FIRST MIDWEST BANCORP INC
Form 10-Q
November 06, 2017

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, 2017

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.)

One Pierce Place, Suite 1500
Itasca, Illinois 60143-1254
(Address of principal executive offices) (zip code)

Registrant's telephone number, including area code: (630) 875-7463

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 November 3, 2017, there were 102,728,899 shares of common stock, $.01 par value, outstanding.

FIRST MIDWEST BANCORP, INC.
FORM 10-Q
TABLE OF CONTENTS

		Page
Part I.	FINANCIAL INFORMATION	
Item 1.	Financial Statements (Unaudited)	
	Consolidated Statements of Financial Condition	3
	Condensed Consolidated Statements of Income	4
	Consolidated Statements of Comprehensive Income	5
	Consolidated Statements of Changes in Stockholders' Equity	6
	Condensed Consolidated Statements of Cash Flows	7
	Notes to the Condensed Consolidated Financial Statements	8
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	46
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	75
Item 4.	Controls and Procedures	76
Part II.	OTHER INFORMATION	
Item 1.	Legal Proceedings	76
Item 1A.	Risk Factors	76
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	77
Item 6.	Exhibits	78

Table of Contents

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

	September 30, 2017	December 31, 2016
Assets	(Unaudited)	
Cash and due from banks	$174,147	$155,055
Interest-bearing deposits in other banks	252,753	107,093
Trading securities, at fair value	20,425	17,920
Securities available-for-sale, at fair value	1,732,984	1,919,450
Securities held-to-maturity, at amortized cost	14,638	22,291
Federal Home Loan Bank ("FHLB") and Federal Reserve Bank ("FRB") stock, at cost	69,708	59,131
Loans	10,390,292	8,254,145
Allowance for loan losses	(94,814)	(86,083)
Net loans	10,295,478	8,168,062
Other real estate owned ("OREO")	19,873	26,083
Premises, furniture, and equipment, net	131,295	82,577
Investment in bank-owned life insurance ("BOLI")	279,639	219,746
Goodwill and other intangible assets	750,436	366,876
Accrued interest receivable and other assets	525,766	278,271
Total assets	$14,267,142	$11,422,555
Liabilities		
Noninterest-bearing deposits	$3,580,922	$2,766,748
Interest-bearing deposits	7,627,575	6,061,855
Total deposits	11,208,497	8,828,603
Borrowed funds	700,536	879,008
Senior and subordinated debt	195,028	194,603
Accrued interest payable and other liabilities	297,951	263,261
Total liabilities	12,402,012	10,165,475
Stockholders' Equity		
Common stock	1,123	913
Additional paid-in capital	1,029,002	498,937
Retained earnings	1,082,921	1,016,674

Accumulated other comprehensive loss, net of tax	(38,036)	(40,910)
Treasury stock, at cost	(209,880)	(218,534)
Total stockholders' equity	1,865,130	1,257,080
Total liabilities and stockholders' equity	$14,267,142	$11,422,555

	September 30, 2017 (Unaudited)		December 31, 2016	
	Preferred Shares	Common Shares	Preferred Shares	Common Shares
Par value	$ —	$ 0.01	$—	$0.01
Shares authorized	1,000	150,000	1,000	150,000
Shares issued	—	112,348	—	91,284
Shares outstanding	—	102,722	—	81,325
Treasury shares	—	9,626	—	9,959

See accompanying unaudited notes to the condensed consolidated financial statements.

Table of Contents

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,	
	2017	2016	2017	2016
Interest Income				
Loans	$118,101	$87,505	$345,286	$252,486
Investment securities	10,667	9,629	31,678	27,550
Other short-term investments	1,148	772	3,167	1,968
Total interest income	129,916	97,906	380,131	282,004
Interest Expense				
Deposits	4,369	2,520	11,307	7,387
Borrowed funds	2,544	1,782	6,837	4,597
Senior and subordinated debt	3,110	2,632	9,314	8,353
Total interest expense	10,023	6,934	27,458	20,337
Net interest income	119,893	90,972	352,673	261,667
Provision for loan losses	10,109	9,998	23,266	25,676
Net interest income after provision for loan losses	109,784	80,974	329,407	235,991
Noninterest Income				
Service charges on deposit accounts	12,561	10,708	36,079	30,350
Wealth management fees	10,169	8,495	30,354	24,696
Card-based fees	5,992	7,332	22,940	21,642
Capital market products income	2,592	2,916	6,185	8,197
Mortgage banking income	2,246	3,394	5,779	6,625
Other service charges, commissions, and fees	4,745	5,621	16,043	16,484
Net gain on sale-leaseback transaction	—	5,509	—	5,509
Net securities gains	3,197	187	3,481	1,097
Other income	1,846	1,691	7,383	5,001
Total noninterest income	43,348	45,853	128,244	119,601
Noninterest Expense				
Salaries and employee benefits	55,638	46,372	165,985	137,233
Net occupancy and equipment expense	12,115	10,755	36,925	30,380
Professional services	8,498	6,772	26,073	17,984
Technology and related costs	4,505	3,881	13,423	11,251
Net OREO expense	657	313	3,988	2,099
Other expenses	15,393	13,623	47,066	41,074
Acquisition and integration related expenses	384	1,172	20,123	6,810
Total noninterest expense	97,190	82,888	313,583	246,831
Income before income tax expense	55,942	43,939	144,068	108,761
Income tax expense	17,707	15,537	48,028	37,130
Net income	$38,235	$28,402	$96,040	$71,631
Per Common Share Data				
Basic earnings per common share	$0.37	$0.35	$0.94	$0.89

Diluted earnings per common share	$0.37	$0.35	$0.94	$0.89
Dividends declared per common share	$0.10	$0.09	$0.29	$0.27
Weighted-average common shares outstanding	101,752	80,396	101,307	79,589
Weighted-average diluted common shares outstanding	101,772	80,409	101,327	79,602

See accompanying unaudited notes to the condensed consolidated financial statements.

Table of Contents

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

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income	$38,235	$28,402	$96,040	$71,631
Securities Available-for-Sale				
Unrealized holding gains (losses):				
Before tax	428	(6,695)	11,078	21,671
Tax effect	(174)	2,676	(4,436)	(8,665)
Net of tax	254	(4,019)	6,642	13,006
Reclassification of net gains included in net income:				
Before tax	3,197	187	3,481	1,097
Tax effect	(1,311)	(75)	(1,425)	(439)
Net of tax	1,886	112	2,056	658
Net unrealized holding (losses) gains	(1,632)	(4,131)	4,586	12,348
Derivative Instruments				
Unrealized holding gains (losses):				
Before tax	276	(779)	(2,849)	4,420
Tax effect	(113)	311	1,137	(1,781)
Net of tax	163	(468)	(1,712)	2,639
Total other comprehensive (loss) income	(1,469)	(4,599)	2,874	14,987
Total comprehensive income	$36,766	$23,803	$98,914	$86,618

	Accumulated Unrealized Gain (Loss) on Securities Available-for-Sale	Accumulated Unrealized Gain (Loss) on Derivative Instruments	Unrecognized Net Pension Costs	Total Accumulated Other Comprehensive Loss
Balance at December 31, 2015	$ (10,271)	$ (2,468)	$ (15,650)	$ (28,389)
Other comprehensive income	12,348	2,639	—	14,987
Balance at September 30, 2016	$ 2,077	$ 171	$ (15,650)	$ (13,402)
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)

See accompanying unaudited notes to the condensed consolidated financial statements.

Table of Contents

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, 2015	77,952	$ 882	$446,672	$953,516	$ (28,389)	$(226,413)	$1,146,268
Net income	—	—	—	71,631	—	—	71,631
Other comprehensive income	—	—	—	—	14,987	—	14,987
Common dividends declared ($0.27 per common share)	—	—	—	(21,876)	—	—	(21,876)
Acquisition, net of issuance costs	3,042	31	54,865	—	—	—	54,896
Common stock issued	10	—	169	—	—	—	169
Restricted stock activity	326	—	(10,610)	—	—	8,062	(2,548)
Treasury stock issued to benefit plans	(6)	—	(21)	—	—	(85)	(106)
Share-based compensation expense	—	—	5,843	—	—	—	5,843
Balance at September 30, 2016	81,324	$ 913	$496,918	$1,003,271	$ (13,402)	$(218,436)	$1,269,264
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

See accompanying unaudited notes to the condensed consolidated financial statements.

Table of Contents

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

	Nine Months Ended September 30,	
	2017	2016
Net cash (used in) provided by operating activities	$(50,073)	$104,626
Investing Activities		
Proceeds from maturities, repayments, and calls of securities available-for-sale	251,160	263,243
Proceeds from sales of securities available-for-sale	437,401	42,794
Purchases of securities available-for-sale	(289,244)	(824,883)
Proceeds from maturities, repayments, and calls of securities held-to-maturity	7,663	4,695
Purchases of securities held-to-maturity	(10)	(16)
Net purchases of FHLB stock	(7,330)	(12,651)
Net increase in loans	(392,384)	(630,012)
Premiums paid on BOLI, net of proceeds from claims	132	1,597
Proceeds from sales of OREO	17,460	6,069
Proceeds from sales of premises, furniture, and equipment	13,135	150,747
Purchases of premises, furniture, and equipment	(11,680)	(12,320)
Net cash received from acquisitions	41,717	57,347
Net cash provided by (used in) investing activities	68,020	(953,390)
Financing Activities		
Net increase in deposit accounts	356,020	413,445
Net (decrease) increase in borrowed funds	(178,472)	472,027
Net proceeds from the issuance of subordinated notes	—	146,484
Payments for the maturity of subordinated debt	—	(38,500)
Cash dividends paid	(26,852)	(21,885)
Restricted stock activity	(3,891)	(2,318)
Net cash provided by financing activities	146,805	969,253
Net increase in cash and cash equivalents	164,752	120,489
Cash and cash equivalents at beginning of period	262,148	381,202
Cash and cash equivalents at end of period	$426,900	$501,691
Supplemental Disclosures of Cash Flow Information:		
Income taxes paid	$14,310	$14,645
Interest paid to depositors and creditors	27,538	17,656
Dividends declared, but unpaid	10,184	7,241
Stock issued for acquisitions, net of issuance costs	534,090	54,896
Non-cash transfers of loans to OREO	3,770	3,894
Non-cash transfers of loans held-for-investment to loans held-for-sale	42,970	77,030

See accompanying unaudited notes to the condensed consolidated financial statements.

Table of Contents

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, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017.
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 2016 Annual Report on Form 10-K ("2016 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 2016 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

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.

Table of Contents

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

Table of Contents

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 and quarterly thereafter, 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. 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.

Ineffectiveness is calculated based on the change in fair value of the hedged item compared with the change in fair value of the hedging instrument. For all types of hedges, any ineffectiveness in the hedging relationship is recognized in earnings during the period the ineffectiveness occurs.

Table of Contents

2. RECENT ACCOUNTING PRONOUNCEMENTS
Adopted Accounting Pronouncements
Contingent Put and Call Options in Debt Instruments: In March of 2016, the Financial Accounting Standards Board ("FASB") issued final guidance clarifying the requirements for assessing whether contingent call (put) options that can accelerate the payment of principal on debt instruments are clearly and closely related to their debt hosts. Entities are required to apply the guidance to existing debt instruments (or hybrid financial instruments that are determined to have a debt host) using a modified retrospective transition method as of the period of adoption. The adoption of this guidance on January 1, 2017 did not impact the Company's financial condition, results of operations, or liquidity.
Equity Method Accounting: In March of 2016, the FASB issued final guidance to simplify the equity method of accounting. The guidance eliminates the requirement to retrospectively apply equity method accounting in previous periods when an investor initially obtains significant influence over an investee. This guidance is effective for annual and interim periods beginning after December 15, 2016. The adoption of this guidance on January 1, 2017 did not impact the Company's financial condition, results of operations, or liquidity.
Accounting for Employee Share-based Payments: In March of 2016, the FASB issued guidance to simplify the accounting for employee share-based payment transactions. The guidance requires entities to recognize the income tax effects of awards in the income statement when the awards vest or are settled. In addition, the guidance allows entities to repurchase more of an employee's shares than it can under current guidance for tax withholding purposes without triggering liability accounting and to make a policy election to account for forfeitures as they occur. The adoption of this guidance on January 1, 2017 resulted in a $638,000 tax benefit to the provision for income tax expense for the nine months ended September 30, 2017, recorded in the Company's results of operations. The Company elected to estimate forfeitures, which is consistent with the Company's practice before the adoption of this guidance.
Accounting Pronouncements Pending Adoption
Revenue from Contracts with Customers: In May of 2014, the 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 was initially effective for annual and interim reporting periods beginning on or after December 15, 2016 but was deferred to December 15, 2017, and must be applied either retrospectively or using the modified retrospective approach. Early adoption is permitted, but not before the original effective date.
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. Based upon the Company's initial assessment, this guidance is expected to affect how the Company currently presents certain contract costs on a gross basis versus a net basis against the related noninterest income and will result in the expansion of the qualitative disclosures regarding noninterest income. The Company will adopt this guidance on January 1, 2018 using the modified retrospective approach and does not expect the changes in presentation of certain contract costs or the expanded disclosures to have a significant impact on the Company's financial condition, results of operations, or liquidity. The Company is in the process of completing its review of contracts to validate this initial assessment.
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 changes in fair value will be recognized in net income unless the investments qualify for a new practicability exception. 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. This guidance is

effective for annual and interim periods beginning after December 15, 2017. 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.

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.

Table of Contents

During 2016, First Midwest Bank (the "Bank") entered into a sale-leaseback transaction that resulted in a deferred gain of $82.5 million, with $76.1 million remaining as of September 30, 2017. Upon adoption of this guidance, the remaining deferred gain 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." Management is evaluating the new guidance and the additional impact to the Company's financial condition, results of operations, or liquidity.
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 new guidance and the impact to the Company's financial condition, results of operations, and 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. This guidance is effective for annual and interim reporting periods beginning on or after December 15, 2017. Early adoption is permitted. Management does not expect the adoption of this guidance will materially impact the Company's Consolidated Statement of Cash Flows.
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. This guidance is effective for annual and interim periods beginning after December 15, 2017. 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.
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. This guidance is effective for annual and interim periods beginning after December 15, 2017. 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.
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.
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 will present the service cost component of 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 will be presented separately from the line item(s) that includes the service cost. This guidance is effective for annual and interim periods beginning after December 15, 2017. 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.

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.

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. This guidance is effective for annual and interim periods beginning after December 15, 2017. 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.

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. Management is evaluating

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Table of Contents

the new guidance, but does not expect the adoption of this guidance will materially impact the Company's financial condition, results of operations, or liquidity.

3. ACQUISITIONS

Completed Acquisitions

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 was 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 $339.2 million associated with the acquisition was recorded by the Company. All operating systems were converted during the first quarter of 2017.

During the third quarter of 2017, the Company updated the fair value adjustments associated with the Standard transaction. The adjustments were recognized in the current period in accordance with accounting guidance applicable to business combinations. The fair value adjustments, including goodwill, associated with this transaction remain preliminary and may change as the Company continues to finalize the fair value of the assets and liabilities acquired.

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. The fair value adjustments, including goodwill, associated with this transaction remain preliminary and may change as the Company continues to finalize the fair value of the assets and liabilities acquired.

NI Bancshares Corporation

On March 8, 2016, the Company completed its acquisition of NI Bancshares Corporation ("NI Bancshares"), the holding company for The National Bank & Trust Company of Sycamore, which included ten banking offices in northern Illinois and over $700.0 million in trust assets under management. The merger consideration was a combination of Company common stock and cash, at a purchase price of $70.1 million. Goodwill of $22.2 million associated with the acquisition was recorded by the Company. The fair value adjustments associated with this transaction were finalized during the first quarter of 2017.

Table of Contents

The following table presents the assets acquired and liabilities assumed, net of the fair value adjustments, in the Standard and NI Bancshares transactions as of the acquisition date. The assets acquired and liabilities assumed, both intangible and tangible, were recorded at their estimated fair values as of the acquisition date and have been accounted for under the acquisition method of accounting.

Acquisition Activity
(Amounts in thousands, except share and per share data)

	Standard	NI Bancshares
	January 6, 2017	March 8, 2016
Assets		
Cash and due from banks and interest-bearing deposits in other banks	$102,149	$ 72,533
Securities available-for-sale	214,107	125,843
Securities held-to-maturity	—	1,864
FHLB and FRB stock	3,247	1,549
Loans	1,769,655	396,181
OREO	8,424	2,863
Investment in BOLI	55,629	8,384
Goodwill	339,207	22,174
Other intangible assets	31,072	10,408
Premises, furniture, and equipment	60,286	19,636
Accrued interest receivable and other assets	56,003	16,453
Total assets	$2,639,779	$ 677,888
Liabilities		
Noninterest-bearing deposits	$675,354	$ 130,909
Interest-bearing deposits	1,348,520	464,012
Total deposits	2,023,874	594,921
Borrowed funds	—	2,416
Intangible liabilities	—	230
Accrued interest payable and other liabilities	35,190	10,239
Total liabilities	2,059,064	607,806
Consideration Paid		
Common stock (2017 - 21,057,085 shares issued at $25.34 per share, 2016 - 3,042,494 shares issued at $18.059 per share), net of issuance costs	533,590	54,896
Cash paid	47,125	15,186
Total consideration paid	580,715	70,082
	$2,639,779	$ 677,888

Expenses related to the acquisition and integration of the transactions above totaled $384,000 and $20.1 million during the quarter and nine months ended September 30, 2017, respectively, and are reported as a separate component within noninterest expense in the Condensed Consolidated Statements of Income. Expenses related to the acquisition and integration of the transactions above totaled $1.2 million and $6.8 million during the quarter and nine months ended September 30, 2016, respectively. The acquisition of Standard was considered material to the Company's financial statements; therefore, pro forma financial data and related disclosures are included in the following tables.

Table of Contents

The unaudited pro forma combined results of operations for the quarters and nine months ended September 30, 2017 and 2016 are presented as if the Standard acquisition had occurred on January 1, 2016, the first day of the Company's 2016 fiscal year. The unaudited pro forma combined results of operations are presented for illustrative purposes only and do not necessarily indicate the financial results of the combined companies had the companies actually been combined at the beginning of the period presented. Fair value adjustments included in the following table are preliminary and may be revised. The unaudited pro forma combined results of operations also do not consider any potential impacts of potential revenue enhancements, anticipated cost savings and expense efficiencies, or asset dispositions, among other factors. Acquisition and integration related expenses directly attributable to the Standard acquisition have been excluded from the following table and are estimated to total $27.0 million, of which $384,000 and $19.1 million was expensed during the quarter and nine months ended September 30, 2017, respectively.

Unaudited Pro Forma Combined Results of Operations
(Dollar amounts in thousands)

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Total revenues [1]	$163,241	$164,786	$482,526	$462,962
Net income	38,462	32,589	106,848	85,054

(1) Includes net interest income and total noninterest income.

Acquired loans are recorded at fair value, which incorporates credit risk, at the date of acquisition. No allowance for credit losses is recorded on the acquisition date. Acquired loans are separated into (i) non-PCI and (ii) 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. PCI loans are accounted for based on estimates of expected future cash flows. 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. For additional discussion regarding significant accounting policies on acquired loans see Note 1, "Summary of Significant Accounting Policies."

The following table presents additional detail for loans acquired in the Standard transaction at the acquisition date.

Standard Acquired Loans
(Dollar amounts in thousands)

	January 6, 2017	
	PCI Loans	Non-PCI Loans
Fair value	$126,469	$1,643,186
Contractually required principal and interest payments	211,931	1,937,060
Best estimate of contractual cash flows not expected to be collected [1]	57,783	100,762
Best estimate of contractual cash flows expected to be collected	154,148	1,836,298

(1) Includes interest payments not expected to be collected due to loan prepayments as well as principal and interest payments not expected to be collected due to customer default.

Table of Contents

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 2016 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, 2017				As of December 31, 2016			
	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	$42,567	$14	$(77)	$42,504	$48,581	$26	$(66)	$48,541
U.S. agency securities	154,666	303	(362)	154,607	183,528	519	(410)	183,637
Collateralized mortgage obligations ("CMOs")	949,762	459	(12,999)	937,222	1,064,130	969	(17,653)	1,047,446
Other mortgage-backed securities ("MBSs")	358,746	307	(3,580)	355,473	337,139	1,395	(5,879)	332,655
Municipal securities	204,571	1,294	(841)	205,024	273,319	1,245	(3,718)	270,846
Trust-preferred collateralized debt obligations ("CDOs")	45,851	275	(15,300)	30,826	47,681	261	(14,682)	33,260
Equity securities	7,358	185	(215)	7,328	3,206	147	(288)	3,065
Total securities available-for-sale	$1,763,521	$2,837	$(33,374)	$1,732,984	$1,957,584	$4,562	$(42,696)	$1,919,450
Securities Held-to-Maturity								
Municipal securities	$14,638	$—	$(1,717)	$12,921	$22,291	$—	$(4,079)	$18,212
Trading Securities				$20,425				$17,920

Remaining Contractual Maturity of Securities
(Dollar amounts in thousands)

	As of September 30, 2017			
	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
One year or less	$97,905	$94,691	$1,947	$1,718
After one year to five years	303,899	293,924	6,065	5,354
After five years to ten years	—	—	2,243	1,980
After ten years	45,851	44,346	4,383	3,869
Securities that do not have a single contractual maturity date	1,315,866	1,300,023	—	—
Total	$1,763,521	$1,732,984	$14,638	$12,921

The carrying value of securities available-for-sale that were pledged to secure deposits or for other purposes as permitted or required by law totaled $1.3 billion for September 30, 2017 and $1.1 billion for December 31, 2016. No securities held-to-maturity were pledged as of September 30, 2017 or December 31, 2016.

Table of Contents

During the quarters and nine months ended September 30, 2017 and 2016 there were no material gross trading gains (losses). The following table presents net realized gains on securities available-for-sale for the quarters and nine months ended September 30, 2017 and 2016.

Securities Available-for-Sale Gains
(Dollar amounts in thousands)

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Gains on sales of securities:				
Gross realized gains	$3,197	$187	$3,481	$1,266
Gross realized losses	—	—	—	(169)
Net realized gains on sales of securities	3,197	187	3,481	1,097
Non-cash impairment charges:				
Other-than-temporary securities impairment ("OTTI")	—	—	—	