FIRST MID ILLINOIS BANCSHARES INC
Form 10-K
March 05, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K
[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2014
Or
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____________ to ______________

Commission file number 0-13368
FIRST MID-ILLINOIS BANCSHARES, INC.
(Exact name of Registrant as specified in its charter)

Delaware	37-1103704
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)
1421 Charleston Avenue, Mattoon, Illinois	61938
(Address of principal executive offices)	(Zip code)

(217) 234-7454
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:
Common stock, par value $4.00 per share
(Title of class)

Securities registered pursuant to Section 12(g) of the Act:
NONE

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. [ ] Yes [X] No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. [ ] Yes [X] No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form   Yes [X]

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

Large accelerated filer [ ]	Accelerated filer [X]
Non-accelerated filer [ ]	Smaller reporting company [ ]

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

The aggregate market value of the outstanding common stock, other than shares held by persons who may be deemed affiliates of the Registrant, as of the last business day of the Registrant’s most recently completed second fiscal quarter was approximately $70,804,295. Determination of stock ownership by non-affiliates was made solely for the purpose of responding to this requirement and the Registrant is not bound by this determination for any other purpose.

As of March 5, 2015, 7,017,236 shares of the Registrant’s common stock, $4.00 par value, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Document	Into Form 10-K Part:
Portions of the Proxy Statement for 2015 Annual Meeting of Shareholders to be held on April 29, 2015	III

First Mid-Illinois Bancshares, Inc.
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PART I

ITEM 1. BUSINESS

Company and Subsidiaries

First Mid-Illinois Bancshares, Inc. (the "Company") is a financial holding company. The Company is engaged in the business of banking through its wholly owned subsidiary, First Mid-Illinois Bank & Trust, N.A. ("First Mid Bank"). The Company provides data processing services to affiliates through another wholly owned subsidiary, Mid-Illinois Data Services, Inc. ("MIDS"). The Company offers insurance products and services to customers through its wholly owned subsidiary, The Checkley Agency, Inc. doing business as First Mid Insurance Group ("First Mid Insurance"). The Company also wholly owns two statutory business trusts, First Mid-Illinois Statutory Trust I ("Trust I"), and First Mid-Illinois Statutory Trust II ("Trust II"), both unconsolidated subsidiaries of the Company.

The Company, a Delaware corporation, was incorporated on September 8, 1981, and pursuant to the approval of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") became the holding company owning all of the outstanding stock of First National Bank, Mattoon ("First National") on June 1, 1982. First National changed its name to First Mid-Illinois Bank & Trust, N.A. in 1992. The Company acquired all of the outstanding stock of a number of community banks or thrift institutions on the following dates, and subsequently combined their operations with those of the Company:

- Mattoon Bank, Mattoon on April 2, 1984
- State Bank of Sullivan on April 1, 1985
- Cumberland County National Bank in Neoga on December 31, 1985
- First National Bank and Trust Company of Douglas County on December 31, 1986
- Charleston Community Bank on December 30, 1987
- Heartland Federal Savings and Loan Association on July 1, 1992
- Downstate Bancshares, Inc. on October 4, 1994
- American Bank of Illinois on April 20, 2001
- Peoples State Bank of Mansfield on May 1, 2006

In 1997, First Mid Bank acquired the Charleston, Illinois branch location and the customer base of First of America Bank and in 1999 acquired the Monticello, Taylorville and DeLand branch offices and deposit base of Bank One Illinois, N.A.

First Mid Bank also opened a de novo branch in Decatur, Illinois and a banking center in the Student Union of Eastern Illinois University in Charleston, Illinois (2000); de novo branches in Champaign, Illinois and Maryville, Illinois (2002), a de novo branch in Highland, Illinois (2005) de novo branches in Decatur, Illinois and Champaign, Illinois (2009), and a de novo branch in Decatur, Illinois (2013).

In 2002, the Company acquired all of the outstanding stock of First Mid Insurance, an insurance agency located in Mattoon.

On September 10, 2010, the Company acquired 10 Illinois branches (the "Branches") from First Bank, a Missouri state chartered bank, located in Bartonville, Bloomington, Galesburg, Knoxville, Peoria and Quincy, Illinois.

Employees

The Company, MIDS, First Mid Insurance and First Mid Bank, collectively, employed 400 people on a full-time equivalent basis as of December 31, 2014. The Company places a high priority on staff development, which involves extensive training, including customer service training. New employees are selected on the basis of both technical skills and customer service capabilities. None of the employees are covered by a collective bargaining agreement with the Company. The Company offers a variety of employee benefits.

Business Lines

The Company has chosen to operate in three primary lines of business—community banking and wealth management through First Mid Bank and insurance brokerage through First Mid Insurance. Of these, the community banking line contributes approximately 91% of the Company's total revenues and profits. Within the community banking line, the Company serves commercial, retail and agricultural customers with a broad array of deposit and loan related products. The wealth management line provides estate planning, investment and farm management services for individuals and employee benefit services for business enterprises. The insurance brokerage line provides commercial lines insurance to businesses as well as homeowner, automobile and other types of personal lines insurance to individuals. All three lines emphasize a "hands on" approach to service so that products and services can be tailored to fit the specific needs of existing and potential customers. Management believes that by emphasizing this personalized approach, the Company can, to a degree, diminish the trend towards homogeneous financial services, thereby differentiating the Company from competitors and allowing for slightly higher operating margins in each of the three lines.

Business Strategies

Mission Statement. The Company's mission statement is to fulfill the financial needs of our communities with exceptional personal service, professionalism and integrity, and deliver meaningful value and results for customers and shareholders.

Excellence 2015. Excellence 2015 is a strategic plan that was developed in 2012. This multi-year strategic plan has broad-based initiatives designed to ensure the Company performs at a level with the highest performing community banks in the Midwest and to increase value for its shareholders, customers and employees in the future. The strategic plan was developed by executive management of the Company, and modified and adopted by the Board of DIrectors, without incurring any costs for third-party assistance. This initiative coincides with the 150th anniversary of the organization that will occur in April 2015. The Excellence 2015 plan was not undertaken as a result of any weaknesses or deficiencies identified during the Company's control assessments but rather as part of the Company's effort to continually assess and improve. Excellence 2015 is comprised of broad strategies for growth, customers, employees, operations and infrastructure, shareholders and risk management. Following is a description of these strategies.

Growth Strategy. The Company believes that growth of revenues and its customer base is vital to the goal of increasing the value of its shareholders' investment. The Company strives to create shareholder value by maintaining a strong balance sheet and increasing profits. Management attempts to grow in two primary ways:

· by organic growth through adding new customers and selling more products and services to existing customers; and
· by acquisitions.

Virtually all of the Company's customer-contact personnel, in each of its business lines, are engaged in organic growth efforts to one degree or another. These personnel attempt to match products and services with the particular financial needs of individual customers and prospective customers. Many senior officers of the organization are required to attend monthly meetings where they report on their business development efforts and results. Executive management uses these meetings as an educational and risk management opportunity as well. Cross-selling opportunities are encouraged between the business lines and is facilitated by an on-line application.

Within the community banking line, the Company has focused on growing business operating and real estate loans. Total commercial real estate loans have increased from $301 million at December 31, 2010 to $380 million at December 31, 2014. Approximately 62% of the Company's total revenues were derived from lending activities in the fiscal year ended December 31, 2014. The Company has also focused on growing its commercial and retail deposit base through growth in checking, money markets and customer repurchase agreement balances. The wealth management line has focused its growth efforts on estate planning, and investment services for individuals and employee benefit services for businesses. The insurance brokerage line has focused on increasing property and casualty and group medical insurance for businesses and personal lines insurance to individuals.

Growth through acquisitions has been an integral part of the Company's strategy for an extended period of time. When reviewing acquisition possibilities, the Company focuses on those organizations where there is a cultural fit with its existing operations and where there is a strong likelihood of adding to shareholder value. Most past acquisitions have been cash-based transactions. The Company would also consider a stock-based acquisition if the strategic and financial metrics were compelling.

Customer Strategy. The Company uses its market and customer knowledge to build relationships that provide high-value customer experiences.

Employee Strategy. The judgments, experiences and capabilities of the Company's employees are used to create an environment where meeting the needs of our customer, communities and stockholders is always a priority.

Strategy for Operations & Infrastructure. Operationally, the Company centralizes most administrative and operational tasks within its home office in Mattoon, Illinois. This allows branches to maintain customer focus, helps assure compliance with banking regulations, keeps fixed administrative costs at as low a level as practicable, and allows for better management of risk inherent in the business. The Company also utilizes technology where practicable in daily banking activities to reduce the potential for human error. While the Company does not employ every new technology that is introduced, it attempts to be competitive with other banking organizations with respect to operational and customer technology.

Shareholder Strategy. The Company strives to provide a competitive dividend as well as the opportunity for stock price appreciation.

Risk Management Strategy. The Company maintains a comprehensive risk management framework. The Company has initiated an Enterprise Risk Management ("ERM") process whereby management assesses the relevant risks inherent in the business, determines internal controls and procedures are in place to address the various risks, develops a structure for monitoring and reporting risk indicators and trends over time, and incorporates action plans to manage risk positions. The ERM process was not undertaken as a result of any weaknesses or deficiencies identified during the Company's control assessments but rather is part of the Company's effort to continually assess and improve by taking a more holistic approach to risk management. The Company's Chief Risk Management Officer is responsible for facilitating the ERM process. The Company utilizes a comprehensive set of operational policies and procedures that have been developed over time. These policies are continually reviewed by management, the Chief Risk Management Officer, and the Board of Directors. The Company's internal audit function completes procedures to ensure compliance with these policies. While there are several risks that pertain to the business of banking, three risks that are inherent with most banking companies are credit risk, interest rate risk, and liquidity risk.

In the business of banking, credit risk is an important risk as losses from uncollectible loans can diminish capital, earnings and shareholder value. In order to address this risk, the lending function of First Mid Bank receives significant oversight from executive management and the Board of Directors. An important element of credit risk management is the quality, experience and training of the loan officers of First Mid Bank. The Company has invested, and will continue to invest, significant resources to ensure the quality, experience and training of First Mid Bank's loan officers in order to keep credit losses at a minimum. In addition to the human element of credit risk management, the Company's loan policies address the additional aspects of credit risk. Most lending personnel have signature authority that allows them to lend up to a certain amount based on their own judgment as to the creditworthiness of a borrower. The amount of the signature authority is based on the lending officers' experience and training. The Senior Loan Committee, consisting of the most experienced lenders within the organization and four non-employee members of the board of directors, must approve all underwriting decisions in excess of $2 million and up to 75% of the legal lending limit which was approximately $26 million at December 31, 2014. The full Board of Directors must approve all underwriting decisions in excess of 75% of the legal lending limit. While the underlying nature of lending will result in some amount of loan losses, First Mid Bank's loan loss experience has been good with average net charge offs amounting to $1.9 million (0.22% of total loans) over the past five years. Nonperforming loans were $4.5 million (0.43% of total loans) at December 31, 2014. These percentages have historically compared well with peer financial institutions and continue to do so today.

Interest rate and liquidity risk are two other forms of risk embedded in the banking business. The Company's Asset Liability Management Committee, consisting of experienced individuals who monitor all aspects of interest rates and maturities of interest earning assets and interest paying liabilities, manages these risks. The underlying objectives of interest rate and liquidity risk management are to shelter the Company's net interest margin from changes in interest rates while maintaining adequate liquidity reserves to meet unanticipated funding demands. The Company uses financial modeling technology as a tool for evaluating these risks. Despite the tools and methods used to monitor this risk, a sustained unfavorable interest rate environment will lead to some amount of compression in the net interest margin. During 2014, the Company's net interest margin increased to 3.43% from 3.38% in 2013.

Markets and Competition

The Company has active competition in all areas in which First Mid Bank does business. First Mid Bank competes for commercial and individual deposits, loans, and trust business with many east central Illinois banks, savings and loan associations, and credit unions. The principal methods of competition in the banking and financial services industry are quality of services to customers, ease of access to facilities, and pricing of services, including interest rates paid on deposits, interest rates charged on loans, and fees charged for fiduciary and other banking services.

During 2014, First Mid Bank operated facilities in the Illinois counties of Adams, Bond, Champaign, Christian, Coles, Cumberland, Dewitt, Douglas, Effingham, Knox, Macon, Madison, McClean, Moultrie, Peoria and Piatt. Each facility primarily serves the community in which it is located. First Mid Bank served twenty-five different communities with thirty-seven separate locations in the towns of Altamont, Arcola, Bartonville, Bloomington, Champaign, Charleston, Decatur, Effingham, Galesburg, Highland, Knoxville, Mansfield, Mahomet, Maryville, Mattoon, Monticello, Neoga, Peoria, Pocahontas, Quincy, Sullivan, Taylorville, Tuscola, Urbana, and Weldon Illinois. Within the areas of service, there are numerous competing financial institutions and financial services companies. Subsequently, on January 16, 2015, First Mid Bank closed its facilities in Bloomington and Pocahontas.

Website

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

NASDAQ Listing

On May 12, 2014, the Company's common stock began trading on The NASDAQ Stock Market under the ticker "FMBH." Prior to the listing of the Company's common stock on NASDAQ, the common stock was traded on the OTC Bulletin Board.

Conversion of Series B Preferred Stock

On September 23, 2014, the Board of Directors of the Company approved the mandatory conversion of all of the Company's issued and outstanding 4,926 shares of Series B 9% Non-Cumulative Perpetual Convertible Preferred Stock (the “Series B Preferred Stock”) into shares of the Company’s common stock. On November 17, 2014, the Company completed the mandatory conversion. The conversion ratio for each share of the Series B Preferred Stock was computed by dividing $5,000 (the issuance price per share of the Series B Preferred Stock) by $21.62 (the then current conversion price). The conversion ratio, therefore, was 231.267 shares of the Company's common stock for each share of Series B Preferred Stock. This resulted in the issuance of approximately 1,139,195 shares of common stock in the aggregate. As a result of the conversion, dividends ceased to accrue on the Series B Preferred Stock and certificates for shares of Series B Preferred Stock only represent the right to receive the appropriate number of shares of common stock, together with net accrued but unpaid dividends, and cash in lieu of fractional share interests.

Rights Agreement

On January 21, 2015, the Company entered into an Amendment No. 1 to the Rights Agreement (the "Rights Agreement"), dated as of September 22, 2009, by and between the Company and Computershare Trust Company, N.A., as rights agent. This amendment accelerated the expiration of the Company's common stock purchase rights (the “Rights”) from 5:00 p.m., Mattoon, Illinois time, on September 22, 2019, to 5:00 p.m., Mattoon, Illinois time, on January 21, 2015, and had the effect of terminating the Rights Agreement on that date. At the time of the termination of the Rights Agreement, all of the Rights distributed to holders of the Company's common stock pursuant to the Rights Agreement expired.

Branch Purchase and Assumption Agreement

On January 30, 2015, First Mid-Illinois Bank & Trust, N.A. (“First Mid Bank”) a wholly-owned subsidiary of the Company, entered into a Purchase and Assumption Agreement (the “Purchase Agreement”) with Old National Bank, a national banking association having its principal office in Evansville, Indiana, pursuant to which First Mid Bank will purchase certain assets and assume certain liabilities of 12 branch offices of Old National Bank in Southern Illinois (the “Branches”). Pursuant to the terms of the Purchase Agreement, First Mid Bank has agreed to assume certain deposit liabilities and to acquire certain loans, as well as cash, real property, furniture, and other fixed operating assets associated with the Branches. The loan and deposit balances to be assumed were approximately $160 million and $502 million, respectively, as of December 31, 2014. First Mid Bank has also agreed to assume certain leases relating to the Branches. The completion of the Purchase is subject to regulatory approval required by the Office of the Comptroller of the Currency and normal customary closing conditions, including First Mid Bank, in conjunction with the Company, obtaining financing in connection with the acquisition. Subject to the satisfaction of such conditions, First Mid Bank and Old National Bank expect to close the acquisition in the third quarter of 2015.

SUPERVISION AND REGULATION

General

Financial institutions, financial services companies, and their holding companies are extensively regulated under federal and state law. As a result, the growth and earnings performance of the Company can be affected not only by management decisions and general economic conditions, but also by the requirements of applicable state and federal statutes and regulations and the policies of various governmental regulatory authorities including, but not limited to, the Office of the Comptroller of the Currency (the “OCC”), the Federal Reserve Board, the Federal Deposit Insurance Corporation (the “FDIC”), the Internal Revenue Service and state taxing authorities. Any change in applicable laws, regulations or regulatory policies may have material effects on the business, operations and prospects of the Company and First Mid Bank. The Company is unable to predict the nature or extent of the effects that fiscal or monetary policies, economic controls or new federal or state legislation may have on its business and earnings in the future.

Federal and state laws and regulations generally applicable to financial institutions and financial services companies, such as the Company and its subsidiaries, regulate, among other things, the scope of business, investments, reserves against deposits, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, mergers, consolidations and dividends. The system of supervision and regulation applicable to the Company and its subsidiaries establishes a comprehensive framework for their respective operations and is intended primarily for the protection of the FDIC’s deposit insurance fund and the depositors, rather than the stockholders, of financial institutions.

The following references to material statutes and regulations affecting the Company and its subsidiaries are brief summaries thereof and do not purport to be complete, and are qualified in their entirety by reference to such statutes and regulations. Any change in applicable law or regulations may have a material effect on the business of the Company and its subsidiaries.

Financial Modernization Legislation

The 1999 Gramm-Leach-Bliley Act (the “GLB Act”) significantly changed financial services regulation by expanding permissible non-banking activities of bank holding companies and removing certain barriers to affiliations among banks, insurance companies, securities firms and other financial services entities. These activities and affiliations can be structured through a holding company structure or, in the case of many of the activities, through a financial subsidiary of a bank. The GLB Act also established a system of federal and state regulation based on functional regulation, meaning that primary regulatory oversight for a particular activity generally resides with the federal or state regulator having the greatest expertise in the area. Banking is supervised by banking regulators, insurance by state insurance regulators and securities activities by the SEC and state securities regulators. The GLB Act also requires the disclosure of agreements reached with community groups that relate to the Community Reinvestment Act, and contains various other provisions designed to improve the delivery of financial services to consumers while maintaining an appropriate level of safety in the financial services industry.

The GLB Act repealed the anti-affiliation provisions of the Glass-Steagall Act and revises the Bank Holding Company Act of 1956 (the “BHCA”) to permit qualifying holding companies, called “financial holding companies,” to engage in, or to affiliate with companies engaged in, a full range of financial activities, including banking, insurance activities (including insurance portfolio investing), securities activities, merchant banking and additional activities that are “financial in nature,” incidental to financial activities or, in certain circumstances, complementary to financial activities. A bank holding company’s subsidiary banks must be “well-capitalized” and “well-managed” and have at least a “satisfactory” Community Reinvestment Act rating for the bank holding company to elect and maintain its status as a financial holding company.

A significant component of the GLB Act's focus on functional regulation relates to the application of federal securities laws and SEC oversight of some bank securities activities previously exempt from broker-dealer registration. Among other things, the GLB Act amended the definitions of "broker" and "dealer" under the Securities Exchange Act of 1934, as amended, to remove the blanket exemption for banks. Under the GLB Act, banks may conduct securities activities without broker-dealer registration only if the activities fall within a set of activity-based exemptions designed to allow banks to conduct only those activities traditionally considered to be primarily banking or trust activities.

Securities activities outside these exemptions, as a practical matter, need to be conducted by registered broker-dealer affiliate. The GLB Act also amended the Investment Advisers Act of 1940 to require the registration of banks that act as investment advisers for mutual funds. The Company believes that it has taken the necessary actions to comply with these requirements of the GLB Act and the regulations adopted under them.

Anti-Terrorism Legislation

The USA PATRIOT Act of 2001 included the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 (the "IMLAFA"). The IMLAFA contains anti-money laundering measures affecting insured depository institutions, broker-dealers, and certain other financial institutions. The IMLAFA requires U.S. financial institutions to adopt policies and procedures to combat money laundering and grants the Secretary of the Treasury broad authority to establish regulations and to impose requirements and restrictions on financial institutions' operations. The Company has established policies and procedures for compliance with the IMLAFA and the related regulations. The Company has designated an officer solely responsible for ensuring compliance with existing regulations and monitoring changes to the regulations as they occur.

Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") was signed into law on July 21, 2010. Generally, the Act is effective the day after it was signed into law, but different effective dates apply to specific sections of the law. The Company will continue to evaluate the affects of these changes. Uncertainty remains as to the ultimate impact of the Act, which could have a material adverse impact either on the financial services industry as a whole, or on the Company's business, results of operations and financial condition. The Act, among other things:

- Resulted in the Federal Reserve issuing rules limiting debit-card interchange fees.

- After a three-year phase-in period which began January 1, 2013, existing trust preferred securities for holding companies with consolidated assets greater than $15 billion and all new issuances of trust preferred securities are removed as a permitted component of a holding company's Tier 1 capital. Trust preferred securities outstanding as of May 19, 2010 that were issued by bank holding companies with total consolidated assets of less than $15 billion, such as First Mid, will continue to count as Tier 1 capital.

- Provides for an increase in the FDIC assessment for depository institutions with assets of $10 billion or more, increases in the minimum reserve ratio for the deposit insurance fund from 1.15% to 1.35% (however, the FDIC is to offset the effect of this increase for holding companies with total consolidated assets of less than $10 billion, such as First Mid) and changes in the basis for determining FDIC premiums from deposits to assets.

- Creates a new Consumer Financial Protection Bureau that will have rulemaking authority for a wide range of consumer protection laws that would apply to all banks and certain non-bank financial institutions and would have broad powers to supervise and enforce consumer protection laws.

- Provides for new disclosure and other requirements relating to executive compensation and corporate governance.

- Changes standards for Federal preemption of state laws related to federally chartered institutions and their subsidiaries.

- Provides mortgage reform provisions including (i) a customer's ability to repay, (ii) restricting variable-rate lending by requiring the ability to repay to be determined for variable-rate loans by requiring lenders to evaluate using the maximum rate that will apply during the first five years of a variable-rate loan term, and (iii) making more loans subject to provisions for higher cost loans and new disclosures.

- Creates a financial stability oversight council that will recommend to the Federal Reserve increasingly strict rules for capital, leverage, liquidity, risk management and other requirements as companies grow in size and complexity.

- Permanently increases the deposit insurance coverage to $250 thousand and allows depository institutions to pay interest on checking accounts.

- Requires publicly-traded bank holding companies with assets of $10 billion or more to establish a risk committee responsible for enterprise-wide risk management practices.

- Limits and regulates, under the provisions of the Act know as the Volker Rule, a financial institution's ability to engage in proprietary trading or to own or invest in certain private equity and hedge funds.

Basel III

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

As included in the proposed rule of June 2012, the final rule includes new risk-based capital and leverage ratios, which will be phased in from 2015 to 2019, and refines the definition of what constitutes “capital” for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Company and First Mid Bank beginning in 2015 are: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6%; (iii) a total capital ratio of 8%; and (iv) a Tier 1 leverage ratio of 4%. The rule also establishes a “capital conservation buffer” of 2.5% above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital and would result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. The new capital conservation buffer requirement will be phased in beginning in January 2016 at 0.625% of risk weighted assets and will increase by that amount each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases and paying discretionary bonuses if its capital level falls below the buffer amount.

The final rule also makes three changes to the proposed rule of June 2012 that impact the Company. First, the proposed rule would have required banking organizations to include accumulated other comprehensive income ("AOCI") in common equity tier 1 capital. AOCI includes accumulated unrealized gains and losses on certain assets and liabilities that have not been included in net income. Under existing general risk-based capital rules, most components of AOCI are not included in a banking organization's regulatory capital calculations. The final rule allows community banking organizations to make a one-time election not to include these additional components of AOCI in regulatory capital and instead use the existing treatment under the general risk-based capital rules that excludes most AOCI components from regulatory capital.

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

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

The Company

General. As a registered bank holding company under the BHCA that has elected to become a financial holding company under the GLB Act, the Company is subject to regulation by the Federal Reserve Board. In accordance with Federal Reserve Board policy, the Company is expected to act as a source of financial strength to First Mid Bank and to commit resources to support First Mid Bank in circumstances where the Company might not do so absent such policy. The Company is subject to inspection, examination, and supervision by the Federal Reserve Board.

Activities. As a financial holding company, the Company may affiliate with securities firms and insurance companies and engage in other activities that are financial in nature or incidental or complementary to activities that are financial in nature. A bank holding company that is not also a financial holding company is limited to engaging in banking and such other activities as determined by the Federal Reserve Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

No Federal Reserve Board approval is required for the Company to acquire a company (other than a bank holding company, bank, or savings association) engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the Federal Reserve Board. However, the Company generally must give the Federal Reserve Board after-the-fact notice of these activities. Prior Federal Reserve Board approval is required before the Company may acquire beneficial ownership or control of more than 5% of the voting shares or substantially all of the assets of a bank holding company, bank, or savings association.

If any subsidiary bank of the Company ceases to be "well-capitalized" or "well-managed" under applicable regulatory standards, the Federal Reserve Board may, among other actions, order the Company to divest its depository institution. Alternatively, the Company may elect to conform its activities to those permissible for a bank holding company that is not also a financial holding company.

If any subsidiary bank of the Company receives a rating under the Community Reinvestment Act of less than "satisfactory", the Company will be prohibited, until the rating is raised to "satisfactory" or better, from engaging in new activities or acquiring companies other than bank holding companies, banks, or savings associations.

Capital Requirements. Bank holding companies are required to maintain minimum levels of capital in accordance with Federal Reserve Board capital adequacy guidelines. The Federal Reserve Board's capital guidelines establish the following minimum regulatory capital requirements for bank holding companies: a risk-based requirement expressed as a percentage of total risk-weighted assets, and a leverage requirement expressed as a percentage of total assets. The risk-based requirement consists of a minimum ratio of total capital to total risk-weighted assets of 8%, at least one-half of which must be Tier 1 capital. The leverage requirement consists of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly rated companies, with minimum requirements of at least 4% for all others. For purposes of these capital standards, Tier 1 capital consists primarily of permanent stockholders' equity, which includes the Series C Preferred Stock issued by the Company in 2011, less intangible assets (other than certain mortgage servicing rights and purchased credit card relationships), and total capital means Tier 1 capital plus certain other debt and equity instruments which do not qualify as Tier 1 capital, limited amounts of unrealized gains on equity securities and a portion of the Company's allowance for loan and lease losses.

The risk-based and leverage standards described above are minimum requirements, and higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual banking organizations. For example, the Federal Reserve Board's capital guidelines contemplate that additional capital may be required to take adequate account of, among other things, interest rate risk, or the risks posed by concentrations of credit, nontraditional activities or securities trading activities. Further, any banking organization experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions (i.e., Tier 1 capital less all intangible assets), well above the minimum levels.

As of December 31, 2014, the Company had regulatory capital, calculated on a consolidated basis, in excess of the Federal Reserve Board's minimum requirements, and its capital ratios exceeded those required for categorization as well-capitalized under the capital adequacy guidelines established by bank regulatory agencies with a total risk-based capital ratio of 15.60%, a Tier 1 risk-based ratio of 14.42% and a leverage ratio of 10.52%.

Control Acquisitions. The Change in Bank Control Act prohibits a person or group of person from acquiring "control" of a bank holding company unless the Federal Reserve Board has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve Board, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended, such as the Company, would, under the circumstances set forth in the presumption, constitute acquisition of control of the Company.

In addition, any company is required to obtain the approval of the Federal Reserve Board under the BHCA before acquiring 25% (5% in the case of an acquirer that is a bank holding company) or more of the outstanding common of the Company, or otherwise obtaining control of a "controlling influence" over the Company or First Mid Bank.

Interstate Banking and Branching. The Dodd-Frank Act expands the authority of banks to engage in interstate branching. The Dodd-Frank Act allows a state or national bank to open a de novo branch in another state if the law of the state where the branch is to be located would permit a state bank chartered by that state to open the branch.

Privacy and Security. The GLB Act establishes a minimum federal standard of financial privacy by, among other provisions, requiring banks to adopt and disclose privacy policies with respect to consumer information and setting forth certain rules with respect to the disclosure to third parties of consumer information. The Company has adopted and disseminated its privacy policies pursuant to the GLB Act. Regulations adopted under the GLB Act set standards for protecting the security, confidentiality and integrity of customer information, and require notice to regulators, and in some cases, to customers, in the event of security breaches. A number of states have adopted their own statutes requiring notification of security breaches. In addition, the GLB Act requires the disclosure of agreements reached with community groups that relate to the CRA, and contains various other provisions designed to improve the delivery of financial services to consumers while maintaining an appropriate level of safety in the financial services industry.

First Mid Bank

General. First Mid Bank is a national bank, chartered under the National Bank Act. The FDIC insures the deposit accounts of First Mid Bank. As a national bank, First Mid Bank is a member of the Federal Reserve System and is subject to the examination, supervision, reporting and enforcement requirements of the OCC, as the primary federal regulator of national banks, and the FDIC, as administrator of the deposit insurance fund.

Deposit Insurance. As an FDIC-insured institution, First Mid Bank is required to pay deposit insurance premium assessments to the FDIC. On July 21, 2010, The Dodd-Frank Act permanently raised the standard maximum deposit insurance amount from $100,000 to $250,000. On November 9, 2010, the FDIC issued a final rule to implement Section 343 of the Dodd-Frank Act, which provides unlimited deposit insurance coverage for "noninterest-bearing transaction accounts" from December 31, 2010 through December 31, 2012. Also, the FDIC will no longer charge a separate assessment for the insurance of these accounts under the Dodd-Frank Act.

On February 27, 2009, the FDIC adopted a final rule setting initial base assessment rates beginning April 1, 2009, at 12 to 45 basis points and, due to extraordinary circumstances, extended the period of the restoration plan to increase the deposit insurance fund to seven years. Also on February 27, 2009, the FDIC issued final rules on changes to the risk-based assessment system which imposes rates based on an institution's risk to the deposit insurance fund. The new rates increased the range of annual risk based assessment rates from 5 to 7 basis points to 7 to 24 basis points. The final rules both increase base assessment rates and incorporate additional assessments for excess reliance on brokered deposits and FHLB advances. This new assessment took effect April 1, 2009. The Company expensed $717,000, $743,000 and $783,000 for this assessment during 2014, 2013 and 2012, respectively. The decrease in this assessment was primarily due to a lower assessment rate as a result of improvement in asset quality.

In addition to its insurance assessment, each insured bank was subject to quarterly debt service assessments in connection with bonds issued by a government corporation that financed the federal savings and loan bailout. The Company expensed $87,000, $89,000 and $92,000 during 2014, 2013 and 2012, respectively, for this assessment.

OCC Assessments. All national banks are required to pay supervisory fees to the OCC to fund the operations of the OCC. The amount of such supervisory fees is based upon each institution's total assets, including consolidated subsidiaries, as reported to the OCC. During the year ended December 31, 2014, 2013, and 2012 First Mid Bank paid supervisory fees to the OCC totaling $342,000, $333,000, and $320,000, respectively.

Capital Requirements. The OCC has established the following minimum capital standards for national banks, such as First Mid Bank: a leverage requirement consisting of a minimum ratio of Tier 1 capital to total assets of 3% for the most highly-rated banks with minimum requirements of at least 4% for all others, and a risk-based capital requirement consisting of a minimum ratio of total capital to total risk-weighted assets of 8%, at least one-half of which must be Tier 1 capital. For purposes of these capital standards, Tier 1 capital and total capital consists of substantially the same components as Tier 1 capital and total capital under the Federal Reserve Board's capital guidelines for bank holding companies (See "The Company—Capital Requirements").

The capital requirements described above are minimum requirements. Higher capital levels will be required if warranted by the particular circumstances or risk profiles of individual institutions. For example, the regulations of the OCC provide that additional capital may be required to take adequate account of, among other things, interest rate risk or the risks posed by concentrations of credit, nontraditional activities or securities trading activities.

During the year ended December 31, 2014, First Mid Bank was not required by the OCC to increase its capital to an amount in excess of the minimum regulatory requirements, and its capital ratios exceeded those required for categorization as well-capitalized under the capital adequacy guidelines established by bank regulatory agencies with a total risk-based capital ratio of 15.02%, a Tier 1 risk-based ratio of 13.84% and a leverage ratio of 10.08%.

Prompt Corrective Action. Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators' powers depends on whether the institution in question is "well-capitalized," "adequately-capitalized," "undercapitalized," "significantly undercapitalized" or "critically undercapitalized." Depending upon the capital category to which an institution is assigned, the regulators' corrective powers include: requiring the submission of a capital restoration plan; placing limits on asset growth and restrictions on activities; requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; restricting transactions with affiliates; restricting the interest rate the institution may pay on deposits; ordering a new election of directors of the institution; requiring that senior executive officers or directors be dismissed; prohibiting the institution from accepting deposits from correspondent banks; requiring the institution to divest certain subsidiaries; prohibiting the payment of principal or interest on subordinated debt; and in the most severe cases, appointing a conservator or receiver for the institution.

Dividends. The National Bank Act imposes limitations on the amount of dividends that may be paid by a national bank, such as First Mid Bank. Generally, a national bank may pay dividends out of its undivided profits, in such amounts and at such times as the bank's board of directors deems prudent. Without prior OCC approval, however, a national bank may not pay dividends in any calendar year which, in the aggregate, exceed the bank's year-to-date net income plus the bank's adjusted retained net income for the two preceding years.

The payment of dividends by any financial institution or its holding company is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, First Mid Bank exceeded its minimum capital requirements under applicable guidelines as of December 31, 2014. As of December 31, 2014, approximately $37.9 million was available to be paid as dividends to the Company by First Mid Bank. Notwithstanding the availability of funds for dividends, however, the OCC may prohibit the payment of any dividends by First Mid Bank if the OCC determines that such payment would constitute an unsafe or unsound practice.

Affiliate and Insider Transactions. First Mid Bank is subject to certain restrictions under federal law, including Regulation W of the Federal Reserve Board, on extensions of credit to the Company and its subsidiaries, on investments in the stock or other securities of the Company and its subsidiaries and the acceptance of the stock or other securities of the Company or its subsidiaries as collateral for loans. Certain limitations and reporting requirements are also placed on extensions of credit by First Mid Bank to its directors and officers, to directors and officers of the Company and its subsidiaries, to principal stockholders of the Company, and to “related interests” of such directors, officers and principal stockholders.

First Mid Bank is subject to restrictions under federal law that limits certain transactions with the Company, including loans, other extensions of credit, investments or asset purchases. Such transactions by a banking subsidiary with any one affiliate are limited in amount to 10% of the bank’s capital and surplus and, with all affiliates together, to an aggregate of 20% of the bank’s capital and surplus. Furthermore, such loans and extensions of credit, as well as certain other transactions, are required to be secured in specified amounts. These and certain other transactions, including any payment of money to the Company, must be on terms and conditions that are or in good faith would be offered to nonaffiliated companies.

In addition, federal law and regulations may affect the terms upon which any person becoming a director or officer of the Company or one of its subsidiaries or a principal stockholder of the Company may obtain credit from banks with which First Mid Bank maintains a correspondent relationship.

Safety and Soundness Standards. The federal banking agencies have adopted guidelines that establish operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines set forth standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings. In general, the guidelines prescribe the goals to be achieved in each area, and each institution is responsible for establishing its own procedures to achieve those goals. If an institution fails to comply with any of the standards set forth in the guidelines, the institution’s primary federal regulator may require the institution to submit a plan for achieving and maintaining compliance. The preamble to the guidelines states that the agencies expect to require a compliance plan from an institution whose failure to meet one or more of the guidelines are of such severity that it could threaten the safety and soundness of the institution. Failure to submit an acceptable plan, or failure to comply with a plan that has been accepted by the appropriate federal regulator, would constitute grounds for further enforcement action.

Community Reinvestment Act. First Mid Bank is subject to the Community Reinvestment Act (CRA). The CRA and the regulations issued thereunder are intended to encourage banks to help meet the credit needs of their service areas, including low and moderate income neighborhoods, consistent with the safe and sound operations of the banks. These regulations also provide for regulatory assessment of a bank's record in meeting the needs of its service area when considering applications to establish branches, merger applications and applications to acquire the assets and assume the liabilities of another bank. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 requires federal banking agencies to make public a rating of a bank's performance under the CRA. In the case of a bank holding company, the CRA performance record of its bank subsidiaries is reviewed by federal banking agencies in connection with the filing of an application to acquire ownership or control of shares or assets of a bank or thrift or to merge with any other bank holding company. An unsatisfactory record can substantially delay or block the transaction. First Mid Bank received a satisfactory CRA rating from its regulator in its most recent CRA examination.

Consumer Laws and Regulations. In addition to the laws and regulations discussed above, First Mid Bank is also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. While the list set forth herein is not exhaustive, these laws and regulations include the Truth in Lending Act, the Truth in Savings Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Fair Credit Reporting Act, the Fair and Accurate Credit Transactions Act and the Real Estate Settlement Procedures Act, among others. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans to or marketing to or engaging in other types of transactions with such customers. Failure to comply with these laws and regulations could lead to substantial penalties, operating restrictions and reputational damage to the financial institution.

Supplemental Item – Executive Officers of the Registrant

The executive officers of the Company are elected annually by the Company's Board of Directors and are identified below.

Name (Age)	Position With Company
Joseph R. Dively (55)	Chairman of the Board of Directors, President and Chief Executive Officer
Michael L. Taylor (46)	Senior Executive Vice President and Chief Financial Officer
John W. Hedges (66)	Senior Executive Vice President
Laurel G. Allenbaugh (54)	Executive Vice President
Eric S. McRae (49)	Executive Vice President
Christopher L. Slabach (52)	Senior Vice President
Clay M. Dean (40)	Senior Vice President
Amanda D. Lewis (35)	Senior Vice President
Danielle Niebrugge (41)	Senior Vice President

Joseph R. Dively, age 55, is the Chairman of the Board of Directors, President and Chief Executive Officer of the Company since January 1, 2014 and the President of First Mid Bank since May 2011. Prior to assuming these positions in the Company, he was the Senior Executive Vice President of the Company beginning in May 2011. He was with Consolidated Communications Holdings, Inc. in Mattoon, Illinois from 2003 to May 2011.

Michael L. Taylor, age 46, has been Senior Executive Vice President since 2014 and Chief Financial Officer of the Company since 2000. He served as Executive Vice President from from 2007 to 2014 and as Vice President from 2000 to 2007. He was with AMCORE Bank in Rockford, Illinois from 1996 to 2000.

John W. Hedges, age 66, has been Senior Executive Vice President of the Company and Senior Executive Vice President and Chief Credit Officer of First Mid Bank since May 2011. He served as President of First Mid Bank from September 1999 to May 2011. He was with National City Bank in Decatur, Illinois from 1976 to 1999.

Laurel G. Allenbaugh, age 54, has been Executive Vice President of the Company and Executive Vice President, Chief Operations Officer of First Mid Bank since April 2008. She served as Vice President of Operations from February 2000 to April 2008. She served as Controller of the Company and First Mid Bank from 1990 to February 2000 and has been President of MIDS since 1998.

Eric S. McRae, age 49, has been Executive Vice President of the Company and Executive Vice President, Senior Lender of First Mid Bank since December 2008. He served as President of the Decatur region from 2001 to December 2008.

Christopher L. Slabach, age 52, has been Senior Vice President of the Company since 2007 and Senior Vice President, Chief Risk Officer of First Mid Bank since 2008. He served as Vice President, Audit of the Company from 1998 to 2007.

Clay M. Dean, age 40, has been Senior Vice President of the Company since 2010 and Senior Vice President and Chief Insurance Services Officer of the First Mid Bank and Chief Executive Officer of First Mid Insurance since September 2014. He served as Senior Vice President, Chief Deposit Services Officer of First Mid Bank from November 2012 to September 2014 and as Senior Vice President, Director of Treasury Management of First Mid

Bank from 2010 to 2012.

Amanda D. Lewis, age 35, has been Senior Vice President of the Company and Senior Vice President, Retail Banking Officer of First Mid Bank since September 2014. She served as Vice President, Director of Marketing from 2001 until September 2014.

Danielle Niebrugge, age 41, has been Senior Vice President of the Company and Director of Human Resources of First Mid Bank since June 2014. She was Director of People Services for St. Anthony's Memorial Hospital prior to joining the Company.

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.

Difficult economic conditions and market disruption have adversely impacted the banking industry and financial markets generally and may again significantly affect the business, financial condition, or results of operations of the Company. The Company’s success depends, to a certain extent, upon economic and political conditions, local and national, as well as governmental monetary policies. Conditions such as inflation, recession, unemployment, changes in interest rates, money supply and other factors beyond the Company’s control may adversely affect its asset quality, deposit levels and loan demand and, therefore, its earnings.

Dramatic declines in the housing market beginning in the latter half of 2007, with falling home prices and increasing foreclosures, unemployment and underemployment, negatively impacted the credit performance of mortgage loans and resulted in significant write-downs of asset values by some financial institutions. The resulting write-downs to assets of financial institutions have caused many financial institutions to merge with other institutions and, in some cases, to seek government assistance or bankruptcy protection. Although the housing, capital and credit markets have materially improved since the declines beginning in 2007, future declines could adversely affect the Company's business.

The Company’s profitability depends significantly on economic conditions in the geographic region in which it operates. A large percentage of the Company’s loans are to individuals and businesses in Illinois, consequently, any decline in the economy of this market area could have a materially adverse effect on the Company’s financial condition and results of operations.

Decline in the strength and stability of other financial institutions may adversely affect the Company’s business. The actions and commercial soundness of other financial institutions could affect the Company’s ability to engage in routine funding transactions. Financial services institutions are interrelated as a result of clearing, counterparty or other relationships. The Company has exposure to different counterparties, and executes transactions with various counterparties in the financial industry. Recent defaults by financial services institutions, and even rumors or questions about one or more financial services institutions or the financial services industry in general, led to market-wide liquidity problems in recent year and could lead to losses or defaults by the Company or by other institutions. Many of these transactions expose the Company to credit risk in the event of default of its counterparty or client. Any such losses could materially and adversely affect the Company’s results of operations.

Changes in interest rates may negatively affect our earnings. Changes in market interest rates and prices may adversely affect the Company’s financial condition or results of operations. The Company’s net interest income, its largest source of revenue, is highly dependent on achieving a positive spread between the interest earned on loans and investments and the interest paid on deposits and borrowings. Changes in interest rates could negatively impact the Company’s ability to attract deposits, make loans, and achieve a positive spread resulting in compression of the net interest margin.

The Company may not have sufficient cash or access to cash to satisfy current and future financial obligations, including demands for loans and deposit withdrawals, funding operating costs, payment of preferred stock dividends and for other corporate purposes. This type of liquidity risk arises whenever the maturities of financial instruments included in assets and liabilities differ. The Company's liquidity can be affected by a variety of factors, including general economic conditions, market disruption, operational problems affecting third parties or the Company, unfavorable pricing, competition, the Company's credit rating and regulatory restrictions. (See "Liquidity" herein for management's actions to mitigate this risk.)

If the Company were unable to borrow funds through access to capital markets, it may not be able to meet the cash flow requirements of its depositors, creditors, and borrowers, or the operating cash needed to fund corporate expansion and other corporate activities. As seen starting in the middle of 2007, significant turmoil and volatility in worldwide financial markets can result in a disruption in the liquidity of financial markets, and could directly impact the Company to the extent it needs to access capital markets to raise funds to support its business and overall liquidity position. These types of situations could affect the cost of such funds or the Company's ability to raise such funds. If the Company were unable to access any of these funding sources when needed, it might be unable to meet customers' needs, which could adversely impact its financial condition, results of operations, cash flows, and level of regulatory-qualifying capital. For further discussion, see the "Liquidity" section.

Loan customers or other counter-parties may not be able to perform their contractual obligations resulting in a negative impact on the Company's earnings. Overall economic conditions affecting businesses and consumers, including the current difficult economic conditions and market disruptions, could impact the Company's credit losses. In addition, real estate valuations could also impact the Company's credit losses as the Company maintains $746 million in loans secured by commercial, agricultural, and residential real estate. A significant decline in real estate values could have a negative effect on the Company's financial condition and results of operations. In addition, the Company's total loan balances by industry exceeded 25% of total risk-based capital for each of four industries as of December 31, 2014. A listing of these industries is contained in under "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations -- Loans" herein. A significant change in one of these industries such as a significant decline in agricultural crop prices, could adversely impact the Company's credit losses.

Deterioration in the real estate market could lead to losses, which could have a material adverse effect on the business, financial condition and results of operations or the Company. Commercial and commercial real estate loans generally involve higher credit risks than residential real estate and consumer loans. Because payments on loans secured by commercial real estate or equipment are often dependent upon the successful operation and management of the underlying assets, repayment of such loans may be influenced to a great extent by conditions in the market or the economy. Increases in commercial and consumer delinquency levels or declines in real estate market values would require increased net charge-offs and increases in the allowance for loan and lease losses, which could have a material adverse effect on our business, financial condition and results of operations and prospects.

The allowance for loan losses may prove inadequate or be negatively affected by credit risk exposures. The Company's business depends on the creditworthiness of its customers. Management periodically reviews the allowance for loan and lease losses for adequacy considering economic conditions and trends, collateral values and credit quality indicators, including past charge-off experience and levels of past due loans and nonperforming assets. There is no certainty that the allowance for loan losses will be adequate over time to cover credit losses in the portfolio because of unanticipated adverse changes in the economy, market conditions or events adversely affecting specific customers, industries or markets. If the credit quality of the customer base materially decreases, if the risk profile of a market, industry or group of customers changes materially, or if the allowance for loan losses is not adequate, the Company's business, financial condition, liquidity, capital, and results of operations could be materially adversely affected.

Declines in the value of securities held in the investment portfolio may negatively affect the Company's earnings and capital. The value of an investment in the portfolio could decrease due to changes in market factors. The market value of certain investment securities is volatile and future declines or other-than-temporary impairments could materially adversely affect the Company's future earnings and capital. Continued volatility in the market value of certain of the investment securities, whether caused by changes in market perceptions of credit risk, as reflected in the expected market yield of the security, or actual defaults in the portfolio could result in significant fluctuations in the value of the securities. This could have a material adverse impact on the Company's accumulated other comprehensive loss and shareholders' equity depending upon the direction of the fluctuations.

Furthermore, future downgrades or defaults in these securities could result in future classifications as other-than-temporarily impaired. The Company has invested in trust preferred securities issued by financial institutions and insurance companies, corporate securities of financial institutions, and stock in the Federal Home Loan Bank of Chicago and Federal Reserve Bank of Chicago. Deterioration of the financial stability of the underlying financial institutions for these investments could result in other-than-temporary impairment charges to the Company and could have a material impact on future earnings. For further discussion of the Company's investments, see Note 4 – "Investment Securities."

A failure in or breach of the company's operational or security systems, or those of it's third party service providers, including as a result of cyber-attacks, could disrupt the company's business, result in unintentional disclosure or misuse of confidential or proprietary information, damage the company's reputation, increase our costs and cause losses. As a financial institution, the company's operations rely heavily on the secure processing, storage and transmission of confidential and other information on it's computer systems and networks. Any failure, interruption or breach in security or operational integrity of these systems could result in failures or disruptions in the company's online banking system, customer relationship management, general ledger, deposit and loan servicing and other systems. The security and integrity of these systems could be threatened by a variety of interruptions or information security breaches, including those caused by computer hacking, cyber-attacks, electronic fraudulent activity or attempted theft of financial assets. Management cannot assert that any such failures, interruption or security breaches will not occur, or if they do occur that they will be adequately addressed. While certain protective policies and procedures are in place, the nature and sophistication of the threats continue to evolve. The Company may be required to expend significant additional resources in the future to modify and enhance these protective measures.

Additionally, the company faces the risk of operational disruption, failure, termination or capacity constraints of any of the third parties that facilitate its business activities, including exchanges, clearing agents, clearing houses or other financial intermediaries. Such parties could also be the source of an attack on, or breach of, its operational systems. Any failures, interruptions or security breaches in the company's information systems could damage its reputation, result in a loss of customer business, result in a violation of privacy or other laws, or expose us to civil litigation, regulatory fines or losses not covered by insurance.

If the Company’s stock price declines from levels at December 31, 2014, management will evaluate the goodwill balances for impairment, and if the values of the businesses have declined, the Company could recognize an impairment charge for its goodwill. Management performed an annual goodwill impairment assessment as of September 30, 2014. Based on these analyses, management concluded that the fair value of the Company’s reporting units exceeded the fair value of its assets and liabilities and, therefore, goodwill was not considered impaired. It is possible that management’s assumptions and conclusions regarding the valuation of the Company’s lines of business could change adversely, which could result in the recognition of impairment for goodwill, which could have a material effect on the Company’s financial position and future results of operations.

The Series C Preferred Stock impacts net income available to common stockholders and earnings per share. As long as shares of the Series C Preferred Stock is outstanding, no dividends may be paid on the Company’s common stock unless all dividends on the Series C Preferred Stock have been paid in full. The dividends declared on the Series C Preferred Stock reduce the net income available to common stockholders and earnings per share.

Holders of Series C Preferred Stock have rights that are senior to those of common stockholders. The Series C Preferred Stock is senior to the shares of common stock and holders of the Series C Preferred Stock have certain rights and preferences that are senior to holders of common stock. The Series C Preferred Stock will rank senior to the common stock and all other equity securities designated as ranking junior to the Series C Preferred Stock. So long as any shares of the Series C Preferred Stock remain outstanding, unless all accrued and unpaid dividends for all prior dividend periods have been paid or are contemporaneously declared and paid in full, no dividend shall be paid or declared on common stock or other junior stock, other than a dividend payable solely in common stock.

The Company also may not purchase, redeem or otherwise acquire for consideration any shares of its common stock or other junior stock unless it has paid in full all accrued dividends on the Series C Preferred Stock for all prior dividend periods. The Series C Preferred Stock is entitled to a liquidation preference over shares of common stock in the event of the Company's liquidation, dissolution or winding up.

The Company may issue additional common stock or other equity securities in the future which could dilute the ownership interest of existing stockholders. In order to maintain capital at desired or regulatory-required levels or to replace existing capital, the Company may be required to issue additional shares of common stock, or securities convertible into, exchangeable for or representing rights to acquire shares of common stock. The Company may sell these shares at prices below the current market price of shares, and the sale of these shares may significantly dilute stockholder ownership. The Company could also issue additional shares in connection with acquisitions of other financial institutions.

Human error, inadequate or failed internal processes and systems, and external events may have adverse effects on the Company. Operational risk includes compliance or legal risk, which is the risk of loss from violations of, or noncompliance with, laws, rules, regulations, prescribed practices, or ethical standards. Operational risk also encompasses transaction risk, which includes losses from fraud, error, the inability to deliver products or services, and loss or theft of information. Losses resulting from operational risk could take the form of explicit charges, increased operational costs, harm to the Company's reputation or forgone opportunities. Any of these could potentially have a material adverse effect on the Company's financial condition and results of operations.

The Company is exposed to various business risks that could have a negative effect on the financial performance of the Company. These risks include: changes in customer behavior, changes in competition, new litigation or changes to existing litigation, claims and assessments, environmental liabilities, real or threatened acts of war or terrorist activity, adverse weather, changes in accounting standards, legislative or regulatory changes, taxing authority interpretations, and an inability on the Company's part to retain and attract skilled employees.

In addition to these risks identified by the Company, investments in the Company's common stock involve risk. The market price of the Company's common stock may fluctuate significantly in response to a number of factors including: volatility of stock market prices and volumes, rumors or erroneous information, changes in market valuations of similar companies, changes in securities analysts' estimates of financial performance, and variations in quarterly or annual operating results.

If the Company is unable to make favorable acquisitions or successfully integrate our acquisitions, the Company's growth could be impacted. In the past several years, the Company has completed acquisitions of banks and bank branches from other institutions. We may continue to make such acquisitions in the future. When the Company evaluates acquisition opportunities, the Company evaluates whether the target institution has a culture similar to the Company, experienced management and the potential to improve the financial performance of the Company. If the Company fails to successfully identify, complete and integrate favorable acquisitions, the Company could experience slower growth. Acquiring other banks or bank branches involves various risks commonly associated with acquisitions, including, among other things: potential exposure to unknown or contingent liabilities or asset quality issues of the target institution, difficulty and expense of integrating the operations and personnel of the target institution, potential disruption to the Company (including diversion of management's time and attention), difficulty in estimating the value of the target institution, and potential changes in banking or tax laws or regulations that may affect the target institution.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company's headquarters is located at 1421 Charleston Avenue, Mattoon Illinois . This location is also used by the loan and deposit operations departments of First Mid Bank. In addition, the Company owns a facility located at 1500 Wabash Avenue, Mattoon, Illinois, which it is currently leasing to a non-affiliated third party.

The main office of First Mid Bank is located at 1515 Charleston Avenue, Mattoon, Illinois and is owned by First Mid Bank. First Mid Bank also owns a building located at 1520 Charleston Avenue, which is used by First Mid Insurance, MIDS or its data processing and by First Mid Bank for back room operations. First Mid Bank also conducts business through numerous facilities, owned and leased, located in seventeen counties throughout Illinois. Of the thirty-six other banking offices operated by First Mid Bank, twenty-three are owned and thirteen are leased from non-affiliated third parties.

None of the properties owned by the Corporation are subject to any major encumbrances. The Company believes these facilities are suitable and adequate to operate its banking and related business. The net investment of the Company and subsidiaries in real estate and equipment at December 31, 2014 was $27.4 million.

ITEM 3. LEGAL PROCEEDINGS

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER OF PURCHASES OF EQUITY SECURITIES

The Company’s common stock was held by approximately 575 shareholders of record as of December 31, 2014 and is included for quotation on the NASDAQ Stock Market, LLC.

The following table shows the high and low bid prices per share of the Company’s common stock for the indicated periods. These quotations represent inter-dealer prices without retail mark-ups, mark-downs or commissions and may not necessarily represent actual transactions.

Quarter	High	Low
2014		
4th	$22.00	$16.90
3rd	22.00	19.05
2nd	23.80	19.05
1st	23.50	21.00
2013		
4th	$23.25	$21.55
3rd	23.30	21.00
2nd	23.95	22.11
1st	25.00	21.60

The Board of Directors of the Company declared cash dividends semi-annually during the two years ended December 31, 2014 and 2013. The following table sets forth the cash dividends per share on the Company’s common stock for the last two years.

Date Declared	Date Paid	Dividend Per Share
10/28/2014	12/08/2014	$0.29
04/30/2014	06/06/2014	0.26
10/22/2013	12/06/2013	0.25
04/24/2013	06/07/2013	0.21

The Company’s shareholders are entitled to receive such dividends as are declared by the Board of Directors, which considers payment of dividends semi-annually. The ability of the Company to pay dividends, as well as fund its operations, is dependent upon receipt of dividends from First Mid Bank. Regulatory authorities limit the amount of dividends that can be paid by First Mid Bank without prior approval from such authorities. For further discussion of First Mid Bank’s dividend restrictions, see Item1 – “Business” – “First Mid Bank” – “Dividends” and Note 16 – “Dividend Restrictions” herein.

The following table summarizes share repurchase activity for the fourth quarter of 2014:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs at End of Period
October 1, 2014 – October 31, 2014	—	$0.00	—	$8,352,000
November 1, 2014 – November 30, 2014	—	—	—	8,352,000
December 1, 2014 – December 31, 2014	5,973	18.99	5,973	8,238,000
Total	5,973	$18.99	5,973	$8,238,000

Since August 5, 1998, the Board of Directors has approved repurchase programs pursuant to which the Company may repurchase a total of approximately $76.7 million of the Company’s common stock. The repurchase programs approved by the Board of Directors are as follows:

- On August 5, 1998, repurchases of up to 3%, or $2 million, of the Company’s common stock.
- In March 2000, repurchases up to an additional 5%, or $4.2 million of the Company’s common stock.
- In September 2001, repurchases of $3 million of additional shares of the Company’s common stock.
- In August 2002, repurchases of $5 million of additional shares of the Company’s common stock.
- In September 2003, repurchases of $10 million of additional shares of the Company’s common stock.
- On April 27, 2004, repurchases of $5 million of additional shares of the Company’s common stock.
- On August 23, 2005, repurchases of $5 million of additional shares of the Company’s common stock.
- On August 22, 2006, repurchases of $5 million of additional shares of the Company’s common stock.
- On February 27, 2007, repurchases of $5 million of additional shares of the Company’s common stock.
- On November 13, 2007, repurchases of $5 million of additional shares of the Company’s common stock.
- On December 16, 2008, repurchases of $2.5 million of additional shares of the Company’s common stock.
- On May 26, 2009, repurchases of $5 million of additional shares of the Company’s common stock.
- On February 22, 2011, repurchases of $5 million of additional shares of the Company’s common stock.
- On November 13, 2012 repurchases of $5 million of additional shares of the Company’s common stock.
- On November 19, 2013, repurchases of $5 million additional shares of the Company's common stock.
- On October 24, 2014, repurchases of $5 million additional shares of the Company's common stock.

ITEM 6. SELECTED FINANCIAL DATA

The following sets forth a five-year comparison of selected financial data (dollars in thousands, except per share data).

	2014		2013		2012		2011		2010	
Summary of Operations										
Interest income	$54,734		$53,459		$55,767		$56,772		$50,883	
Interest expense	3,252		3,535		6,157		8,504		10,756	
Net interest income	51,482		49,924		49,610		48,268		40,127	
Provision for loan losses	629		2,193		2,647		3,101		3,737	
Other income	18,369		19,341		18,310		15,787		13,820	
Other expense	44,507		43,504		42,838		43,053		36,927	
Income before income taxes	24,715		23,568		22,435		17,901		13,283	
Income tax expense	9,254		8,846		8,410		6,529		4,522	
Net income	15,461		14,722		14,025		11,372		8,761	
Dividends on preferred shares	4,152		4,417		4,252		3,576		2,240	
Net income available to common stockholders	$11,309		$10,305		$9,773		$7,796		$6,521	
Per Common Share Data										
Basic earnings per share	$1.88		$1.74		$1.62		$1.29		$1.07	
Diluted earnings per share	1.85		1.73		1.62		1.29		1.07	
Dividends declared per share	0.55		0.46		0.42		0.40		0.38	
Book value per common share	19.55		16.54		17.53		16.18		14.46	
Tangible Book Value per common share	15.63		11.75		12.68		11.24		9.00	
Capital Ratios										
Total capital to risk-weighted assets	15.60	%	15.58	%	15.65	%	14.48	%	12.84	%
Tier 1 capital to risk-weighted assets	14.42	%	14.37	%	14.51	%	13.37	%	11.71	%
Common equity tier 1 ratio	10.32	%	7.78	%	7.54	%	7.00	%	6.88	%
Tier 1 capital to average assets	10.52	%	10.12	%	9.66	%	8.99	%	7.42	%
Financial Ratios										
Net interest margin	3.43	%	3.38	%	3.44	%	3.45	%	3.51	%
Return on average assets	0.97	%	0.94	%	0.91	%	0.76	%	0.72	%
Return on average common equity	10.34	%	10.11	%	9.53	%	8.36	%	7.20	%
Dividend on common shares payout ratio	29.26	%	26.44	%	25.93	%	31.01	%	35.51	%
Average equity to average assets	9.94	%	9.81	%	9.76	%	8.88	%	9.44	%
Allowance for loan losses as a percent of total loans	1.29	%	1.35	%	1.29	%	1.29	%	1.29	%
Year End Balances										
Total assets	$1,607,103		$1,605,498		$1,578,032		$1,500,956		$1,468,245	
Net loans, including loans held for sale	1,048,724		969,555		899,289		848,954		794,188	
Total deposits	1,272,077		1,287,616		1,274,065		1,170,734		1,212,710	
Total equity	164,916		149,381		156,687		140,967		112,265	
Average Balances										
Total assets	$1,593,227		$1,568,638		$1,543,453		$1,502,794		$1,219,353	
Net loans, including loans held for sale	1,008,980		912,452		855,335		796,520		708,367	
Total deposits	1,293,621		1,283,599		1,236,598		1,212,206		972,811	
Total equity	158,364		153,922		150,578		133,444		115,151	

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis is intended to provide a better understanding of the consolidated financial condition and results of operations of the Company and its subsidiaries years ended December 31, 2014, 2013 and 2012. This discussion and analysis should be read in conjunction with the consolidated financial statements, related notes and selected financial data appearing elsewhere in this report.

Forward-Looking Statements

This report may contain certain forward-looking statements, such as discussions of the Company's pricing and fee trends, credit quality and outlook, liquidity, new business results, expansion plans, anticipated expenses and planned schedules. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1955. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are identified by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project," or similar expressions. Actual results could differ materially from the results indicated by these statements because the realization of those results is subject to many risks and uncertainties, including those described in Item 1A. "Risk Factors" and other sections of the Company's Annual Report on Form 10-K and the Company's other filings with the SEC, and changes in interest rates, general economic conditions and those in the Company's market area, legislative/regulatory changes, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board, the quality or composition of the loan or investment portfolios and the valuation of the investment portfolio, the Company's success in raising capital, demand for loan products, deposit flows, competition, demand for financial services in the Company's market area and accounting principles, policies and guidelines. Furthermore, forward-looking statements speak only as of the date they are made. Except as required under the federal securities laws or the rules and regulations of the SEC, we do not undertake any obligation to update or review any forward-looking information, whether as a result of new information, future events or otherwise.

For the Years Ended December 31, 2014, 2013 and 2012

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 $15.5 million, 14.7 million, and $14.0 million and diluted earnings per share were $1.85, $1.73, and $1.62 for the years ended December 31, 2014, 2013 and 2012, respectively. The increase in net income and earnings per share in 2014 was primarily the result of an increase in net interest income due to growth in loan balances and sustained low funding costs, a reduction in provision for loan losses given lower non-performing assets and net charge-offs. The following table shows the Company's annualized performance ratios for the years ended December 31, 2014, 2013 and 2012:

	2014		2013		2012	
Return on average assets	0.97	%	0.94	%	0.91	%
Return on average common equity	10.34	%	10.11	%	9.53	%
Average common equity to average assets	9.94	%	9.81	%	9.76	%

Total assets at December 31, 2014, 2013 and 2012 were $1.61 billion, $1.61 billion, and $1.58 billion, respectively. Net loan balances increased to $1.05 billion at December 31, 2014, from $970 million at December 31, 2013, from $899 million at December 31, 2012. Of the increase in 2014, $55.4 million or 32.9% was due to increases in commercial and industrial loans and $19.8 million or 2.5% was due to increases in loans secured by real estate. Of the increase in 2013, $61.4 million or 86% was due to increases in loans secured by real estate. Of the increase in 2012, $46.9 million or 93% was due to increases in loans secured by real estate.

Total deposit balances decreased to $1.27 billion at December 31, 2014 from $1.29 billion at December 31, 2013 and from $1.27 billion at December 31, 2012. The decline in 2014 was due to declines in non-interest bearing deposits and higher rate CDs that matured and were not replaced offset by an increase in interest bearing deposits. The increase in 2013 was due to increases in interest-bearing deposits offset by declines in savings account balances and non-interest bearing deposits.

Net interest margin, defined as net interest income divided by average interest-earning assets, was 3.43% for 2014, 3.38% for 2013 and 3.44% for 2012. The increase during 2014 was primarily due to the growth in loan balances. The decrease during 2013 was primarily due to a greater decrease in rates on earning assets compared to the decline in rates on interest bearing liabilities.

Net interest income increased to $51.5 million in 2014 from $49.9 million in 2013 and $49.6 million in 2012. The ability of the Company to continue to grow net interest income is largely dependent on management's ability to succeed in its overall business development efforts. Management expects these efforts to continue but does not intend to compromise credit quality and prudent management of the maturities of interest-earning assets and interest-paying liabilities in order to achieve growth.

Non-interest income decreased to $18.4 million in 2014 compared to $19.3 million in 2013 and $18.3 million in 2012. The primary reason for the decrease of $.9 million or 5% from 2013 to 2014 was less gains on sales of securities and a decline in mortgage banking income as refinance and new purchase activity has slowed, offset by increases in revenue from brokerage and insurance commissions and deposit account service charges. The primary reason for the increase of $1 million or 5.6% from 2012 to 2013 was more gains on the sale of securities primarily due to the sale of two trust preferred securities which resulted in a gain of $1.4 million. In addition to security gains, revenues from trust and wealth management also increased by $380,000 due to increased revenue from the retirement services area and more growth through the brokerage platform. These increases offset the decline in mortgage banking income during the year as refinances slowed with the increase in interest rates.

Non-interest expenses increased $1,003,000, to $44.5 million in 2014 compared to $43.5 million in 2013, and $42.8 million in 2012. The increase during 2014 of 2.3% was primarily due to an increase in salary and benefits expense as a result of higher officer salary and insurance costs. The increase during 2013 of less than 2% was primarily due to an increase in salaries and benefits expenses due to additions in sales staff and employees added for a new branch location.

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

	2014 vs 2013	2013 vs 2012
Net interest income	$1,558	$314
Provision for loan losses	1,564	454
Other income, including securities transactions	(972)	1,031
Other expenses	(1,003)	(666)
Income taxes	(408)	(436)
Increase in net income	$739	$697

Credit quality is an area of importance to the Company. Year-end total nonperforming loans were $4.5 million at December 31, 2014 compared to $6.5 million at December 31, 2013, and $7.6 million at December 31, 2012. The decrease in 2014 and 2013 was the result of loans that paid off or became current during the year and loans transferred to other real estate owned. Other real estate owned balances totaled $263,000 at December 31, 2014 compared to $568,000 at December 31, 2013, and $1.2 million at December 31, 2012. The decreases in 2014 and 2013 were due to more properties sold during the year than properties transferred in. The Company's provision for loan losses was $629,000 for 2014, compared to $2.2 million for 2013, and $2.6 million for 2012. At December 31, 2014, the composition of the loan portfolio remained similar to year-end 2013. Loans secured by both commercial and residential real estate comprised 70%, 74%, and 73% of the loan portfolio for 2014, 2013, and 2012, respectively.

The Company also held an investment in one trust preferred security with a fair value of $364,000 and unrealized losses of $2.9 million at December 31, 2014 compared to a fair value of $191,000 and unrealized losses of $3.5 million at December 31, 2013. On July 22, 2013, the Company sold its holding in PreTSL I and II. The proceeds of these sales were sufficient to pay off the book value of $1.1 million of these securities, reverse the recorded OTTI impairment of $2.9 million and record a gain on sale of approximately $1.4 million. During 2014 and 2013 the Company did not record any additional impairment charges for these securities. See Note 4 – "Investment Securities" for additional details regarding these investments.

The Company's capital position remains strong and the Company has consistently maintained regulatory capital ratios above the "well-capitalized" standards. The Company's Tier 1 capital ratio to risk weighted assets ratio at December 31, 2014, 2013, and 2012 was 14.42%, 14.37%, and 14.51%, respectively. The Company's total capital to risk weighted assets ratio at December 31, 2014, 2013, and 2012 was 15.60%, 15.58% ,and 15.65%, respectively. The increase in these ratios during 2014 was primarily the result of an increase in retained earnings from current year net income and slightly lower preferred dividends due to the conversion of Series B Preferred Stock. The decline in these ratios during 2013 was primarily due to a decrease in retained earning resulting from a greater amount of preferred dividends paid following the issuance of additional Series C Preferred Stock in 2012. (See "Preferred Stock" in Note 1 to consolidated financial statements for more detailed information.)

The Company's liquidity position remains sufficient to fund operations and meet the requirements of borrowers, depositors, and creditors. The Company maintains various sources of liquidity to fund its cash needs. See "Liquidity" herein for a full listing of its sources and anticipated significant contractual obligations.

The Company enters into financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include lines of credit, letters of credit and other commitments to extend credit. The total outstanding commitments at December 31, 2014, 2013 and 2012 were $242.8 million, $244.2 million, and $234.9 million, respectively. See Note 17 – "Commitments and Contingent Liabilities" herein for further information.

Critical Accounting Policies and Use of Significant Estimates

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

Allowance for Loan Losses. The Company believes the allowance for loan losses is the critical accounting policy that requires the most significant judgments and assumptions used in the preparation of its consolidated financial statements. An estimate of potential losses inherent in the loan portfolio are determined and an allowance for those losses is established by considering factors including historical loss rates, expected cash flows and estimated collateral values. In assessing these factors, the Company use organizational history and experience with credit decisions and related outcomes. The allowance for loan losses represents the best estimate of losses inherent in the existing loan portfolio. The allowance for loan losses is increased by the provision for loan losses charged to expense and reduced by loans charged off, net of recoveries. The Company evaluates the allowance for loan losses quarterly. If the underlying assumptions later prove to be inaccurate based on subsequent loss evaluations, the allowance for loan losses is adjusted.

The Company estimates the appropriate level of allowance for loan losses by separately evaluating impaired and nonimpaired loans. A specific allowance is assigned to an impaired loan when expected cash flows or collateral do not justify the carrying amount of the loan. The methodology used to assign an allowance to a nonimpaired loan is more subjective. Generally, the allowance assigned to nonimpaired loans is determined by applying historical loss rates to existing loans with similar risk characteristics, adjusted for qualitative factors including the volume and severity of identified classified loans, changes in economic conditions, changes in credit policies or underwriting standards, and changes in the level of credit risk associated with specific industries and markets. Because the economic and business climate in any given industry or market, and its impact on any given borrower, can change rapidly, the risk profile of the loan portfolio is continually assessed and adjusted when appropriate. Notwithstanding these procedures, there still exists the possibility that the assessment could prove to be significantly incorrect and that an immediate adjustment to the allowance for loan losses would be required.

Other Real Estate Owned. Other real estate owned acquired through loan foreclosure is initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. The adjustment at the time of foreclosure is recorded through the allowance for loan losses. Due to the subjective nature of establishing the fair value when the asset is acquired, the actual fair value of the other real estate owned or foreclosed asset could differ from the original estimate. If it is determined that fair value temporarily declines subsequent to foreclosure, a valuation allowance is recorded through noninterest expense. Operating costs associated with the assets after acquisition are also recorded as noninterest expense. Gains and losses on the disposition of other real estate owned and foreclosed assets are netted and posted to other noninterest expense.

Investment in Debt and Equity Securities. The Company classifies its investments in debt and equity securities as either held-to-maturity or available-for-sale in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities," which was codified into ASC 320. Securities classified as held-to-maturity are recorded at cost or amortized cost. Available-for-sale securities are carried at fair value. Fair value calculations are based on quoted market prices when such prices are available. If quoted market prices are not available, estimates of fair value are computed using a variety of techniques, including extrapolation from the quoted prices of similar instruments or recent trades for thinly traded securities, fundamental analysis, or through obtaining purchase quotes. Due to the subjective nature of the valuation process, it is possible that the actual fair values of these investments could differ from the estimated amounts, thereby affecting the financial position, results of operations and cash flows of the Company. If the estimated value of investments is less than the cost or amortized cost, the Company evaluates whether an event or change in circumstances has occurred that may have a significant adverse effect on the fair value of the investment. If such an event or change has occurred and the Company determines that the impairment is other-than-temporary, a further determination is made as to the portion of impairment that is related to credit loss. The impairment of the investment that is related to the credit loss is expensed in the period in which the event or change occurred. The remainder of the impairment is recorded in other comprehensive income.

Deferred Income Tax Assets/Liabilities. The Company’s net deferred income tax asset arises from differences in the dates that items of income and expense enter into our reported income and taxable income. Deferred tax assets and liabilities are established for these items as they arise. From an accounting standpoint, deferred tax assets are reviewed to determine if they are realizable based on the historical level of taxable income, estimates of future taxable income and the reversals of deferred tax liabilities. In most cases, the realization of the deferred tax asset is based on future profitability. If the Company were to experience net operating losses for tax purposes in a future period, the realization of deferred tax assets would be evaluated for a potential valuation reserve.

Additionally, the Company reviews its uncertain tax positions annually under FASB Interpretation No. 48 (FIN No. 48), “Accounting for Uncertainty in Income Taxes,” codified within ASC 740. An uncertain tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount actually recognized is the largest amount of tax benefit that is greater than 50% likely to be recognized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. A significant amount of judgment is applied to determine both whether the tax position meets the "more likely than not" test as well as to determine the largest amount of tax benefit that is greater than 50% likely to be recognized. Differences between the position taken by management and that of taxing authorities could result in a reduction of a tax benefit or increase to tax liability, which could adversely affect future income tax expense.

Impairment of Goodwill and Intangible Assets. Core deposit and customer relationships, which are intangible assets with a finite life, are recorded on the Company's balance sheets. These intangible assets were capitalized as a result of past acquisitions and are being amortized over their estimated useful lives of up to 15 years. Core deposit intangible assets, with finite lives will be tested for impairment when changes in events or circumstances indicate that its carrying amount may not be recoverable. Core deposit intangible assets were tested for impairment during 2014 as part of the goodwill impairment test and no impairment was deemed necessary.

As a result of the Company's acquisition activity, goodwill, an intangible asset with an indefinite life, is reflected on the balance sheets. Goodwill is evaluated for impairment annually, unless there are factors present that indicate a potential impairment, in which case, the goodwill impairment test is performed more frequently than annually.

Fair Value Measurements. The fair value of a financial instrument is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The Company estimates the fair value of a financial instrument using a variety of valuation methods. Where financial instruments are actively traded and have quoted market prices, quoted market prices are used for fair value. When the financial instruments are not actively traded, other observable market inputs, such as quoted prices of securities with similar characteristics, may be used, if available, to determine fair value. When observable market prices do not exist, the Company estimates fair value. The Company's valuation methods consider factors such as liquidity and concentration concerns. Other factors such as model assumptions, market dislocations, and unexpected correlations can affect estimates of fair value. Imprecision in estimating these factors can impact the amount of revenue or loss recorded.

SFAS No. 157, "Fair Value Measurements", which was codified into ASC 820, establishes a framework for measuring the fair value of financial instruments that considers the attributes specific to particular assets or liabilities and establishes a three-level hierarchy for determining fair value based on the transparency of inputs to each valuation as of the fair value measurement date. The three levels are defined as follows:

- Level 1 — quoted prices (unadjusted) for identical assets or liabilities in active markets.

- Level 2 — inputs include quoted prices for similar assets and liabilities in active markets, quoted prices of identical or similar assets or liabilities in markets that are not active, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

- Level 3 — inputs that are unobservable and significant to the fair value measurement.

At the end of each quarter, the Company assesses the valuation hierarchy for each asset or liability measured. From time to time, assets or liabilities may be transferred within hierarchy levels due to changes in availability of observable market inputs to measure fair value at the measurement date. Transfers into or out of hierarchy levels are based upon the fair value at the beginning of the reporting period. A more detailed description of the fair values measured at each level of the fair value hierarchy can be found in Note 11 – "Disclosures of Fair Values of Financial Instruments."

Results of Operations

Net Interest Income

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

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

	Year Ended December 31, 2014			Year Ended December 31, 2013			Year Ended December 31, 2012		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS									
Interest-bearing deposits	$32,379	$83	0.26 %	$13,633	$33	0.24 %	$16,559	$40	0.24 %
Federal funds sold	495	1	0.10 %	6,923	6	0.09 %	41,484	37	0.09 %
Certificates of deposit investments	—	—	— %	2,554	14	0.55 %	10,714	57	0.53 %
Investment securities									
Taxable	374,285	7,499	2.00 %	466,031	9,153	1.96 %	458,158	9,970	2.18 %
Tax-exempt (1)	69,614	2,352	3.38 %	61,127	2,069	3.38 %	49,198	1,714	3.48 %
Loans (2) (3)	1,022,605	44,799	4.38 %	924,900	42,184	4.56 %	866,912	43,949	5.07 %
Total earning assets	1,499,378	54,734	3.65 %	1,475,168	53,459	3.62 %	1,443,025	55,767	3.85 %
Cash and due from banks	34,782			30,397			35,125		
Premises and equipment	27,892			29,089			30,234		
Other assets	44,800			46,432			46,646		
Allowance for loan losses	(13,625)			(12,448)			(11,577)		
Total assets	$1,593,227			$1,568,638			$1,543,453		
LIABILITIES AND STOCKHOLDERS' EQUITY									
Deposits:									
Demand deposits, interest-bearing	$559,168	689	0.12 %	$544,157	795	0.15 %	$511,199	1,443	0.28 %
Savings deposits	281,185	375	0.13 %	294,615	452	0.15 %	281,831	1,186	0.42 %
Time deposits	229,763	1,287	0.56 %	207,454	1,456	0.70 %	224,350	2,214	0.99 %
Securities sold under agreements									
to repurchase	97,478	47	0.05 %	87,468	46	0.05 %	113,443	117	0.10 %
FHLB advances	14,575	339	2.33 %	13,258	254	1.91 %	10,619	308	2.90 %
Federal funds purchased	16	—	0.52 %	1,463	9	0.62 %	59	—	0.68 %
Subordinated debentures	20,620	514	2.49 %	20,620	523	2.54 %	20,620	563	2.73 %
Other debt	101	1	1.22 %	—	—	— %	4,035	326	8.00 %
Total interest-bearing liabilities	1,202,906	3,252	0.27 %	1,169,035	3,535	0.30 %	1,166,156	6,157	0.53 %
Demand deposits	223,505			237,373			219,218		
Other liabilities	8,452			8,308			7,501		
Stockholders' equity	158,364			153,922			150,578		
Total liabilities & equity	$1,593,227			$1,568,638			$1,543,453		
Net interest income		$51,482			$49,924			$49,610	

Net interest spread	3.38 %	3.32 %	3.32 %
Impact of non-interest bearing funds	0.05 %	0.06 %	0.12 %
Net yield on interest-earning assets	3.43 %	3.38 %	3.44 %

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

Changes in net interest income may also be analyzed by segregating the volume and rate components of interest income and interest expense. The following table summarizes the approximate relative contribution of changes in average volume and interest rates to changes in net interest income for the past two years (in thousands):

	2014 Compared to 2013 Increase – (Decrease)			2013 Compared to 2012 Increase – (Decrease)		
	Total Change	Volume (1)	Rate (1)	Total Change	Volume (1)	Rate (1)
Earning Assets:						
Interest-bearing deposits	$50	$47	$3	$(7)	$(7)	$—
Federal funds sold	(5)	(6)	1	(31)	(31)	—
Certificates of deposit investments	(14)	(7)	(7)	(43)	(45)	2
Investment securities:						
Taxable	(1,654)	(1,836)	182	(817)	175	(992)
Tax-exempt (2)	283	287	(4)	355	405	(50)
Loans (3)	2,615	4,328	(1,713)	(1,765)	2,827	(4,592)
Total interest income	1,275	2,813	(1,538)	(2,308)	3,324	(5,632)
Interest-Bearing Liabilities:						
Deposits:						
Demand deposits, interest-bearing	(106)	27	(133)	(648)	83	(731)
Savings deposits	(77)	(19)	(58)	(734)	52	(786)
Time deposits	(169)	144	(313)	(758)	(155)	(603)
Securities sold under agreements to repurchase	1	1	—	(71)	(22)	(49)
FHLB advances	85	26	59	(54)	66	(120)
Federal funds purchased	(9)	(8)	(1)	9	9	—
Subordinated debentures	(9)	—	(9)	(40)	—	(40)
Other debt	1	(326)	327	(326)	(326)	—
Total interest expense	(283)	(155)	(128)	(2,622)	(293)	(2,329)
Net interest income	$1,558	$2,968	$(1,410)	$314	$3,617	$(3,303)

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

Net interest income increased $1.6 million or 3.1% in 2014 compared to an increase of $314,000 or .6% in 2013. The increase in 2014 is primarily due to growth in average earning assets and an increase in net interest margin. The net interest margin increased due to the shift in balances of investment securities to higher-yielding loans, an increase in yield on investments and the reduction in deposit costs. The increase in 2013 was primarily due to growth in investment security and loan balances offset by a decline in earning asset rates that was greater than the decline in rates of interest-bearing liabilities.

In 2014, average earning assets increased by $24.2 million or 1.6% and average interest-bearing liabilities increased $33.9 million or 2.9% compared with 2013. In 2013, average earning assets increased by $32.1 million, or 2.2%, and average interest-bearing liabilities increased $2.9 million or .2% compared with 2012. Changes in average balances are shown below:

- Average interest-bearing deposits held by the Company increased $18.7 million or 137.5% in 2014 compared to 2013. In 2013, average interest-bearing deposits held by the Company decreased $2.9 million or 17.7% compared to 2012.

- Average federal funds sold decreased $6.4 million or 92.8% in 2014 compared to 2013. In 2013, average federal funds sold decreased $34.6 million or 83.3% compared to 2012.

- Average certificates of deposit investments decreased $2.6 million or 100% in 2013 compared to 2012. In 2013, average certificates of deposit investments decreased $8.2 million or 76.2% compared to 2012.

- Average loans increased by $97.7 million or 10.6% in 2014 compared to 2013. In 2013, average loans increased by $58.0 million or 6.7% compared to 2012.

- Average securities decreased by $83.3 million or 15.8% in 2014 compared to 2013. In 2013, average securities increased by $19.8 million or 3.9% compared to 2012.

- Average deposits increased by $23.9 million or 2.3% in 2014 compared to 2013. In 2013, average deposits increased by $28.8 million or 2.8% compared to 2012.

- Average securities sold under agreements to repurchase increased by $10 million or 11.4% in 2014 compared to 2013. In 2013, average securities sold under agreements to repurchase decreased by $26 million or 22.9% compared to 2012.

- Average borrowings and other debt remained relatively the same in 2014 compared to 2013. In 2013, average borrowings and other debt increased by $8 million or .02% compared to 2012.

- The federal funds rate remained at a range of .25% to .30% at December 31, 2014, 2013 and 2012.

- Net interest margin increased to 3.43% compared to 3.38% in 2013 and 3.44% in 2012. Asset yields increased by 3 basis points in 2014, and interest-bearing liabilities decreased by 3 basis points.

To compare the tax-exempt yields on interest-earning assets to taxable yields, the Company also computes non-GAAP net interest income on a tax equivalent basis where the interest earned on tax-exempt securities is adjusted to an amount comparable to interest subject to normal income taxes, assuming a federal tax rate of 35% (referred to as the tax equivalent adjustment). The tax equivalent basis adjustments to net interest income for 2014, 2013 and 2012 were $1,435,000, $1,316,000, and $1,038,000, respectively. The net yield on interest-earning assets on a tax equivalent basis was 3.53% in 2014, 3.47% in 2013 and 3.51% in 2012.

Provision for Loan Losses

The provision for loan losses in 2014 was $629,000 compared to $2,193,000 in 2013 and $2,647,000 in 2012. Nonperforming loans decreased to $4,540,000 at December 31, 2014 from $6,469,000 at December 31, 2013 and compared to $7,593,000 at December 31, 2012. The declines in provision expense in 2014 and 2013 was the result of a decrease in nonperforming loans and net charge offs. Net charge-offs were $196,000 during 2014, $720,000 during 2013 and $1,991,000 during 2012. For information on loan loss experience and nonperforming loans, see “Nonperforming Loans and Repossessed Assets” and “Loan Quality and Allowance for Loan Losses” herein.

Other Income

An important source of the Company’s revenue is derived from other income. The following table sets forth the major components of other income for the last three years (in thousands):

				$ Change From Prior Year	
	2014	2013	2012	2014	2013
Trust	$3,571	$3,565	$3,330	$6	$235
Brokerage	1,039	833	688	206	145
Insurance commissions	1,796	1,638	1,813	158	(175)
Service charges	5,264	4,865	4,808	399	57
Securities gains	715	2,293	934	(1,578)	1,359

Impairment recoveries (losses) on securities	—	—	127	—	(127)
Mortgage banking	596	935	1,509	(339)	(574)
ATM / debit card revenue	3,915	3,772	3,554	143	218
Other	1,473	1,440	1,547	33	(107)
Total other income	$18,369	$19,341	$18,310	$(972)	$1,031

Total non-interest income decreased to $18.4 million in 2014 compared to $19.3 million in 2014 and $18.3 million in 2012. The primary reasons for the more significant year-to-year changes in other income components are as follows:

- Trust revenues increased $6,000 or .2% in 2014 to $3,571,000 from $3,565,000 in 2013 and $3,330,000 in 2012. The increases during 2014 and 2013 in trust revenues were due primarily to an increase in revenues from Investment Management & Advisory Agency accounts and increases in market value related fees. Trust assets were $757.3 million at December 31, 2014 compared to $722.9 million at December 31, 2013 and $633.8 million at December 31, 2012.

- Revenue from brokerage increased $206,000 or 24.7% to $1,039,000 in 2014 from $833,000 in 2013 and $688,000 in 2012. The increase from 2013 to 2014 was due to an increase in the number of brokerage accounts from new business development efforts.

- Insurance commissions increased $158,000 or 9.6% to $1,796,000 in 2014 from $1,638,000 in 2013 compared to $1,813,000 in 2012. The increase from 2013 to 2014 was due to an increase in contingency income received from carriers based on claims experience. The decrease from 2012 to 2013 was due to a decrease in property and casualty insurance commissions.

- Fees from service charges increased $399,000 or 8.2% to $5,264,000 in 2014 from $4,865,000 in 2013 and $4,808,000 in 2012. The increase from 2013 to 2014 was primarily due to an increase in overdraft fees and transaction service charges. The increase from 2012 to 2013 was primarily due to an increase in commercial transaction account fees.

- Net securities gains in 2013 were $715,000 down $1.6 million or 68.8% from $2.3 million in 2013 and $934,000 in 2012. The decline in security gains from 2013 to 2014 and the increase during 2013 was primarily due to the sale of two trust preferred securities that resulted in net security gains of $1.4 million.

- Mortgage banking income decreased $339,000 or 36.3% to $596,000 in 2014 from $935,000 in 2013 and $1,509,000 in 2012. The decline during 2014 was due to an decrease in the volume of loans originated and sold by First Mid Bank due to less refinancing as interest rates rose on various loan types. Loans sold balances are as follows:

  $44 million (representing 368 loans) in 2014
  $65 million (representing 552 loans) in 2013
  $101 million (representing 796 loans) in 2012

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

- Revenue from ATMs and debit cards increased $143,000 or 3.8% to $3,915,000 in 2014 from $3,772,000 in 2013 compared to $3,554,000 in 2012. The increase from 2013 to 2014 was primarily due to an increase in electronic transactions and incentives received from VISA. The increase from 2012 to 2013 was primarily due to in increase in electronic transactions.

- Other income increased $33,000 or 2.3% in 2014 to $1,473,000 from $1,440,000 in 2013 compared to $1,547,000 in 2012. The increase from 2013 to 2014 was primarily due to an increase in merchant card processing fees. The decrease from 2012 to 2013 was primarily due to a decline in rental income from other real estate owned that was sold during the third quarter of 2013 and less loan closing fees compared to 2012.

Other Expense

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