FIRST MIDWEST BANCORP INC
Form 10-Q
November 06, 2018

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

FORM 10-Q
(Mark One)

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2018

or

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

Commission File Number 0-10967

(Exact name of registrant as specified in its charter)

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

8750 West Bryn Mawr Avenue, Suite 1300
Chicago, Illinois 60631-3655
(Address of principal executive offices) (zip code)

Registrant's telephone number, including area code: (708) 831-7483

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 Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ].

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

Large accelerated filer [X]	Accelerated filer [ ]
Non-accelerated filer [ ]	Smaller reporting company [ ]
(Do not check if a smaller reporting company)	Emerging growth company [ ]

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

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

As of October 31, 2018, there were 106,382,834 shares of common stock, $.01 par value, outstanding.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS (Unaudited)
FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Amounts in thousands, except per share data)

	September 30, 2018	December 31, 2017
Assets	(Unaudited)	
Cash and due from banks	$185,239	$192,800
Interest-bearing deposits in other banks	111,360	153,770
Trading securities, at fair value	—	20,447
Equity securities, at fair value	29,046	—
Securities available-for-sale, at fair value	2,179,410	1,884,209
Securities held-to-maturity, at amortized cost	12,673	13,760
Federal Home Loan Bank ("FHLB") and Federal Reserve Bank ("FRB") stock, at cost	87,728	69,708
Loans	11,050,548	10,437,812
Allowance for loan losses	(99,925)	(95,729)
Net loans	10,950,623	10,342,083
Other real estate owned ("OREO")	12,244	20,851
Premises, furniture, and equipment, net	126,389	123,316
Investment in bank-owned life insurance ("BOLI")	284,074	279,900
Goodwill and other intangible assets	751,248	754,757
Accrued interest receivable and other assets	231,465	221,451
Total assets	$14,961,499	$14,077,052
Liabilities		
Noninterest-bearing deposits	$3,618,384	$3,576,190
Interest-bearing deposits	7,908,730	7,477,135
Total deposits	11,527,114	11,053,325
Borrowed funds	1,073,546	714,884
Senior and subordinated debt	195,595	195,170
Accrued interest payable and other liabilities	247,569	248,799
Total liabilities	13,043,824	12,212,178
Stockholders' Equity		
Common stock	1,124	1,123
Additional paid-in capital	1,028,635	1,031,870

Retained earnings	1,164,133	1,074,990
Accumulated other comprehensive loss, net of tax	(75,133)	(33,036)
Treasury stock, at cost	(201,084)	(210,073)
Total stockholders' equity	1,917,675	1,864,874
Total liabilities and stockholders' equity	$14,961,499	$14,077,052

	September 30, 2018 (Unaudited)		December 31, 2017	
	Preferred Shares	Common Shares	Preferred Shares	Common Shares
Par value per share	$ —	$ 0.01	$—	$0.01
Shares authorized	1,000	250,000	1,000	250,000
Shares issued	—	112,359	—	112,351
Shares outstanding	—	103,058	—	102,717
Treasury shares	—	9,301	—	9,634

See accompanying unaudited notes to the condensed consolidated financial statements.

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FIRST MIDWEST BANCORP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Amounts in thousands, except per share data)
(Unaudited)

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest Income				
Loans	$133,997	$118,101	$380,420	$345,286
Investment securities	14,170	10,667	38,936	31,678
Other short-term investments	1,365	1,148	3,609	3,167
Total interest income	149,532	129,916	422,965	380,131
Interest Expense				
Deposits	10,426	4,369	24,637	11,307
Borrowed funds	3,927	2,544	10,919	6,837
Senior and subordinated debt	3,152	3,110	9,416	9,314
Total interest expense	17,505	10,023	44,972	27,458
Net interest income	132,027	119,893	377,993	352,673
Provision for loan losses	11,248	10,109	38,043	23,266
Net interest income after provision for loan losses	120,779	109,784	339,950	329,407
Noninterest Income				
Service charges on deposit accounts	12,378	12,561	36,088	36,079
Wealth management fees	10,622	10,169	32,561	30,354
Card-based fees, net	4,123	5,992	12,450	22,940
Capital market products income	1,936	2,592	6,313	6,185
Mortgage banking income	1,657	2,246	5,790	5,779
Other service charges, commissions, and fees	2,786	4,745	8,172	16,043
Net securities gains	—	3,197	—	3,481
Other income	2,164	1,846	6,756	7,383
Total noninterest income	35,666	43,348	108,130	128,244
Noninterest Expense				
Salaries and employee benefits	54,160	55,638	168,879	165,985
Net occupancy and equipment expense	13,183	12,115	40,607	36,925
Professional services	7,944	8,498	23,822	26,073
Technology and related costs	4,763	4,505	14,371	13,423
Net OREO expense	(413)	657	399	3,988
Other expenses	14,541	15,393	40,083	47,066
Delivering Excellence implementation costs	2,239	—	17,254	—
Acquisition and integration related expenses	60	384	60	20,123
Total noninterest expense	96,477	97,190	305,475	313,583
Income before income tax expense	59,968	55,942	142,605	144,068
Income tax expense	6,616	17,707	26,143	48,028
Net income	$53,352	$38,235	$116,462	$96,040
Per Common Share Data				
Basic earnings per common share	$0.52	$0.37	$1.13	$0.94

Diluted earnings per common share	$0.52	$0.37	$1.13	$0.94
Dividends declared per common share	$0.11	$0.10	$0.33	$0.29
Weighted-average common shares outstanding	102,178	101,752	102,087	101,307
Weighted-average diluted common shares outstanding	102,178	101,772	102,092	101,327

See accompanying unaudited notes to the condensed consolidated financial statements.

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FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollar amounts in thousands)
(Unaudited)

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$53,352	$38,235	$116,462	$96,040
Securities Available-for-Sale				
Unrealized holding (losses) gains:				
Before tax	(13,632)	428	(47,765)	11,078
Tax effect	3,548	(174)	13,055	(4,436)
Net of tax	(10,084)	254	(34,710)	6,642
Reclassification of net gains included in net income:				
Before tax	—	3,197	—	3,481
Tax effect	—	(1,311)	—	(1,425)
Net of tax	—	1,886	—	2,056
Net unrealized holding (losses) gains	(10,084)	(1,632)	(34,710)	4,586
Derivative Instruments				
Unrealized holding (losses) gains:				
Before tax	(880)	276	(948)	(2,849)
Tax effect	231	(113)	250	1,137
Net of tax	(649)	163	(698)	(1,712)
Total other comprehensive (loss) income	(10,733)	(1,469)	(35,408)	2,874
Total comprehensive income	$42,619	$36,766	$81,054	$98,914

	Accumulated Unrealized Loss on Securities Available-for-Sale	Accumulated Unrealized Loss on Derivative Instruments	Unrecognized Net Pension Costs	Total Accumulated Other Comprehensive Loss
Balance at December 31, 2016	$ (22,645)	$ (1,176)	$ (17,089)	$ (40,910)
Other comprehensive income	4,586	(1,712)	—	2,874
Balance at September 30, 2017	$ (18,059)	$ (2,888)	$ (17,089)	$ (38,036)
Balance at December 31, 2017	$ (13,976)	$ (3,763)	$ (15,297)	$ (33,036)
Adjustment to apply recent accounting pronouncements[1]	(2,864)	(784)	(3,041)	(6,689)
Other comprehensive loss	(34,710)	(698)	—	(35,408)
Balance at September 30, 2018	$ (51,550)	$ (5,245)	$ (18,338)	$ (75,133)

(1) As a result of accounting guidance adopted in the first quarter of 2018, certain reclassifications were made from accumulated other comprehensive loss to retained earnings as of January 1, 2018. For further discussion of this guidance, see Note 2, "Recent Accounting Pronouncements."

See accompanying unaudited notes to the condensed consolidated financial statements.

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FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Amounts in thousands, except per share data)
(Unaudited)

	Common Shares Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance at December 31, 2016	81,325	$ 913	$498,937	$1,016,674	$ (40,910)	$(218,534)	$1,257,080
Net income	—	—	—	96,040	—	—	96,040
Other comprehensive income	—	—	—	—	2,874	—	2,874
Common dividends declared ($0.29 per common share)	—	—	—	(29,793)	—	—	(29,793)
Acquisitions, net of issuance costs	21,078	210	533,322	—	—	558	534,090
Common stock issued	7	—	175	—	—	—	175
Restricted stock activity	321	—	(11,987)	—	—	8,308	(3,679)
Treasury stock issued to benefit plans	(9)	—	1	—	—	(212)	(211)
Share-based compensation expense	—	—	8,554	—	—	—	8,554
Balance at September 30, 2017	102,722	$ 1,123	$1,029,002	$1,082,921	$ (38,036)	$(209,880)	$1,865,130
Balance at December 31, 2017	102,717	$ 1,123	$1,031,870	$1,074,990	$ (33,036)	$(210,073)	$1,864,874
Adjustment to apply recent accounting pronouncements[(1)]	—	—	—	6,689	(6,689)	—	—
Net income	—	—	—	116,462	—	—	116,462
Other comprehensive loss	—	—	—	—	(35,408)	—	(35,408)
Common dividends declared ($0.33 per common share)	—	—	—	(34,008)	—	—	(34,008)
Common stock issued	8	1	227	—	—	667	895
Restricted stock activity	335	—	(12,667)	—	—	8,426	(4,241)
Treasury stock issued to benefit plans	(2)	—	41	—	—	(104)	(63)
Share-based compensation expense	—	—	9,164	—	—	—	9,164
Balance at September 30, 2018	103,058	$ 1,124	$1,028,635	$1,164,133	$ (75,133)	$(201,084)	$1,917,675

(1) As a result of accounting guidance adopted in the first quarter of 2018, certain reclassifications were made from accumulated other comprehensive loss to retained earnings as of January 1, 2018. For further discussion of this guidance, see Note 2, "Recent Accounting Pronouncements."

See accompanying unaudited notes to the condensed consolidated financial statements.

FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollar amounts in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2018	2017
Operating Activities		
Net income	$116,462	$96,040
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	38,043	23,266
Depreciation of premises, furniture, and equipment	11,693	10,477
Net amortization of premium on securities	11,444	12,334
Net securities gains	—	(3,481)
Gains on sales of 1-4 family mortgages and corporate loans held-for-sale	(4,475)	(5,354)
Net (gains) losses on sales and valuation adjustments of OREO	(318)	944
Amortization of the FDIC indemnification asset	906	906
Net losses (gains) on sales and valuation adjustments of premises, furniture, and equipment	5,423	(364)
BOLI income	(4,280)	(4,095)
Share-based compensation expense	9,164	8,554
Tax benefit related to share-based compensation	208	252
Amortization of other intangible assets	5,368	6,059
Originations of mortgage loans held-for-sale	(175,408)	(183,907)
Proceeds from sales of mortgage loans held-for-sale	193,476	190,544
Net increase in equity securities	(1,191)	—
Net increase in trading securities	—	(2,505)
Net increase in accrued interest receivable and other assets	(14,725)	(191,492)
Net decrease in accrued interest payables and other liabilities	(1,949)	(8,463)
Net cash provided by (used in) operating activities	189,841	(50,285)
Investing Activities		
Proceeds from maturities, repayments, and calls of securities available-for-sale	233,659	251,160
Proceeds from sales of securities available-for-sale	—	437,401
Purchases of securities available-for-sale	(595,477)	(289,244)
Proceeds from maturities, repayments, and calls of securities held-to-maturity	1,087	7,663
Purchases of securities held-to-maturity	—	(10)
Net purchases of FHLB stock	(18,020)	(7,330)
Net increase in loans	(649,197)	(392,384)
Premiums paid on BOLI, net of proceeds from claims	106	132
Proceeds from sales of OREO	12,951	17,460
Proceeds from sales of premises, furniture, and equipment	549	13,135
Purchases of premises, furniture, and equipment	(20,738)	(11,680)
Net cash received from acquisitions	—	41,717
Net cash (used in) provided by investing activities	(1,035,080)	68,020
Financing Activities		
Net increase in deposit accounts	473,789	356,020
Net increase (decrease) in borrowed funds	358,662	(178,472)

Cash dividends paid	(32,942)	(26,852)
Restricted stock activity	(4,241)	(3,679)
Net cash provided by financing activities	795,268	147,017
Net (decrease) increase in cash and cash equivalents	(49,971)	164,752
Cash and cash equivalents at beginning of period	346,570	262,148
Cash and cash equivalents at end of period	$296,599	$426,900

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FIRST MIDWEST BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS – (Continued)
(Dollar amounts in thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2018	2017
Supplemental Disclosures of Cash Flow Information:		
Income taxes (refunded) paid	$(7,001)	$14,310
Interest paid to depositors and creditors	43,270	27,538
Dividends declared, but unpaid	11,250	10,184
Stock issued for acquisitions, net of issuance costs	—	534,090
Non-cash transfers of loans to OREO	4,026	3,770
Non-cash transfers of loans held-for-investment to loans held-for-sale	12,373	42,970
Non-cash transfer of trading securities and securities available-for-sale to equity securities	27,855	—

See accompanying unaudited notes to the condensed consolidated financial statements.

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
Basis of Presentation – The accompanying unaudited condensed consolidated interim financial statements ("consolidated financial statements") of First Midwest Bancorp, Inc. (the "Company"), a Delaware corporation, were prepared in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC") for quarterly reports on Form 10-Q and reflect all adjustments that management deems necessary for the fair presentation of the financial position and results of operations for the periods presented. The results of operations for the quarter and nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.
The accounting and reporting policies of the Company and its subsidiaries conform to U.S. generally accepted accounting principles ("GAAP") and general practices within the banking industry. The accompanying consolidated financial statements do not include certain information and note disclosures required by GAAP for complete annual financial statements. Therefore, these financial statements should be read in conjunction with the Company's 2017 Annual Report on Form 10-K ("2017 10-K"). The Company uses the accrual basis of accounting for financial reporting purposes. Certain reclassifications were made to prior year amounts to conform to the current year presentation.
Use of Estimates – The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Although these estimates and assumptions are based on the best available information, actual results could differ from those estimates.
Principles of Consolidation – The accompanying consolidated financial statements include the financial position and results of operations of the Company and its subsidiaries after elimination of all significant intercompany accounts and transactions. Assets held in a fiduciary or agency capacity are not assets of the Company or its subsidiaries and are not included in the consolidated financial statements.
The accounting policies related to business combinations, loans, the allowance for credit losses, and derivative financial instruments are presented below. For a summary of all other significant accounting policies, see Note 1, "Summary of Significant Accounting Policies," in the Company's 2017 10-K.
Business Combinations – Business combinations are accounted for under the acquisition method of accounting. Assets acquired and liabilities assumed are recorded at their estimated fair values as of the date of acquisition, with any excess of the purchase price of the acquisition over the fair value of the identifiable net tangible and intangible assets acquired recorded as goodwill. Alternatively, a gain is recorded if the fair value of assets purchased exceeds the fair value of liabilities assumed and consideration paid. The results of operations of the acquired business are included in the Condensed Consolidated Statements of Income from the effective date of the acquisition.
Loans – Loans held-for-investment are loans that the Company intends to hold until they are paid in full and are carried at the principal amount outstanding, including certain net deferred loan origination fees. Loan origination fees, commitment fees, and certain direct loan origination costs are deferred, and the net amount is amortized as a yield adjustment over the contractual life of the related loans or commitments and included in interest income. Fees related to letters of credit are amortized into fee income over the contractual life of the commitment. Other credit-related fees are recognized as fee income when earned. The Company's net investment in direct financing leases is included in loans and consists of future minimum lease payments and estimated residual values, net of unearned income. Interest income on loans is accrued based on principal amounts outstanding. Loans held-for-sale are carried at the lower of aggregate cost or fair value and included in other assets in the Consolidated Statements of Financial Condition.
Acquired and Covered Loans – Covered loans consists of loans acquired by the Company in Federal Deposit Insurance Corporation ("FDIC")-assisted transactions, which are covered by loss share agreements with the FDIC (the "FDIC Agreements"), under which the FDIC reimburses the Company for the majority of the losses and eligible expenses

related to these assets during the coverage period. Acquired loans consist of all other loans that were acquired in business combinations that are not covered by the FDIC Agreements. Certain loans that were previously classified as covered loans are no longer covered under the FDIC Agreements, and are included in acquired loans. Covered loans and acquired loans are included within loans held-for-investment.

Acquired and covered loans are separated into (i) non-purchased credit impaired ("non-PCI") and (ii) purchased credit impaired ("PCI") loans. Non-PCI loans include loans that did not have evidence of credit deterioration since origination at the acquisition date. PCI loans include loans that had evidence of credit deterioration since origination and for which it was probable at acquisition that the Company would not collect all contractually required principal and interest payments. Evidence of credit deterioration

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was evaluated using various indicators, such as past due and non-accrual status. Leases and revolving loans do not qualify to be accounted for as PCI loans and are accounted for as non-PCI loans.

The acquisition adjustment related to non-PCI loans is amortized into interest income over the contractual life of the related loans. If an acquired non-PCI loan is renewed subsequent to the acquisition date, any remaining acquisition adjustment is accreted into interest income and the loan is considered a new loan that is no longer classified as an acquired loan.

PCI loans are accounted for based on estimates of expected future cash flows. To estimate the fair value, the Company generally aggregates purchased consumer loans and commercial loans into pools of loans with common risk characteristics, such as delinquency status, credit score, and internal risk ratings. The fair values of larger balance commercial loans are estimated on an individual basis. Expected future cash flows in excess of the fair value of loans at the purchase date ("accretable yield") are recorded as interest income over the life of the loans if the timing and amount of the expected future cash flows can be reasonably estimated. The non-accretable yield represents the difference between contractually required payments and the expected future cash flows determined at acquisition. Subsequent increases in expected future cash flows are offset against the allowance for credit losses to the extent an allowance has been established or otherwise recognized as interest income prospectively. The present value of any decreases in expected future cash flows is recognized by recording a charge-off through the allowance for loan losses or providing an allowance for loan losses.

90-Days Past Due Loans – The Company's accrual of interest on loans is generally discontinued at the time the loan is 90 days past due unless the credit is sufficiently collateralized and in the process of renewal or collection.

Non-accrual Loans – Generally, corporate loans are placed on non-accrual status (i) when either principal or interest payments become 90 days or more past due unless the credit is sufficiently collateralized and in the process of renewal or collection, or (ii) when an individual analysis of a borrower's creditworthiness warrants a downgrade to non-accrual regardless of past due status. When a loan is placed on non-accrual status, unpaid interest credited to income in the current year is reversed, and unpaid interest accrued in prior years is charged against the allowance for loan losses. After the loan is placed on non-accrual status, all debt service payments are applied to the principal on the loan. Future interest income may only be recorded on a cash basis after recovery of principal is reasonably assured. Non-accrual loans are returned to accrual status when the financial position of the borrower and other relevant factors indicate that the Company will collect all principal and interest.

Commercial loans and loans secured by real estate are charged-off when deemed uncollectible. A loss is recorded if the net realizable value of the underlying collateral is less than the outstanding principal and interest. Consumer loans that are not secured by real estate are subject to mandatory charge-off at a specified delinquency date and are usually not classified as non-accrual prior to being charged-off. Closed-end consumer loans, which include installment, automobile, and single payment loans, are usually charged-off no later than the end of the month in which the loan becomes 120 days past due.

PCI loans are generally considered accruing loans unless reasonable estimates of the timing and amount of expected future cash flows cannot be determined. Loans without reasonable future cash flow estimates are classified as non-accrual loans, and interest income is not recognized on those loans until the timing and amount of the expected future cash flows can be reasonably determined.

Troubled Debt Restructurings ("TDRs") – A restructuring is considered a TDR when (i) the borrower is experiencing financial difficulties, and (ii) the creditor grants a concession, such as forgiveness of principal, reduction of the interest rate, changes in payments, or extension of the maturity date. Loans are not classified as TDRs when the modification is short-term or results in an insignificant delay in payments. The Company's TDRs are determined on a case-by-case basis.

The Company does not accrue interest on a TDR unless it believes collection of all principal and interest under the modified terms is reasonably assured. For a TDR to begin accruing interest, the borrower must demonstrate some level of past performance and the future capacity to perform under the modified terms. Generally, six months of consecutive payment performance under the restructured terms is required before a TDR is returned to accrual status. However, the period could vary depending on the individual facts and circumstances of the loan. An evaluation of the borrower's current creditworthiness is used to assess the borrower's capacity to repay the loan under the modified terms. This evaluation includes an estimate of expected future cash flows, evidence of strong financial position, and estimates of the value of collateral, if applicable. For TDRs to be removed from TDR status in the calendar year after the restructuring, the loans must (i) have an interest rate and terms that reflect market conditions at the time of restructuring, and (ii) be in compliance with the modified terms. If the loan was restructured at below market rates and terms, it continues to be separately reported as restructured until it is paid in full or charged-off.

Impaired Loans – Impaired loans consist of corporate non-accrual loans and TDRs. A loan is considered impaired when it is probable that the Company will not collect all contractual principal and interest. With the exception of accruing TDRs, impaired loans are classified as non-accrual and are exclusive of smaller homogeneous loans, such as home equity, 1-4 family mortgages, and installment loans. Impaired loans with balances under a specified threshold are not individually evaluated for impairment. For all other impaired loans, impairment is measured by comparing the estimated value of the loan to the recorded book value.

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The value of collateral-dependent loans is based on the fair value of the underlying collateral, less costs to sell. The value of other loans is measured using the present value of expected future cash flows discounted at the loan's initial effective interest rate.

Allowance for Credit Losses – The allowance for credit losses is comprised of the allowance for loan losses and the reserve for unfunded commitments, and is maintained by management at a level believed adequate to absorb estimated losses inherent in the existing loan portfolio. Determination of the allowance for credit losses is subjective since it requires significant estimates and management judgment, including the amounts and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans, consideration of current economic trends, and other factors.

Loans deemed to be uncollectible are charged-off against the allowance for loan losses, while recoveries of amounts previously charged-off are credited to the allowance for loan losses. Additions to the allowance for loan losses are charged to expense through the provision for loan losses. The amount of provision depends on a number of factors, including net charge-off levels, loan growth, changes in the composition of the loan portfolio, and the Company's assessment of the allowance for loan losses based on the methodology discussed below.

Allowance for Loan Losses – The allowance for loan losses consists of (i) specific reserves for individual loans where the recorded investment exceeds the value, (ii) an allowance based on a loss migration analysis that uses historical credit loss experience for each loan category, and (iii) an allowance based on other internal and external qualitative factors.

The specific reserves component of the allowance for loan losses is based on a periodic analysis of impaired loans exceeding a fixed dollar amount. If the value of an impaired loan is less than the recorded book value, the Company either establishes a valuation allowance (i.e., a specific reserve) equal to the excess of the book value over the collateral value of the loan as a component of the allowance for loan losses or charges off the amount if it is a confirmed loss.

The general reserve component is based on a loss migration analysis, which examines actual loss experience by loan category for a rolling 8-quarter period and the related internal risk rating for corporate loans. The loss migration analysis is updated quarterly, primarily using actual loss experience. This component is then adjusted based on management's consideration of many internal and external qualitative factors, including:

- Changes in the composition of the loan portfolio, trends in the volume of loans, and trends in delinquent and non-accrual loans that could indicate that historical trends do not reflect current conditions.
- Changes in credit policies and procedures, such as underwriting standards and collection, charge-off, and recovery practices.
- Changes in the experience, ability, and depth of credit management and other relevant staff.
- Changes in the quality of the Company's loan review system and Board of Directors oversight.
- The effect of any concentration of credit and changes in the level of concentrations, such as loan type or risk rating.
- Changes in the value of the underlying collateral for collateral-dependent loans.
- Changes in the national and local economy that affect the collectability of various segments of the portfolio.
- The effect of other external factors, such as competition and legal and regulatory requirements, on the Company's loan portfolio.

The allowance for loan losses also consists of an allowance on acquired and covered non-PCI and PCI loans. No allowance for loan losses is recorded on acquired loans at the acquisition date. Subsequent to the acquisition date, an allowance for credit losses is established as necessary to reflect credit deterioration. The acquired non-PCI allowance is based on management's evaluation of the acquired non-PCI loan portfolio giving consideration to the current portfolio balance, including the remaining acquisition adjustments, maturity dates, and overall credit quality. The allowance for covered non-PCI loans is calculated in the same manner as the general reserve component based on a loss migration analysis as discussed above. The acquired and covered PCI allowance reflects the difference between the carrying value and the discounted expected future cash flows of the acquired and covered PCI loans. On a periodic basis, the adequacy of this allowance is determined through a re-estimation of expected future cash flows on all of the outstanding acquired and covered PCI loans using either a probability of default/loss given default ("PD/LGD") methodology or a specific review methodology. The PD/LGD model is a loss model that estimates expected future cash flows using a probability of default curve and loss given default estimates. Acquired non-PCI loans that have renewed subsequent to the respective acquisition dates are no longer classified as acquired loans. Instead, they are included in the general loan population and allocated an allowance based on a loss migration analysis.

Reserve for Unfunded Commitments – The Company also maintains a reserve for unfunded commitments, including letters of credit, for the risk of loss inherent in these arrangements. The reserve for unfunded commitments is estimated using the loss migration analysis from the allowance for loan losses, adjusted for probabilities of future funding requirements. The reserve for unfunded commitments is included in other liabilities in the Consolidated Statements of Financial Condition.

The establishment of the allowance for credit losses involves a high degree of judgment given the difficulty of assessing the factors impacting loan repayment and estimating the timing and amount of losses. While management utilizes its best judgment and

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information available, the adequacy of the allowance for credit losses depends on a variety of factors beyond the Company's control, including the performance of its loan portfolio, the economy, changes in interest rates and property values, and the interpretation of loan risk classifications by regulatory authorities.

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

On the date the Company enters into a derivative contract, the derivative is designated as a fair value hedge, a cash flow hedge, or a non-hedge derivative instrument. Fair value hedges are designed to mitigate exposure to changes in the fair value of an asset or liability attributable to a particular risk, such as interest rate risk. Cash flow hedges are designed to mitigate exposure to variability in expected future cash flows to be received or paid related to an asset, liability, or other type of forecasted transaction. The Company formally documents all relationships between hedging instruments and hedged items, including its risk management objective and strategy at inception.

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

For fair value hedges, changes in the fair value of the derivative instruments, as well as changes in the fair value of the hedged item, are recognized in earnings in the same income statement line item as the earnings effect of the hedged item. For cash flow hedges, the effective portion of the change in fair value of the derivative instrument is reported as a component of accumulated other comprehensive loss and is reclassified to earnings when the hedged transaction is reflected in earnings.

2. RECENT ACCOUNTING PRONOUNCEMENTS

Adopted Accounting Pronouncements

Revenue from Contracts with Customers: In May of 2014, the Financial Accounting Standards Board ("FASB") issued guidance that requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In March of 2016, the FASB issued an amendment to this guidance to clarify the implementation of guidance on principal versus agent consideration. Additional amendments to clarify the implementation guidance on the identification of performance obligations and licensing were issued in April of 2016 and narrow-scope improvements and practical expedients were issued in May of 2016. The guidance is effective for annual and interim reporting periods beginning on or after December 15, 2017, and must be applied either retrospectively or using the modified retrospective approach.

The Company's revenue is comprised of net interest income on financial assets and liabilities, which is excluded from the scope of this guidance, and noninterest income. The primary sources of revenue within noninterest income are service charges on deposit accounts, wealth management fees, card-based fees, and merchant servicing fees. The adoption of this guidance on January 1, 2018, using the modified retrospective approach, affected how the Company presents merchant servicing fees, merchant card expenses, card-based fees, and cardholder expenses, which are presented on a gross basis within noninterest income and noninterest expense for the prior period and are presented on a net basis within noninterest income for the current period. Total expenses of $4.2 million and $11.9 million for the

quarter and nine months ended September 30, 2018 were netted in noninterest income. The adoption of this guidance did not impact net income; therefore, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Consistent with the modified retrospective approach, the Company did not adjust prior period amounts for the reclassification of merchant card expenses and cardholder expenses.
A description of the Company's revenue streams accounted for under the scope of this guidance follows:
Service charges on deposit accounts – Service charges on deposit accounts consist of account analysis fees (net fees earned on analyzed business and public checking accounts), monthly service fees, and other deposit account related fees. The Company's performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Other deposit account related fees are largely transactional based and, therefore, the Company's performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges

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on deposit accounts is primarily received as a direct charge to customers' accounts. As a result of the adoption of this guidance, there was no impact to the method of recognizing revenue related to service charges on deposit accounts for the quarter and nine months ended September 30, 2018.

Wealth management fees – Wealth management fees represents quarterly fees due from wealth management customers as consideration for managing the customers' assets. Wealth management services include custody of assets, investment management, escrow services, fees for trust services and similar fiduciary activities. Revenue is recognized when our performance obligation is completed each quarter, which is generally the time that payment is received. Also included are fees received from a third-party broker-dealer as part of a revenue-sharing agreement. These fees are paid to us by the third-party on a quarterly basis and recognized ratably throughout the quarter as our performance obligation is satisfied. As a result of the adoption of this guidance, there was no impact to the method of recognizing revenue related to wealth management fees for the quarter and nine months ended September 30, 2018.

Card-based fees, net – Card-based fees, net consists of debit and credit card interchange fees for processing transactions, as well as various fees for automated teller machine ("ATM") and point-of-sale transactions processed through the related networks. Interchange, ATM, and point-of-sale fees from cardholder transactions represent a percentage of the underlying transaction value or a flat fee and are recognized daily in connection with the transaction processing services provided to the cardholder. Card-based fees are presented net of certain contract costs associated with the debit, credit and ATM card interchange networks. As a result of the adoption of this guidance, $1.9 million and $5.5 million of cardholder expenses are netted against card-based fees for the quarter and nine months ended September 30, 2018, respectively.

Merchant servicing fees, net – Merchant servicing fees, net is included in other service charges, commissions, and fees in the Consolidated Statements of Income. The Company acts in an agency capacity with respect to its merchants to process their debit and credit card transactions, deriving revenue from assisting another entity in transactions with the Company's customers. Merchant servicing fees represent a percentage of the underlying net transaction volume or a flat fee and are recognized monthly. Merchant servicing fees are presented net of certain contract costs associated with the third-party merchant processing. As a result of the adoption of this guidance, $2.3 million and $6.4 million of merchant card expenses are netted against merchant servicing fees for the quarter and nine months ended September 30, 2018, respectively.

Amendments to Guidance on Classifying and Measuring Financial Instruments: In January of 2016, the FASB issued guidance that will require entities to measure equity investments that do not result in consolidation and are not accounted for under the equity method at fair value. Any subsequent changes in fair value will be recognized in net income unless the investments qualify for a new practicability exception. Equity securities totaling $29.0 million are no longer classified as trading securities or securities available-for-sale. This guidance also requires entities to adjust the fair value disclosures for financial instruments carried at amortized cost from an entry price to an exit price. No changes were made to the guidance for classifying and measuring investments in debt securities and loans. Except as discussed above, the adoption of this guidance on January 1, 2018 did not materially impact the Company's financial condition, results of operations, or liquidity.

Classification of Certain Cash Receipts and Cash Payments: In August of 2016, the FASB issued guidance clarifying certain cash flow presentation and classification issues to reduce diversity in practice. The adoption of this guidance on January 1, 2018 did not materially impact the Company's financial condition, results of operations, or liquidity.

Income Taxes: In October of 2016, the FASB issued guidance that requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The adoption of this guidance on January 1, 2018 did not materially impact the Company's financial condition, results of operations, or liquidity.

Clarifying the Definition of a Business: In January of 2017, the FASB issued guidance that clarifies the definition of a business to assist entities with evaluating whether transactions should be accounted for as acquisitions or disposals of assets or businesses. The adoption of this guidance on January 1, 2018 did not impact the Company's financial

condition, results of operations, or liquidity.
Presentation of Defined Benefit Retirement Plan Costs: In March of 2017, the FASB issued guidance that changes how employers that sponsor defined pension and or other postretirement benefit plans present the net periodic benefit cost in the income statement. Employers are required to present the service cost component of the net periodic benefit cost in the same income statement line item as other employee compensation costs arising from services rendered during the period. Other components of net periodic benefit cost are required to be presented separately from the line item(s) that includes the service cost. The adoption of this guidance on January 1, 2018 did not materially impact the Company's financial condition, results of operations, or liquidity.
Share-based Payment Award Modifications: In May of 2017, the FASB issued guidance to reduce diversity in practice by clarifying when changes to the terms or conditions of a share-based payment award must be accounted for as a modification. The adoption of this guidance on January 1, 2018 did not materially impact the Company's financial condition, results of operations, or liquidity.

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Derivatives and Hedging: In August of 2017, the FASB issued guidance to better align the financial reporting related to hedging activities with the economic objectives of those activities and to simplify the application of current hedge accounting guidance. Entities are required to apply the guidance using a modified retrospective method as of the period of adoption. This guidance is effective for annual and interim periods beginning after December 31, 2018. Early adoption is permitted, and the Company elected to do so on January 1, 2018, which did not materially impact the Company's financial condition, results of operations, or liquidity.

Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income: In February of 2018, the FASB issued guidance that requires a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017. Entities electing the reclassification are required to apply the guidance either at the beginning of the period of adoption or retrospectively for all periods impacted. This guidance is effective for annual and interim periods beginning after December 15, 2018. Early adoption is permitted and the Company elected to do so on January 1, 2018, which resulted in the reclassification of $6.8 million of stranded tax effects from accumulated other comprehensive loss to retained earnings as of the beginning of the period of adoption.

Accounting Pronouncements Pending Adoption

Leases: In February of 2016, the FASB issued guidance to increase transparency and comparability across entities for leasing arrangements. This guidance requires lessees to recognize assets and liabilities for most leases. For lessors, this guidance modifies the lease classification criteria and the accounting for sales-type and direct financing leases. In addition, this guidance clarifies criteria for the determination of whether a contract is or contains a lease. This guidance is effective for annual and interim periods beginning after December 15, 2018. Early adoption is permitted. The Company will adopt this guidance on January 1, 2019, which will result in the recognition of right-of-use assets and associated lease liabilities for its operating leases. The amount of right-of-use assets and associated lease liabilities recorded upon adoption will be based on the present value of future minimum lease payments, the amount of which will depend on the population of leases in effect at the date of adoption. In addition, First Midwest Bank (the "Bank") entered into a sale-leaseback transaction in 2016 that resulted in a deferred gain. Upon adoption of this guidance, the remaining deferred gain, which is estimated to be approximately $50 million after tax, will be recognized immediately as a cumulative-effect adjustment to equity. For additional discussion of the sale-leaseback transaction, see Note 8 "Premises, Furniture, and Equipment" to the Consolidated Financial Statements in the Company's 2017 10-K. Management is completing its evaluation of the guidance and does not expect the adoption of the guidance will materially impact the Company's results of operations or liquidity, but anticipates a material increase in assets, liabilities, and equity.

Measurement of Credit Losses on Financial Instruments: In June of 2016, the FASB issued guidance that will require entities to present financial assets measured at amortized cost at the net amount expected to be collected, considering an entity's current estimate of all expected credit losses. In addition, credit losses relating to available-for-sale debt securities will be required to be recorded through an allowance for credit losses, with changes in credit loss estimates recognized through current earnings. This guidance is effective for annual and interim periods beginning after December 15, 2019. Early adoption is permitted, but not for periods beginning before December 15, 2018. Management is evaluating the guidance and the impact to the Company's financial condition, results of operations, or liquidity.

Accounting for Goodwill Impairment: In January of 2017, the FASB issued guidance that simplifies the accounting for goodwill impairment for all entities. The new guidance eliminates the requirement to calculate the implied fair value of goodwill using the second step of the quantitative two-step goodwill impairment model prescribed under current accounting guidance. Under the new guidance, if a reporting unit's carrying amount exceeds its fair value, an entity will record an impairment charge based on that difference. This guidance is effective for annual and interim goodwill impairment testing dates beginning after December 15, 2019. Early adoption is permitted for annual and interim goodwill impairment testing dates after January 1, 2017. Management does not expect the adoption of this guidance will materially impact the Company's financial condition, results of operations, or liquidity.

Premium Amortization on Purchased Callable Debt Securities: In March of 2017, the FASB issued guidance that shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. This guidance is effective for annual and interim periods beginning after December 15, 2018. Early adoption is permitted. Management does not expect the adoption of this guidance will materially impact the Company's financial condition, results of operations, or liquidity.

Improvements to Nonemployee Share-based Payment Accounting: In June of 2018, the FASB issued guidance that aligns the measurement and classification guidance for share-based payments to nonemployees with the guidance for share-based payments to employees. This guidance is effective for annual and interim periods beginning after December 15, 2018. Early adoption is permitted. Management does not expect the adoption of this guidance will materially impact the Company's financial condition, results of operations, or liquidity.

Changes to the Disclosure Requirements for Fair Value Measurement: In August of 2018, the FASB issued guidance that eliminates, modifies, and adds to certain fair value measurement disclosure requirements associated with the three-tiered fair value

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hierarchy. This guidance is effective for annual and interim periods beginning after December 15, 2019. Early adoption is permitted. Management does not expect the adoption of this guidance will materially impact the Company's financial condition, results of operations, or liquidity.
Changes to the Disclosure Requirements for Defined Benefit Plans: In August of 2018, the FASB issued guidance that makes minor changes and clarifications to the disclosure requirements for entities that sponsor defined benefit plans. This guidance is effective for annual and interim periods beginning after December 15, 2020. Early adoption is permitted. Management does not expect the adoption of this guidance will materially impact the Company's financial condition, results of operations, or liquidity.
Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract: In August of 2018, the FASB issued guidance to reduce diversity in practice by clarifying when implementation costs are required to be capitalized in a cloud computing arrangement that is a service contract. This guidance is effective for annual and interim periods beginning after December 15, 2019. Early adoption is permitted. Management does not expect the adoption of this guidance will materially impact the Company's financial condition, results of operations, or liquidity.

3. ACQUISITIONS

Northern States Financial Corporation

On June 6, 2018, the Company entered into a definitive agreement to acquire Northern States Financial Corporation, ("Northern States"), the holding company for NorStates Bank, based in Waukegan, Illinois. On October 12, 2018, the Company completed its acquisition of Northern States. At closing, the Company acquired approximately $550 million in total assets, $465 million in deposits, and $305 million in loans. Under the terms of the merger agreement, the final exchange ratio was determined to be 0.0363 shares of Company common stock for each outstanding share of Northern States common stock, excluding shares held in treasury or otherwise owned by the Company or Northern States. The merger consideration totaled approximately $83 million and resulted in the Company issuing approximately 3.3 million shares of Company common stock. The Company expects that NorStates Bank will be merged with and into First Midwest Bank, with associated systems conversions completed, in early December 2018.

Standard Bancshares, Inc.

On January 6, 2017, the Company completed its acquisition of Standard Bancshares, Inc. ("Standard"), the holding company for Standard Bank and Trust Company. Pursuant to the terms of the merger agreement, on January 6, 2017, each outstanding share of Standard common stock was canceled and converted into the right to receive 0.4350 of a share of Company common stock. Based on the closing price of shares of Company common stock of $25.34 on that date, as reported by NASDAQ, the value of the merger consideration per share of Standard common stock was $11.02. Each outstanding Standard stock settled right was redeemed for cash, and each outstanding Standard stock option and each share of Standard phantom stock were canceled and terminated in exchange for the right to receive cash, in each case, pursuant to the terms of the merger agreement. This resulted in an overall transaction value of approximately $580.7 million, which consisted of 21,057,085 shares of Company common stock and $47.1 million in cash. Goodwill of $345.3 million associated with the acquisition was recorded by the Company. All operating systems were converted during the first quarter of 2017. During 2017, the Company finalized the fair value adjustments associated with the Standard transaction.

Premier Asset Management LLC

On February 28, 2017, the Company completed its acquisition of Premier Asset Management LLC ("Premier"), a registered investment advisor based in Chicago, Illinois. At the close of the acquisition, the Company acquired approximately $550.0 million of trust assets under management. During the first quarter of 2018, the Company finalized the fair value adjustments associated with the Premier transaction.

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4. SECURITIES

The significant accounting policies related to securities are presented in Note 1, "Summary of Significant Accounting Policies" to the Consolidated Financial Statements in the Company's 2017 10-K.

A summary of the Company's securities portfolio by category and maturity is presented in the following tables.

Securities Portfolio

(Dollar amounts in thousands)

	As of September 30, 2018				As of December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available-for-Sale								
U.S. treasury securities	$49,434	$ —	$ (325)	$49,109	$46,529	$ —	$ (184)	$46,345
U.S. agency securities	143,765							