounting principles in the preparation of the Company's financial statements. The significant accounting policies of the Company are described in the footnotes to the consolidated financial statements included in the Company's 2005 Annual Report on Form 10-K. Certain accounting policies involve significant judgments and assumptions by management that have a material impact on the carrying value of certain assets and liabilities; management considers such accounting policies to be critical accounting policies. The judgments and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and assumptions made by management, actual results could differ from these judgments and assumptions, which could have a material impact on the carrying values of assets and liabilities and the results of operations of the Company.

The Company believes the allowance for loan losses is the critical accounting policy that requires the most significant judgments and assumptions used in the preparation of its consolidated financial statements. In estimating the allowance for loan losses, management utilizes historical experience, as well as other factors, including the effect of changes in the local real estate market on collateral values, the effect on the loan portfolio of current economic indicators and their probable impact on borrowers, and increases or decreases in nonperforming and impaired loans. Changes in these factors may cause management's estimate of the allowance for loan losses to increase or decrease and result in adjustments to the Company's provision for loan losses. See heading "Loan Quality and Allowance for Loan Losses" for a more detailed description of the Company's estimation process and methodology related to the allowance for loan losses.

Results of Operations

Net Interest Income

The largest source of revenue for the Company is net interest income. Net interest income represents the difference between total interest income earned on earning assets and total interest expense paid on interest-bearing liabilities. The amount of interest income is dependent upon many factors, including the volume and mix of earning assets, the general level of interest rates and the dynamics of changes in interest rates. The cost of funds necessary to support earning assets varies with the volume and mix of interest-bearing liabilities and the rates paid to attract and retain such funds. The Company's average balances, interest income and expense and rates earned or paid for major balance sheet categories are set forth in the following table (dollars in thousands):

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

	Nine months ended September 30, 2006			Ni Se
	Average Balance	Interest	Average Rate	Average Balance
ASSETS				
Interest-bearing deposits	\$ 789	\$ 25	4.24%	\$1,
Federal funds sold	4,738	183	5.16%	8,
Investment securities				
Taxable	157,008	5,357	4.55%	141,
Tax-exempt (1)	17,834	580	4.34%	20,
Loans (2) (3)	681,362	34,169	6.70%	605,
Total earning assets	861,731	40,314	6.25%	777,
Cash and due from banks	19,611			18,
Premises and equipment	16,075			15,
Other assets	28,141			22,
Allowance for loan losses	(5,708)			(4,7
Total assets	\$919,850			\$828,
LIABILITIES AND STOCKHOLDERS' EQUITY				
Interest-bearing deposits				
Demand deposits	\$238,329	\$ 3,734	2.09%	\$229,
Savings deposits	62,715	238	.51%	60,
Time deposits	316,478	9,119	3.85%	267,
Securities sold under agreements to repurchase	52,510	1,665	4.24%	57,
FHLB advances	37,872	1,291	4.56%	32,
Federal funds purchased	3,393	129	5.08%	
Junior subordinated debt	16,229	920	7.58%	10,
Other debt	10,102	470	6.22%	5,
Total interest-bearing liabilities	737,628	17,566	3.18%	664,
Non interest-bearing demand deposits	101,715			88,
Other liabilities	6,460			4,
Stockholders' equity	74,047			71,
Total liabilities & equity	\$919,850			\$828,
Net interest income		\$22,748		
Net interest spread			3.07%	
Impact of non-interest bearing funds			.45%	
Net yield on interest- earning assets			3.52%	

- (1) The tax-exempt income is not recorded on a tax equivalent basis.
(2) Nonaccrual loans have been included in the average balances.
(3) Includes loans held for sale.

Changes in net interest income may also be analyzed by segregating the volume and rate components of interest income and interest expense. The following table summarizes the approximate relative contribution of changes in average volume and interest rates to changes in net interest income for the nine months ended

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

September 30, 2006, compared to the same period in 2005 (in thousands):

	For the nine months ended September 30, 2006 compared to 2005 Increase / (Decrease)		
	Total Change	Volume (1)	Rate (1)
<hr/>			
Earning Assets:			
Interest-bearing deposits	\$ (10)	\$ (27)	\$ 17
Federal funds sold	-	(145)	145
Investment securities:			
Taxable	1,415	456	959
Tax-exempt (2)	(96)	(76)	(20)
Loans (3)	6,275	3,695	2,580
<hr/>			
Total interest income	7,584	3,903	3,681
<hr/>			
Interest-Bearing Liabilities:			
Interest-bearing deposits			
Demand deposits	1,698	82	1,616
Savings deposits	57	6	51
Time deposits	3,018	1,246	1,772
Securities sold under agreements to repurchase			
FHLB advances	668	(148)	816
Federal funds purchased	89	230	(141)
Junior subordinated debt	111	97	14
Other debt	459	294	165
Other debt	282	166	116
<hr/>			
Total interest expense	6,382	1,973	4,409
<hr/>			
Net interest income	\$ 1,202	\$ 1,930	\$ (728)
<hr/>			

- (1) Changes attributable to the combined impact of volume and rate have been allocated proportionately to the change due to volume and the change due to rate.
- (2) The tax-exempt income is not recorded on a tax-equivalent basis.
- (3) Nonaccrual loans have been included in the average balances.

Net interest income increased \$1.2 million, or 5.6% to \$22.7 million for the nine months ended September 30, 2006, from \$21.5 million for the same period in 2005. The increase in net interest income was due to an increase in rates and growth in earning assets, primarily composed of loan growth and increase in loan rate, which was largely offset by an increase in the cost of interest-bearing liabilities.

For the nine months ended September 30, 2006, average earning assets increased by \$84.1 million, or 10.8%, and average interest-bearing liabilities increased \$73.3 million, or 11%, compared with average balances for the same period in 2005. The changes in average balances for these periods are shown below:

- > Average loans increased by \$76 million or 12.6%.
- > Average securities increased by \$12.9 million or 8%.
- > Average interest-bearing deposits increased by \$60.1 million or 10.8%.

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

- > Average securities sold under agreements to repurchase decreased by \$5 million or 8.7%.
- > Average borrowings and other debt increased by \$18.3 million or 37.1%.
- > Net interest margin decreased to 3.52% for the first nine months of 2006 from 3.69% for the first nine months of 2005.

To compare the tax-exempt yields on interest-earning assets to taxable yields, the Company also computes non-GAAP net interest income on a tax equivalent basis (TE) where the interest earned on tax-exempt securities is adjusted to an amount comparable to interest subject to normal income taxes assuming a federal tax rate of 34% (referred to as the tax equivalent adjustment). The net yield on interest-earning assets (TE) was 3.57% for the first nine months of 2006 and 3.75% for the first nine months of 2005. The TE adjustments to net interest income for September 30, 2006 and 2005 were \$299,000 and \$348,000, respectively.

Provision for Loan Losses

The provision for loan losses for the nine months ended September 30, 2006 and 2005 was \$575,000 and \$550,000, respectively. Nonperforming loans were \$3.6 million and \$3.3 million as of September 30, 2006 and 2005, respectively. Net charge-offs were \$652,000 for the nine months ended September 30, 2006 compared to \$497,000 during the same period in 2005. For information on loan loss experience and nonperforming loans, see discussion under the "Nonperforming Loans" and "Loan Quality and Allowance for Loan Losses" sections below.

Other Income

An important source of the Company's revenue is derived from other income. The following table sets forth the major components of other income for the three months and nine months ended September 30, 2006 and 2005 (in thousands):

	Three months ended September 30,			Nine months ended September 30,		
	2006	2005	\$ Change	2006	2005	\$
Trust	\$592	\$548	\$ 44	\$1,801	\$1,756	
Brokerage	122	72	50	418	284	
Insurance commissions	361	352	9	1,343	1,264	
Service charges	1,413	1,233	180	3,897	3,420	
Security gains	67	61	6	66	315	
Mortgage banking	127	284	(157)	288	605	
Other	686	587	99	2,011	1,737	
Total other income	\$3,368	\$3,137	\$ 231	\$9,824	\$9,381	

Following are explanations for the three months ended September 30, 2006 compared to the same period in 2005:

- > Trust revenues increased \$44,000 or 8% to \$592,000 from \$548,000. Trust assets, at market value, were \$423 million at September 30, 2006 compared to \$392 million at September 30, 2005. The increase in trust revenues was due to non-recurring executor and sales fees received in

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

the third quarter of 2006 that were not received in 2005.

- > Revenues from brokerage increased \$50,000 or 69.4% to \$122,000 from \$72,000 due to greater commissions received on sales of annuities.
- > Insurance commissions increased \$9,000 or 2.6% to \$361,000 from \$352,000 due to an increase in commissions received on sales of business property and casualty insurance.
- > Fees from service charges increased \$180,000 or 14.6% to \$1,413,000 from \$1,233,000. This was primarily the result of an increase in the number of overdrafts and an increase in the per overdraft fee to \$25 from \$22.50.
- > The sale of securities during the three months ended September 30, 2006 resulted in net securities gains of \$67,000 compared to the three months ended September 30, 2005 which resulted in net securities gains of \$61,000.
- > Mortgage banking income decreased \$157,000 or 55.3% to \$127,000 from \$284,000. This decrease was due to the decreased volume of fixed rate loans originated and sold by First Mid Bank. Loans sold balances were as follows:
 - > \$10.4 million (representing 103 loans) for the third quarter of 2006.
 - > \$23.4 million (representing 204 loans) for the third quarter of 2005.

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

- > Other income increased \$99,000 or 16.9% to \$686,000 from \$587,000. This increase was primarily due to increased ATM service fees.

Following are explanations for the nine months ended September 30, 2006 compared to the same period in 2005:

- > Trust revenues increased \$45,000 or 2.6% to \$1,801,000 from \$1,756,000. Trust assets, at market value, were \$423 million at September 30, 2006 compared to \$392 million at September 30, 2005. The increase in trust revenues was the result of new business and an increase in equity prices.
- > Revenues from brokerage increased \$134,000 or 47.2% to \$418,000 from \$284,000 due to greater commissions received on sales of annuities.
- > Insurance commissions increased \$79,000 or 6.3% to \$1,343,000 from \$1,264,000 due to an increase in commissions received on sales of business property and casualty insurance.
- > Fees from service charges increased \$477,000 or 13.9% to \$3,897,000 from \$3,420,000. This was primarily the result of an increase in the number of overdrafts and an increase in the per overdraft fee to \$25 from \$22.50.
- > The sale of securities during the nine months ended September 30, 2006 resulted in net securities gains of \$66,000 compared to the nine months ended September 30, 2005 which resulted in net securities gains of \$315,000.

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

- > Mortgage banking income decreased \$317,000 or 52.4% to \$288,000 from \$605,000. This decrease was due to the decreased volume of fixed rate loans originated and sold by First Mid Bank. Loans sold balances were as follows:
 - > \$24.4 million (representing 241 loans) for the first nine months of 2006.
 - > \$50.8 million (representing 472 loans) for the first nine months of 2005.

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

- > Other income increased \$274,000 or 15.8% to \$2,011,000 from \$1,737,000. This increase was primarily due to increased ATM service fees.

Other Expense

The major categories of other expense include salaries and employee benefits, occupancy and equipment expenses and other operating expenses associated with day-to-day operations. The following table sets forth the major components of other expense for the three months and nine months ended September 30, 2006 and 2005 (in thousands):

	Three months ended September 30,			Nine months ended September 30,	
	2006	2005	\$ Change	2006	2005
Salaries and benefits	\$ 4,036	\$ 3,343	\$ 693	\$11,391	\$10,223
Occupancy and equipment	1,236	1,119	117	3,570	3,199
Amortization of intangibles	216	143	73	545	430
Stationery and supplies	165	114	51	430	378
Legal and professional fees	374	342	32	1,005	1,200
Marketing and promotion	240	198	42	660	549
Other operating expenses	1,106	1,134	(28)	3,346	3,214
Total other expense	\$ 7,373	\$ 6,393	\$ 980	\$20,947	\$19,193

Following are explanations for the three months ended September 30, 2006 compared to the same period in 2005:

- > Salaries and employee benefits, the largest component of other expense, increased \$693,000 or 20.7% to \$4,036,000 from \$3,343,000. This increase is due to additional expense as a result of the acquisition of Mansfield, merit increases for continuing employees and \$43,000 of additional compensation expense recorded in accordance with the provisions of SFAS 123R. There were 342 full-time equivalent employees at September 30, 2006, of which 29 were added through the acquisition of Mansfield, compared to 314 at September 30, 2005.
- > Occupancy and equipment expense increased \$117,000 or 10.5% to \$1,236,000 from \$1,119,000 due to an increase in occupancy expenses

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

for Mansfield, and the new office location of Checkley and the Highland branch facility that were opened in 2005.

- > Expense for amortization of intangible assets increased \$73,000 or 51% to \$216,000 from \$143,000 due to the additional core deposit intangible amortization expense resulting from the acquisition of Mansfield.
- > Other operating expenses decreased \$28,000 or 2.5% to \$1,106,000 in 2006 from \$1,134,000 in 2005 due to expenses associated with other real estate owned that occurred in the third quarter of 2005 that did not occur in the third quarter of 2006.
- > All other categories of operating expenses increased a net of \$125,000 or 19.1% to \$779,000 from \$654,000. The increase was primarily due to increased expenses following the acquisition of Mansfield.

Following are explanations for the nine months ended September 30, 2006 compared to the same period in 2005:

- > Salaries and employee benefits, the largest component of other expense, increased \$1,168,000 or 11.4% to \$11,391,000 from \$10,223,000. This increase is due to additional expense as a result of the acquisition of Mansfield, merit increases for continuing employees and \$135,000 of additional compensation expense recorded in accordance with the provisions of SFAS 123R. There were 342 full-time equivalent employees at September 30, 2006, of which 29 were added through the acquisition of Mansfield, compared to 314 at September 30, 2005.
- > Occupancy and equipment expense increased \$371,000 or 11.6% to \$3,570,000 from \$3,199,000 due to an increase in occupancy expenses for Mansfield, and for the new office location of Checkley and the Highland branch facility that were opened in 2005.
- > Expense for amortization of intangible assets increased \$115,000 or 26.7% to \$545,000 from \$430,000 due to the additional core deposit intangible amortization expense resulting from the acquisition of Mansfield.
- > Other operating expenses increased \$132,000 or 4.1% to \$3,346,000 in 2006 from \$3,214,000 in 2005 due to increases in various expenses including ATM and bankcard expenses.
- > All other categories of operating expenses decreased a net of \$32,000 or 1.5% to \$2,095,000 from \$2,127,000. The decrease was primarily due to decreases in various professional fees.

Income Taxes

Total income tax expense amounted to \$3,691,000 (33.4% effective tax rate) for the nine months ended September 30, 2006, compared to \$3,942,000 (35.2% effective tax rate) for the same period in 2005. The change in the effective tax rate in 2006 is due to a \$142,000 reduction in the state tax expense accrual as a result of amending the 2004 state income tax return for a greater deduction in enterprise zone interest filed during the first quarter of 2006. This resulted in a \$92,000 net reduction in tax expense. Additional reduction in state tax expense for 2006 resulted from an increase in deductible enterprise zone loans.

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

Analysis of Balance Sheets

Loans

The loan portfolio (net of unearned interest) is the largest category of the Company's earning assets. The following table summarizes the composition of the loan portfolio, including loans held for sale, as of September 30, 2006 and December 31, 2005 (in thousands):

	September 30, 2006	December 31, 2005
Real estate - residential	\$143,953	\$117,204
Real estate - agricultural	57,925	50,730
Real estate - commercial	304,408	282,501
Total real estate - mortgage	506,286	450,435
Commercial and agricultural	170,490	150,598
Installment	45,271	34,385
Other	4,907	2,715
Total loans	\$726,954	\$638,133

Overall loans increased \$88.8 million, or 13.9%. The acquisition of Mansfield resulted in an increase of approximately \$55.8 million in overall loans. The remaining increase was primarily a result of an increase in residential and commercial real estate loans. Total real estate mortgage loans have averaged approximately 70% of the Company's total loan portfolio for the past several years. This is the result of the Company's focus on commercial real estate lending and long-term commitment to residential real estate lending. The balance of real estate loans held for sale amounted to \$1,202,000 and \$1,778,000 as of September 30, 2006 and December 31, 2005, respectively.

At September 30, 2006, the Company had loan concentrations in agricultural industries of \$110 million, or 15%, of outstanding loans and \$92.3 million, or 14.5%, at December 31, 2005. In addition, the Company had loan concentrations in the following industries as of September 30, 2006 compared to December 31, 2005 (dollars in thousands):

	September 30, 2006		December 31, 2005	
	Principal balance	% Outstanding loans	Principal Balance	% Outstanding loans
Operators of non-residential buildings	\$29,618	4.07%	\$22,446	3.52%
Apartment building owners	36,521	5.02%	40,843	6.40%
Motels, hotels & tourist courts	31,601	4.35%	28,054	4.40%
Subdividers & developers	29,109	4.00%	26,397	4.14%

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

The following table presents the balance of loans outstanding as of September 30, 2006, by maturities (in thousands):

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

	Maturity (1)			Total
	One year or less (2)	Over 1 through 5 years	Over 5 years	
Real estate - residential	\$ 60,833	\$ 68,627	\$ 14,493	\$143,953
Real estate - agricultural	11,955	38,000	7,970	57,925
Real estate - commercial	70,072	208,766	25,570	304,408
Total real estate - mortgage	142,860	315,393	48,033	506,286
Commercial and agricultural	114,833	51,563	4,094	170,490
Installment	22,408	22,581	282	45,271
Other	1,061	2,390	1,456	4,907
Total loans	\$281,162	\$391,927	\$ 53,865	\$726,954

(1) Based on scheduled principal repayments.

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

As of September 30, 2006, loans with maturities over one year consisted of approximately \$370 million fixed rate loans and \$76 million in variable rate loans. The loan maturities noted above are based on the contractual provisions of the individual loans. Rollovers and borrower requests are handled on a case-by-case basis.

Nonperforming Loans

Nonperforming loans are defined as: (a) loans accounted for on a nonaccrual basis; (b) accruing loans contractually past due ninety days or more as to interest or principal payments; and (c) loans not included in (a) and (b) above which are defined as "renegotiated loans". The Company's policy is to cease accrual of interest on all loans that become ninety days past due as to principal or interest. Nonaccrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collection of interest or principal.

The following table presents information concerning the aggregate amount of nonperforming loans at September 30, 2006 and December 31, 2005 (in thousands):

	September 30, 2006	December 31, 2005
Nonaccrual loans	\$3,607	\$3,458
Renegotiated loans which are performing in accordance with revised terms	31	-
Total nonperforming loans	\$3,638	\$3,458

The \$180,000 increase in nonaccrual loans during the nine months ended September 30, 2006 resulted from the net of \$108,000 of loans added to nonaccrual through

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

acquisition of Mansfield, \$1,304,000 of additional loans put on nonaccrual status, \$921,000 of loans brought current or paid-off, \$127,000 of loans transferred to other real estate owned and \$184,000 of loans charged-off.

Interest income that would have been reported if nonaccrual and renegotiated loans had been performing totaled \$65,000 and \$65,000 for the periods ended September 30, 2006 and 2005, respectively.

Loan Quality and Allowance for Loan Losses

The allowance for loan losses represents management's estimate of the reserve necessary to adequately account for probable losses that could ultimately be realized from current loan exposures. The provision for loan losses is the charge against current earnings that is determined by management as the amount needed to maintain an adequate allowance for loan losses. In determining the adequacy of the allowance for loan losses, and therefore the provision to be charged to current earnings, management relies predominantly on a disciplined credit review and approval process that extends to the full range of the Company's credit exposure. The review process is directed by overall lending policy and is intended to identify, at the earliest possible stage, borrowers who might be facing financial difficulty. Once identified, the magnitude of exposure to individual borrowers is quantified in the form of specific allocations of the allowance for loan losses. Management considers collateral values and guarantees in the determination of such specific allocations. Additional factors considered by management in evaluating the overall adequacy of the allowance include historical net loan losses, the level and composition of nonaccrual, past due and renegotiated loans, trends in volumes and terms of loans, effects of changes in risk selection and underwriting standards or lending practices, lending staff changes, concentrations of credit, industry conditions and the current economic conditions in the region where the Company operates. Management considers the allowance for loan losses a critical accounting policy.

Management recognizes there are risk factors that are inherent in the Company's loan portfolio. All financial institutions face risk factors in their loan portfolios because risk exposure is a function of the business. The Company's operations (and therefore its loans) are concentrated in east central Illinois, an area where agriculture is the dominant industry. Accordingly, lending and other business relationships with agriculture-based businesses are critical to the Company's success. At September 30, 2006, the Company's loan portfolio included \$110 million of loans to borrowers whose businesses are directly related to agriculture. The balance increased \$17.7 million from \$92.3 million at December 31, 2005. While the Company adheres to sound underwriting practices, including collateralization of loans, any extended period of low commodity prices, significantly reduced yields on crops and/or reduced levels of government assistance to the agricultural industry could result in an increase in the level of problem agriculture loans and potentially result in loan losses within the agricultural portfolio.

In addition, the Company has \$31.6 million of loans to motels, hotels and tourist courts. The performance of these loans is dependent on borrower specific issues as well as the general level of business and personal travel within the region. While the Company adheres to sound underwriting standards, a prolonged period of reduced business or personal travel could result in an increase in non-performing loans to this business segment and potentially in loan losses. The Company also has \$29.6 million of loans to operators of non-residential buildings, \$36.5 million of loans to apartment building owners and \$29.1 million of loans to subdividers and developers. A significant widespread decline in real estate values could result in an increase in non-performing loans to this segment and potentially in loan losses.

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

Analysis of the allowance for loan losses as of September 30, 2006 and 2005, and of changes in the allowance for the three-month and nine-month periods ended September 30, 2006 and 2005, is as follows (dollars in thousands):

	Three months ended September 30, 2006	2005	Nine months e 2006
Average loans outstanding, net of unearned income	\$717,966	\$621,864	\$681,36
Allowance-beginning of period	\$ 6,223	\$ 4,687	\$ 4,64
Allowance of Mansfield acquired in business combination	-	-	1,40
Charge-offs:			
Real estate-mortgage	25	54	7
Commercial, financial & agricultural	332	162	51
Installment	71	15	9
Other	60	43	13
Total charge-offs	488	274	82
Recoveries:			
Real estate-mortgage	2	2	2
Commercial, financial & agricultural	2	22	2
Installment	25	7	3
Other	41	17	10
Total recoveries	70	48	16
Net charge-offs (recoveries)	418	226	65
Provision for loan losses	171	213	57
Allowance-end of period	\$ 5,976	\$ 4,674	\$ 5,97
Ratio of annualized net charge-offs to average loans	.23%	.15%	.13
Ratio of allowance for loan losses to loans outstanding (less unearned interest at end of period)	.82%	.74%	.82
Ratio of allowance for loan losses to nonperforming loans	164.3%	140.0%	164.3%

During the first nine months of 2006, the Company had charge-offs of \$353,000 on commercial loans of four borrowers. During the first nine months of 2005, the Company had charge-offs of \$53,000 on two agricultural loans of a single borrower and charge-offs of \$234,000 on commercial loans of four borrowers. The Company also recovered \$56,000 on a commercial real estate loan that had been charged-off in a prior period.

The Company minimizes credit risk by adhering to sound underwriting and credit review policies. Management and the board of directors of the Company review these policies at least annually. Senior management is actively involved in business development efforts and the maintenance and monitoring of credit underwriting and approval. The loan review system and controls are designed to identify, monitor and address asset quality problems in an accurate and timely manner. On a quarterly basis, the board of directors and management review the

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

status of problem loans and determine a best estimate of the allowance. In addition to internal policies and controls, regulatory authorities periodically review asset quality and the overall adequacy of the allowance for loan losses.

Securities

The Company's overall investment objectives are to insulate the investment portfolio from undue credit risk, maintain adequate liquidity, insulate capital against changes in market value and control excessive changes in earnings while optimizing investment performance. The types and maturities of securities purchased are primarily based on the Company's current and projected liquidity and interest rate sensitivity positions.

The following table sets forth the amortized cost of the securities as of September 30, 2006 and December 31, 2005 (dollars in thousands):

	September 30, 2006		December 31, 2005	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$149,061	4.71%	\$108,506	
Obligations of states and political subdivisions	20,543	4.32%	16,829	
Mortgage-backed securities	16,485	4.48%	20,046	
Other securities	13,319	6.36%	13,083	
Total securities	\$199,408	4.76%	\$158,464	

At September 30, 2006, the Company's investment portfolio showed an increase of \$40.9 million from 2005 due to securities acquired in the acquisition of Mansfield offset by various securities that matured during the first quarter of 2006 and were not immediately replaced. The amortized cost, gross unrealized gains and losses and estimated fair values for available-for-sale and held-to-maturity securities by major security type at September 30, 2006 and December 31, 2005 were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
September 30, 2006				
Available-for-sale:				
U.S. Treasury securities and obligations of U.S. government corporations & agencies	\$149,061	\$508	\$(1,059)	\$148,510
Obligations of states and political subdivisions	19,200	240	(49)	19,391
Mortgage-backed securities	16,485	23	(405)	16,103
Federal Home Loan Bank stock	4,523	-	-	4,523
Other securities	8,796	492	-	9,288
Total available-for-sale	\$198,065	\$ 1,263	\$(1,513)	\$197,815

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

Held-to-maturity:				
Obligations of states and political subdivisions	\$ 1,343	\$ 22	\$ -	\$1,365
December 31, 2005				
Available-for-sale:				
U.S. Treasury securities and obligations of U.S. government corporations & agencies	\$ 108,506	\$ 31	\$(1,500)	\$ 107,037
Obligations of states and political subdivisions	15,417	239	(50)	15,606
Mortgage-backed securities	20,046	25	(442)	19,629
Federal Home Loan Bank stock	5,557	-	-	5,557
Other securities	7,526	486	-	8,012
Total available-for-sale	\$157,052	\$ 781	\$(1,992)	\$155,841
Held-to-maturity:				
Obligations of states and political subdivisions	\$ 1,412	\$ 30	\$ -	\$ 1,442

At September 30, 2006, there were four obligations of states and political subdivisions with a fair value of \$1,065,000 and an unrealized loss of \$14,000, six mortgage-backed securities with a fair value of \$14,363,000 and an unrealized loss of \$404,000, and ten obligations of U.S. government agencies with a fair value of \$53,960,000 and an unrealized loss of \$958,000, in a continuous unrealized loss position for twelve months or more. At September 30, 2005, there was one mortgage-backed security with a fair value of \$2,089,000 and an unrealized loss of \$19,000, and five obligations of U.S. government agencies with a fair value of \$21,394,000 and an unrealized loss of \$250,000, in a continuous unrealized loss position for twelve months or more. This position is due to short-term and intermediate rates increasing since the purchase of these securities resulting in the market value of the security being lower than book value. Management does not believe any individual unrealized loss as of September 30, 2006 or December 31, 2005 represents an other than temporary impairment.

The following table indicates the expected maturities of investment securities classified as available-for-sale and held-to-maturity, presented at amortized cost, at September 30, 2006 and the weighted average yield for each range of maturities. Mortgage-backed securities are included based on their weighted average life. All other securities are shown at their contractual maturity (dollars in thousands).

	One year or less	After 1 through 5 years	After 5 through 10 years	After ten years
Available-for-sale:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$23,369	\$ 92,128	\$32,609	\$ 95
Obligations of state and political subdivisions	2,006	7,856	6,222	3,111
Mortgage-backed securities	769	15,716	-	-
Federal Home Loan Bank stock	-	-	-	4,521
Other securities	500	-	2,500	5,791
Total investments	\$26,644	\$115,700	\$41,331	\$14,397

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

Weighted average yield	4.44%	4.52%	5.26%	5.76%
Full tax-equivalent yield	4.59%	4.65%	5.55%	6.17%
Held-to-maturity:				
Obligations of state and political subdivisions	\$ 145	\$ 505	\$ 191	\$ 50
Weighted average yield	5.36%	5.54%	5.48%	5.35%
Full tax-equivalent yield	7.89%	8.16%	7.82%	7.88%

The weighted average yields are calculated on the basis of the amortized cost and effective yields weighted for the scheduled maturity of each security. Tax-equivalent yields have been calculated using a 34% tax rate. With the exception of obligations of the U.S. Treasury and other U.S. government agencies and corporations, there were no investment securities of any single issuer, the book value of which exceeded 10% of stockholders' equity at September 30, 2006.

Investment securities carried at approximately \$155,842,000 and \$136,787,000 at September 30, 2006 and December 31, 2005, respectively, were pledged to secure public deposits and repurchase agreements and for other purposes as permitted or required by law.

Deposits

Funding of the Company's earning assets is substantially provided by a combination of consumer, commercial and public fund deposits. The Company continues to focus its strategies and emphasis on retail core deposits, the major component of funding sources. The following table sets forth the average deposits and weighted average rates for the nine months ended September 30, 2006 and for the year ended December 31, 2005 (dollars in thousands):

	September 30, 2006		December 31, 2005	
	Average Balance	Weighted Average Rate	Average Balance	Weighted Average Rate
Demand deposits:				
Non-interest-bearing	\$101,715	-	\$ 89,593	-
Interest-bearing	238,329	2.09%	229,532	1.30%
Savings	62,715	.51%	59,830	.41%
Time deposits	316,478	3.85%	271,161	3.13%
Total average deposits	\$719,237	2.43%	\$650,116	1.80%

(dollars in thousands)	September 30, 2006	December 31, 2005
High month-end balances of total deposits	\$794,211	\$677,872
Low month-end balances of total deposits	651,392	627,107

The following table sets forth the maturity of time deposits of \$100,000 or more

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

at September 30, 2006 and December 31, 2005 (in thousands):

	September 30, 2006	December 31, 2005
3 months or less	\$46,271	\$ 15,947
Over 3 through 6 months	25,975	23,593
Over 6 through 12 months	39,308	34,944
Over 12 months	21,689	28,950
Total	\$133,243	\$103,434

During the first nine months of 2006, the balance of time deposits of \$100,000 or more increased by approximately \$29.8 million. The increase in balances was primarily attributable to time deposits acquired in the acquisition of Mansfield, an increase in brokered CD balances and to a promotion run in the first quarter of 2006.

Balances of time deposits of \$100,000 or more include brokered CDs, time deposits maintained for public fund entities, and consumer time deposits. The balance of brokered CDs was \$43.2 million and \$38.4 million as of September 30, 2006 and December 31, 2005, respectively. The Company also maintained time deposits for the State of Illinois with balances of \$3.1 million and \$3.4 million as of September 30, 2006 and December 31, 2005, respectively. The State of Illinois deposits are subject to bid annually and could increase or decrease in any given year.

Repurchase Agreements and Other Borrowings

Securities sold under agreements to repurchase are short-term obligations of First Mid Bank. First Mid Bank collateralizes these obligations with certain government securities that are direct obligations of the United States or one of its agencies. First Mid Bank offers these retail repurchase agreements as a cash management service to its corporate customers. Other borrowings consist of Federal Home Loan Bank ("FHLB") advances, federal funds purchased and loans (short-term or long-term debt) that the Company has outstanding and junior subordinated debentures.

Information relating to securities sold under agreements to repurchase and other borrowings as of September 30, 2006 and December 31, 2005 is presented below (dollars in thousands):

	September 30, 2006	December 31, 2005
Federal funds purchased	\$ 3,200	\$ 4,000
Securities sold under agreements to repurchase	55,031	67,380
Federal Home Loan Bank advances:		
Overnight	1,000	12,000
Fixed term - due in one year or less	7,000	3,000
Fixed term - due after one year	18,000	20,000
Debt:		
Loans due in one year or less	-	5,500
Loans due after one year	15,000	-
Junior subordinated debentures	20,620	10,310
Total	\$119,851	\$122,190

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

Average interest rate at end of period	5.39%	4.27%
Maximum outstanding at any month-end		
Federal funds purchased	\$ 4,000	\$ 4,000
Securities sold under agreements to repurchase	63,542	67,380
Federal Home Loan Bank advances:		
Overnight	19,500	12,014
Fixed term - due in one year or less	7,000	20,000
Fixed term - due after one year	30,000	20,000
Debt:		
Loans due in one year or less	4,500	6,200
Loans due after one year	15,000	200
Junior subordinated debentures	20,620	10,310
Averages for the period (YTD)		
Federal funds purchased	\$ 3,393	\$ 874
Securities sold under agreements to repurchase	52,510	57,799
Federal Home Loan Bank advances:		
Overnight	8,748	2,447
Fixed term - due in one year or less	5,667	13,575
Fixed term - due after one year	23,457	15,523
Debt:		
Loans due in one year or less	1,329	5,607
Loans due after one year	8,773	104
Junior subordinated debentures	16,229	10,310
Total	\$ 121,338	\$106,239
Average interest rate during the period	4.55%	3.74%

FHLB advances represent borrowings by First Mid Bank to economically fund loan demand. The fixed term advances consist of \$25 million as follows:

- > \$7 million advance at 4.00% with a 2-year maturity, due April 15, 2007
- > \$5 million advance at 4.58% with a 5-year maturity, due March 22, 2010
- > \$3 million advance at 5.98% with a 10-year maturity, due March 1, 2011
- > \$5 million advance at 4.33% with a 10-year maturity, due November 23, 2011, five year lockout, one time call November 23, 2006
- > \$5 million advance at 4.58% with a 10-year maturity, due July 14, 2016, one year lockout, callable quarterly beginning July, 2007

At September 30, 2006, outstanding debt balances include \$15,000,000 on a revolving credit agreement with The Northern Trust Company. This loan was renegotiated on April 24, 2006 in conjunction with obtaining financing for the acquisition of Mansfield. The revolving credit agreement has a maximum available balance of \$22.5 million with a term of three years from the date of closing. The interest rate (6.55% as of September 30, 2006) is floating at 1.25% over the federal funds rate when the ratio of senior debt to Tier 1 capital is equal to or below 35% as of the end of the previous quarter and 1.50% over the federal funds rate when the ratio of senior debt to Tier 1 capital is above 35%. Currently senior debt to Tier 1 capital is below 35%. The loan is secured by the common stock of First Mid Bank and subject to a borrowing agreement containing requirements for the Company and First Mid Bank similar to those of the prior agreement including requirements for operating and capital ratios. The Company and its subsidiary bank were in compliance with the existing covenants at September 30, 2006 and 2005 and December 31, 2005.

On February 27, 2004, the Company completed the issuance and sale of \$10 million of floating rate trust preferred securities through First Mid-Illinois Statutory Trust I ("Trust I"), a statutory business trust and wholly-owned unconsolidated

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

subsidiary of the Company, as part of a pooled offering. The Company established Trust I for the purpose of issuing the trust preferred securities. The \$10 million in proceeds from the trust preferred issuance and an additional \$310,000 for the Company's investment in common equity of Trust I, a total of \$10,310,000, was invested in junior subordinated debentures of the Company. The underlying junior subordinated debentures issued by the Company to Trust I mature in 2034, bear interest at nine-month London Interbank Offered Rate ("LIBOR") plus 280 basis points, reset quarterly, and are callable, at the option of the Company, at par on or after April 7, 2009 (8.31% and 6.95% at September 30, 2006 and December 31, 2005, respectively). The Company used the proceeds of the offering for general corporate purposes.

On April 26, 2006, the Company completed the issuance and sale of \$10 million of fixed/floating rate trust preferred securities through First Mid-Illinois Statutory Trust II ("Trust II"), a statutory business trust and wholly-owned unconsolidated subsidiary of the Company, as part of a pooled offering. The Company established Trust II for the purpose of issuing the trust preferred securities. The \$10 million in proceeds from the trust preferred issuance and an additional \$310,000 for the Company's investment in common equity of Trust II, a total of \$10,310,000, was invested in junior subordinated debentures of the Company. The underlying junior subordinated debentures issued by the Company to Trust II mature in 2036, bear interest at a fixed rate of 6.98% (three-month LIBOR plus 160 basis points) paid quarterly and converts to floating rate (LIBOR plus 160 basis points) after June 15, 2011. The net proceeds to the Company were used for general corporate purposes, including the Company's acquisition of Mansfield.

The trust preferred securities issued by Trust I and Trust II are included as Tier 1 capital of the Company for regulatory capital purposes. On March 1, 2005, the Federal Reserve Board adopted a final rule that allows the continued limited inclusion of trust preferred securities in the calculation of Tier 1 capital for regulatory purposes. The final rule provides a five-year transition period, ending September 30, 2009, for application of the quantitative limits. The Company does not expect the application of the quantitative limits to have a significant impact on its calculation of Tier 1 capital for regulatory purposes or its classification as well-capitalized.

Interest Rate Sensitivity

The Company seeks to maximize its net interest margin while maintaining an acceptable level of interest rate risk. Interest rate risk can be defined as the amount of forecasted net interest income that may be gained or lost due to changes in the interest rate environment, a variable over which management has no control. Interest rate risk, or sensitivity, arises when the maturity or repricing characteristics of interest-bearing assets differ significantly from the maturity or repricing characteristics of interest-bearing liabilities.

The Company monitors its interest rate sensitivity position to maintain a balance between rate sensitive assets and rate sensitive liabilities. This balance serves to limit the adverse effects of changes in interest rates. The Company's asset liability management committee (ALCO) oversees the interest rate sensitivity position and directs the overall allocation of funds.

In the banking industry, a traditional way to measure potential net interest income exposure to changes in interest rates is through a technique known as "static GAP" analysis which measures the cumulative differences between the amounts of assets and liabilities maturing or repricing at various intervals. By comparing the volumes of interest-bearing assets and liabilities that have contractual maturities and repricing points at various times in the future, management can gain insight into the amount of interest rate risk embedded in the balance sheet.

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

The following table sets forth the Company's interest rate repricing GAP for selected maturity periods at September 30, 2006 (dollars in thousands):

	Rate Sensitive Within					Th
	1 year	1-2 years	2-3 years	3-4 years	4-5 years	
Interest-earning assets:						
Federal funds sold and other interest-bearing deposits	\$ 476	\$ -	\$ -	\$ -	\$ -	
Taxable investment securities	29,846	32,571	21,133	21,178	11,911	
Nontaxable investment securities	2,153	2,069	1,997	2,392	1,963	
Loans	319,323	125,719	139,284	68,715	49,908	
Total	\$351,798	\$160,359	\$162,414	\$92,285	\$63,782	
Interest-bearing liabilities:						
Savings and N.O.W. accounts	\$ 54,718	\$ 10,321	10,768	\$ 15,685	\$ 16,212	
Money market accounts	97,970	1,559	1,603	2,079	2,122	
Other time deposits	278,844	52,116	10,644	10,476	5,501	
Short-term borrowings/debt	71,231	-	-	-	-	
Long-term borrowings/debt	-	-	15,000	5,000	23,620	
Total	\$502,763	\$63,996	\$38,015	\$33,240	\$ 47,455	
Rate sensitive assets -						
rate sensitive liabilities	\$(150,965)	\$ 96,363	\$ 124,399	\$59,045	\$ 16,327	
Cumulative GAP	\$(150,965)	\$(54,602)	\$ 69,797	\$128,842	\$145,169	
Cumulative amounts as % of						
total rate sensitive assets	-16.3%	10.4%	13.4%	6.4%	1.8%	
Cumulative Ratio	-16.3%	-5.9%	7.5%	13.9%	15.7%	

The static GAP analysis shows that at September 30, 2006, the Company was liability sensitive, on a cumulative basis, through the twelve-month time horizon. This indicates that future increases in interest rates, if any, could have an adverse effect on net interest income. Conversely, future decreases in interest rates could have a positive effect on net interest income.

There are several ways the Company measures and manages the exposure to interest rate sensitivity, including static GAP analysis. The Company's ALCO also uses other financial models to project interest income under various rate scenarios and prepayment/extension assumptions consistent with First Mid Bank's historical experience and with known industry trends. ALCO meets at least monthly to review the Company's exposure to interest rate changes as indicated by the various techniques and to make necessary changes in the composition terms and/or rates of the assets and liabilities. Based on all information available, management does not believe that changes in interest rates, which might reasonably be expected to occur in the next twelve months, will have a material adverse effect on the Company's net interest income.

Capital Resources

At September 30, 2006, the Company's stockholders' equity had increased

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

\$3,404,000 or 4.7% to \$75,730,000 from \$72,326,000 as of December 31, 2005. During the first nine months of 2006, net income contributed \$7,359,000 to equity before the payment of dividends to common stockholders. The change in market value of available-for-sale investment securities increased stockholders' equity by \$587,000, net of tax. Additional purchases of treasury stock (128,449 shares at an average cost of \$41.29 per share) decreased stockholders' equity by approximately \$5,303,000.

The Company is subject to various regulatory capital requirements administered by the federal banking agencies. Bank holding companies follow minimum regulatory requirements established by the Board of Governors of the Federal Reserve System ("Federal Reserve System"), and First Mid Bank follows similar minimum regulatory requirements established for national banks by the Office of the Comptroller of the Currency ("OCC"). Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary action by regulators that, if undertaken, could have a direct material effect on the Company's financial statements.

Quantitative measures established by each regulatory agency to ensure capital adequacy require the reporting institutions to maintain a minimum total risk-based capital ratio of 8%, a minimum Tier 1 risk-based capital ratio of 4%, and a minimum leverage ratio of 3% for the most highly rated banks that do not expect significant growth. All other institutions are required to maintain a minimum leverage ratio of 4%. Management believes that, as of September 30, 2006 and December 31, 2005, the Company and First Mid Bank met all capital adequacy requirements.

The trust preferred securities issued by Trust I and Trust II are included as Tier 1 capital of the Company for regulatory capital purposes. On March 1, 2005, the Federal Reserve Board adopted a final rule that allows the continued limited inclusion of trust preferred securities in the calculation of Tier 1 capital for regulatory purposes. The final rule provides a five-year transition period, ending September 30, 2009, for application of revised quantitative limits. The Company does not expect the application of the quantitative limits to have a significant impact on its calculation of Tier 1 capital for regulatory purposes or its classification as well-capitalized.

As of September 30, 2006, both the Company and First Mid Bank had capital ratios above the required minimums for regulatory capital adequacy and that qualified them for treatment as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, total risk-based, Tier 1 risk-based and Tier 1 leverage ratios must be maintained as set forth in the following table (dollars in thousands).

	Actual		Required Minimum For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
September 30, 2006				
Total Capital (to risk-weighted assets)				
Company	\$79,130	10.80%	\$58,620	> 8.00%
First Mid Bank	87,389	12.03%	58,096	> 8.00%
Tier 1 Capital (to risk-weighted assets)				
Company	73,154	9.98%	29,310	> 4.00%

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

First Mid Bank	81,413	11.21%	29,048	-
				> 4.00%
				-
Tier 1 Capital (to average assets) Company	73,154	7.56%	38,683	-
				> 4.00%
First Mid Bank	81,413	9.30%	35,016	-
				> 4.00%
				-
December 31, 2005				
Total Capital (to risk-weighted assets) Company	\$75,901	11.87%	\$ 51,163	-
				> 8.00%
First Mid Bank	73,913	11.66	50,726	-
				> 8.00%
				-
Tier 1 Capital (to risk-weighted assets) Company	71,253	11.14	25,581	-
				> 4.00%
First Mid Bank	69,265	10.92	25,363	-
				> 4.00%
				-
Tier 1 Capital (to average assets) Company	71,253	8.55	33,330	-
				> 4.00%
First Mid Bank	69,265	8.36	33,152	-
				> 4.00%
				-

These ratios allow the Company to operate without capital adequacy concerns.

Stock Plans

Participants may purchase Company stock under the following four plans of the Company: the Deferred Compensation Plan, the First Retirement and Savings Plan, the Dividend Reinvestment Plan, and the Stock Incentive Plan. For more detailed information on these plans, refer to the Company's 2005 Annual Report on Form 10-K.

On August 5, 1998, the Company announced a stock repurchase program for up to 3% of its common stock. In March 2000, the Board of directors approved the repurchase of an additional 5% of the Company's common stock. In September 2001, the Board of directors approved the repurchase of \$3 million of additional shares of the Company's common stock and in August 2002, the Board of directors approved the repurchase of \$5 million of additional shares of the Company's common stock. In September 2003, the Board of directors approved the repurchase of \$10 million of additional shares of the Company's common stock. On April 27, 2004, the Board of directors approved the repurchase of an additional \$5 million shares of the Company's common stock. On August 23, 2005 the Board of directors approved the repurchase of an additional \$5 million shares of the Company's common stock and on August 22, 2006 the Board of directors approved the repurchase of an additional \$5 million shares of the Company's common stock, bringing the aggregate total on September 30, 2006 to 8% of the Company's common stock plus \$33 million of additional shares.

During the nine-month period ending September 30, 2006, the Company repurchased 128,449 shares at a total cost of approximately \$5,303,000. Since 1998, the Company has repurchased a total of 1,365,308 shares at a total price of approximately \$35,054,000. As of September 30, 2006, the Company was authorized per all repurchase programs to purchase \$4,153,000 in additional shares.

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

Liquidity

Liquidity represents the ability of the Company and its subsidiaries to meet all present and future financial obligations arising in the daily operations of the business. Financial obligations consist of the need for funds to meet extensions of credit, deposit withdrawals and debt servicing. The Company's liquidity management focuses on the ability to obtain funds economically through assets that may be converted into cash at minimal costs or through other sources. The Company's other sources of cash include overnight federal fund lines, Federal Home Loan Bank advances, deposits of the State of Illinois, the ability to borrow at the Federal Reserve Bank of Chicago, and the Company's operating line of credit with The Northern Trust Company. Details for the sources include:

- > First Mid Bank has \$23.5 million available in overnight federal fund lines, including \$10 million from Harris Trust and Savings Bank of Chicago, \$1 million from Illinois Bankers' Bank, and \$12.5 million from The Northern Trust Company. Availability of the funds is subject to First Mid Bank meeting minimum regulatory capital requirements for total capital to risk-weighted assets and Tier 1 capital to total average assets. As of September 30, 2006, First Mid Bank met these regulatory requirements.
- > First Mid Bank can also borrow from the Federal Home Loan Bank as a source of liquidity. Availability of the funds is subject to the pledging of collateral to the Federal Home Loan Bank. Collateral that can be pledged includes one-to-four family residential real estate loans and securities. At September 30, 2006, the excess collateral at the Federal Home Loan Bank will support approximately \$80.9 million of additional advances.
- > First Mid Bank also receives deposits from the State of Illinois. The receipt of these funds is subject to competitive bid and requires collateral to be pledged at the time of placement.
- > First Mid Bank is also a member of the Federal Reserve System and can borrow funds provided that sufficient collateral is pledged.
- > In addition, as of September 30, 2006, the Company had a revolving credit agreement in the amount of \$22.5 million with The Northern Trust Company with an outstanding balance of \$15 million and \$7.5 million in available funds.

Management monitors its expected liquidity requirements carefully, focusing primarily on cash flows from:

- > lending activities, including loan commitments, letters of credit and mortgage prepayment assumptions;
- > deposit activities, including seasonal demand of private and public funds;
- > investing activities, including prepayments of mortgage-backed securities and call provisions on U.S. Treasury and government agency securities; and
- > operating activities, including scheduled debt repayments and dividends to stockholders.

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

The following table summarizes significant contractual obligations and other commitments at September 30, 2006 (in thousands):

	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
	-----	-----	-----	-----	-----
Time deposits	\$357,641	\$278,783	\$62,821	\$15,977	\$ 60
Debt	35,620	-	15,000	-	20,620
Other borrowings	81,031	63,031	-	13,000	5,000
Operating leases	3,845	438	926	814	1,667
Supplemental retirement	789	50	100	100	539
	-----	-----	-----	-----	-----
	\$478,926	\$342,302	\$ 78,847	\$29,891	\$27,886
	=====	=====	=====	=====	=====

For the nine-month period ended September 30, 2006, net cash of \$8.2 million and \$25.1 million was provided from operating activities and financing activities, respectively, while investing activities used net cash of \$34.7 million. In total, cash and cash equivalents decreased by \$1.4 million since year-end 2005.

The Company has also issued \$10 million of floating rate trust preferred securities through each of Trust I and Trust II. See heading "Repurchase Agreements and Other Borrowings" for a more detailed description.

Off-Balance Sheet Arrangements

First Mid Bank enters into financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include lines of credit, letters of credit and other commitments to extend credit. Each of these instruments involves, to varying degrees, elements of credit, interest rate and liquidity risk in excess of the amounts recognized in the consolidated balance sheets. The Company uses the same credit policies and requires similar collateral in approving lines of credit and commitments and issuing letters of credit as it does in making loans. The exposure to credit losses on financial instruments is represented by the contractual amount of these instruments. However, the Company does not anticipate any losses from these instruments.

The off-balance sheet financial instruments whose contract amounts represent credit risk at September 30, 2006 and December 31, 2005 were as follows (in thousands):

	September 30, 2006	December 31, 2005
	-----	-----
Unused commitments, including lines of credit:		
Commercial real estate	\$ 24,233	\$ 28,745
Commercial operating	52,004	46,012
Home equity	17,307	16,160
Other	27,002	23,178
	-----	-----
Total	\$120,546	\$114,095
	=====	=====
Standby letters of credit	\$ 5,113	\$ 3,694

=====

Commitments to originate credit represent approved commercial, residential real estate and home equity loans that generally are expected to be funded within ninety days. Lines of credit are agreements by which the Company agrees to provide a borrowing accommodation up to a stated amount as long as there is no violation of any condition established in the loan agreement. Both commitments to originate credit and lines of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the lines and some commitments are expected to expire without being drawn upon, the total amounts do not necessarily represent future cash requirements.

Standby letters of credit are conditional commitments issued by the Company to guarantee the financial performance of customers to third parties. Standby letters of credit are primarily issued to facilitate trade or support borrowing arrangements and generally expire in one year or less. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending credit facilities to customers. The maximum amount of credit that would be extended under letters of credit is equal to the total off-balance sheet contract amount of such instrument.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There has been no material change in the market risk faced by the Company since December 31, 2005. For information regarding the Company's market risk, refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

ITEM 4. CONTROLS AND PROCEDURES

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's "disclosure controls and procedures" (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of the end of the period covered by this report. Based on such evaluation, such officers have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective in bringing to their attention on a timely basis material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic filings under the Exchange Act. Further, there have been no changes in the Company's internal control over financial reporting during the last fiscal quarter that have materially affected or that are reasonably likely to affect materially the Company's internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

Since First Mid Bank acts as a depository of funds, it is named from time to time as a defendant in lawsuits (such as garnishment proceedings) involving claims as to the ownership of funds in particular accounts. Management believes that all such litigation as well as other pending legal proceedings in which the Company is involved constitute ordinary, routine litigation incidental to the business of the Company and that such litigation will not materially adversely

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

affect the Company's consolidated financial condition.

ITEM 1A. RISK FACTORS

Various risks and uncertainties, some of which are difficult to predict and beyond the Company's control, could negatively impact the Company. As a financial institution, the Company is exposed to interest rate risk, liquidity risk, credit risk, operational risk, risks from economic or market conditions, and general business risks among others. Adverse experience with these or other risks could have a material impact on the Company's financial condition and results of operations, as well as the value of its common stock. There has been no material change to the risk factors described in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

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

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs
July 1, 2006 --			
July 31, 2006	-	-	-
August 1, 2006 --			
August 31, 2006	15,039	41.80	15,039
September 1, 2006 -			
September 30, 2006	10,391	\$41.98	10,391
Total	25,430	\$41.87	25,430

See heading "Stock Plans" for more information regarding stock purchases.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEM 5. OTHER INFORMATION

None.

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

ITEM 6. EXHIBITS

The exhibits required by Item 601 of Regulation S-K and filed herewith are listed in the Exhibit Index that follows the Signature Page and that immediately precedes the exhibits filed.

SIGNATURES

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

FIRST MID-ILLINOIS BANCSHARES, INC.
(Registrant)

Date: November 8, 2006

/s/ William S. Rowland

William S. Rowland
President and Chief Executive Officer

/s/ Michael L. Taylor

Michael L. Taylor
Chief Financial Officer

Exhibit Index to Quarterly Report on Form 10-Q

Exhibit Number	Description and Filing or Incorporation Reference
4.1	The Registrant agrees to furnish to the Commission, upon request, a copy of each instrument with respect to issues of long-term debt involving a total amount which does not exceed 10% of the total assets of the Registrant and its subsidiaries on a consolidated basis
11.1	Statement re: Computation of Earnings Per Share (Filed herewith on page 7)

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

- 31.1 Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 31.1

Certification pursuant to section 302
of the Sarbanes-Oxley Act of 2002

I, William S. Rowland, certify that:

- 1. I have reviewed this quarterly report on Form 10-Q of First Mid-Illinois Bancshares, Inc.;
- 2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

and procedures, as of the end of the period covered by this report based on such evaluation; and

- d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2006

By: /s/ William S. Rowland

William S. Rowland, President and
Chief Executive Officer

Exhibit 31.2

Certification pursuant to section 302
of the Sarbanes-Oxley Act of 2002

I, Michael L. Taylor, certify that:

1. I have reviewed this report on Form 10-Q of First Mid-Illinois Bancshares, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2006

By: /s/ Michael L. Taylor

Michael L. Taylor, Chief Financial Officer

Exhibit 32.1

Certification pursuant to
18 U.S.C. section 1350,
as adopted pursuant to
section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report of First Mid-Illinois Bancshares, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William S. Rowland, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 8, 2006

/s/ William S. Rowland

William S. Rowland
President and Chief Executive Officer

Exhibit 32.2

Certification pursuant to
18 U.S.C. section 1350,
as adopted pursuant to
section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report of First Mid-Illinois Bancshares, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael L. Taylor, Chief Financial Officer of the Company, certify, pursuant

Edgar Filing: FIRST MID ILLINOIS BANCSHARES INC - Form 10-Q

to 18 U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 8, 2006

/s/ Michael L. Taylor

Michael L. Taylor
Chief Financial Officer