

# META FINANCIAL GROUP INC

## FORM 10-Q (Quarterly Report)

Filed 8/13/1998 For Period Ending 6/30/1998

Address	121 EAST FIFTH STREET P O BOX 1307 STORM LAKE, Iowa 50588
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Industry	S&Ls/Savings Banks
Sector	Financial
Fiscal Year	09/30

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended June 30, 1998

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

For the transaction period from \_\_\_\_\_ to \_\_\_\_\_

*Commission File Number: 0-22140*

**FIRST MIDWEST FINANCIAL, INC.**

(Exact name of small business issuer as specified in its charter)

Delaware

42-1406262

-----  
(State or other jurisdiction of  
incorporation or organization)

-----  
(IRS Employer Identification No.)

Fifth at Erie, Storm Lake, Iowa 50588

(Address of principal executive offices)

(712) 732-4117

(Issuer's telephone number, including area code)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class: Outstanding at June 30, 1998:

Common Stock, \$.01 par value 2,614,471 Common Shares

Transitional Small Business Disclosure Format: Yes ☐ No ☒

**FIRST MIDWEST FINANCIAL, INC.**

**FORM 10-Q**

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# Part I. Financial Information

## Item 1. Financial Statements

### FIRST MIDWEST FINANCIAL, INC. AND SUBSIDIARIES Consolidated Balance Sheets (Unaudited)

	June 30, 1998	September 30, 1997
	-----	-----
<b>Assets</b>		
Cash and cash equivalents .....	\$ 10,617,964	\$ 12,852,426
Interest-bearing deposits in other financial institutions - (cost approximates market value) .....	100,000	200,000
Securities available for sale, amortized cost of \$131,430,715 and \$114,456,661 .....	132,947,454	115,985,045
Loans receivable - net of allowances of \$3,098,995 and \$2,379,091 .....	257,196,682	254,640,971
Foreclosed assets, net of allowances of \$350,000 and \$0 .....	1,099,582	156,300
Accrued interest receivable .....	5,116,844	5,366,109
Federal Home Loan Bank stock, at cost .....	5,171,000	5,629,300
Premises and equipment, net .....	4,064,098	4,176,311
Excess of cost over net assets acquired .....	4,589,048	4,862,747
Other assets .....	355,762	719,369
	-----	-----
Total Assets .....	\$ 421,258,434	\$ 404,588,578
	=====	=====
<b>Liabilities and Shareholders' Equity</b>		
<b>Liabilities</b>		
Deposits .....	\$ 269,493,349	\$ 246,115,698
Advances from Federal Home Loan Bank .....	100,116,835	107,426,225
Securities sold under agreements to repurchase .....	3,618,334	1,800,000
Other borrowings .....	2,000,000	2,900,000
Advances from borrowers for taxes and insurance .....	555,801	449,487
Accrued interest payable .....	895,625	1,065,746
Other liabilities .....	1,692,315	1,354,418
	-----	-----
Total Liabilities .....	378,372,259	361,111,574
	-----	-----
<b>Shareholders' Equity</b>		
Preferred stock, 800,000 shares authorized, no shares issued or outstanding .....	--	--
Common stock, \$.01 par value, 5,200,000 shares authorized, 2,957,999 shares issued and 2,614,471 shares outstanding at June 30, 1998; 2,957,999 shares issued and 2,698,904 shares outstanding at September 30, 1997 .....	29,580	29,580
Additional paid-in capital .....	21,227,569	20,984,754
Retained earnings - substantially restricted .....	27,397,904	26,427,657
Net unrealized appreciation on securities available for sale, net of tax of \$576,194 and \$568,013 .....	940,545	960,371
Unearned Employee Stock Ownership Plan shares .....	(417,150)	(567,200)
Treasury stock, 343,528 and 259,095 common shares, at cost ..	(6,292,273)	(4,358,158)
	-----	-----
Total Shareholders' Equity .....	42,886,175	43,477,004
	-----	-----
Total Liabilities and Shareholders' Equity .....	\$ 421,258,434	\$ 404,588,578
	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

FIRST MIDWEST FINANCIAL, INC.  
AND SUBSIDIARIES  
Consolidated Statements of Income (Unaudited)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	1998	1997	1998	1997
Interest and Dividend Income:				
Loans receivable .....	\$5,659,259	\$5,709,833	\$17,111,276	\$16,659,797
Securities available for sale .....	2,250,501	1,525,251	6,346,976	4,570,744
Dividends on Federal Home Loan Bank stock .....	86,531	96,417	272,554	288,985
Total interest and dividend income .....	7,996,291	7,331,501	23,730,806	21,519,526
Interest Expense:				
Deposits .....	3,389,794	3,056,035	9,878,382	8,884,273
Other borrowings .....	1,425,525	1,300,332	4,272,347	3,734,872
Total interest expense .....	4,815,319	4,356,367	14,150,729	12,619,145
Net interest income .....	3,180,972	2,975,134	9,580,077	8,900,381
Provision for loan losses .....	55,000	30,000	1,435,000	90,000
Net interest income after provision for loan losses ...	3,125,972	2,945,134	8,145,077	8,810,381
Non-interest income:				
Loan fees and deposit service charges .....	372,388	275,600	981,693	840,931
Gain on sales of securities available for sale, net .....	85,518	91,340	308,443	91,340
Brokerage commissions from subsidiary .....	9,315	20,693	53,383	58,061
Other .....	60,397	39,630	133,575	228,017
Total non-interest income .....	527,618	427,263	1,477,094	1,218,349
Non-interest expense:				
Compensation and benefits .....	1,233,784	1,104,391	3,538,821	3,173,940
Occupancy and equipment .....	292,478	240,224	857,080	741,564
Federal deposit insurance .....	32,443	51,233	106,533	184,655
Data processing .....	79,387	80,594	252,137	240,508
Provision for loss on foreclosed real estate .....	150,000	--	350,000	--
Other .....	388,639	368,794	1,174,474	1,147,704
Total non-interest expense .....	2,176,731	1,845,236	6,279,045	5,488,371
Income before income taxes .....	1,476,859	1,527,161	3,343,126	4,540,359
Income tax expense .....	583,803	614,657	1,414,699	1,825,099
Net income .....	\$ 893,056	\$ 912,504	\$ 1,928,427	\$ 2,715,260
Earnings Per Share (see Note 2):				
Basic .....	\$ .35	\$ .34	\$ .74	\$ .99
Diluted .....	\$ .33	\$ .33	\$ .70	\$ .94

The accompanying notes are an integral part of these consolidated financial statements.

FIRST MIDWEST FINANCIAL, INC.  
AND SUBSIDIARIES  
Consolidated Statement of Changes in Shareholders' Equity (Unaudited)  
For the Nine Months Ended June 30, 1998

	Common Stock -----	Additional Paid-In Capital -----	Retained Earnings -----	Net Unrealized Appreciation on Securities Available for Sale, Net of Tax -----	Unearned Employee Stock Ownership Plan Shares -----	Treasury Stock -----	Total Shareholders' Equity -----
Balance at September 30, 1997 .....	\$29,580	\$ 20,984,754	\$ 26,427,657	\$ 960,371	\$(567,200)	\$(4,358,158)	\$ 43,477,004
22,500 common shares committed to be released under the ESOP .....	--	351,954	--	--	150,050	--	502,004
Cash dividends declared on common stock - \$0.36 per share .....	--	--	(958,180)	--	--	--	(958,180)
Net change in unrealized appreciation on securities available for sale, net of tax of \$8,181 .....	--	--	--	(19,826)	--	--	(19,826)
Purchase of 91,000 common shares of treasury stock.....	--	--	--	--	--	(2,071,950)	(2,071,950)
Exchange of 1,033 common shares upon exercise of stock options .....	--	--	--	--	--	(21,972)	(21,972)
Issuance of 7,600 common shares from treasury stock due to exercise of stock options .....	--	(109,139)	--	--	--	159,807	50,668
Net income for the nine months ended June 30, 1998 .....	--	--	1,928,427	--	--	--	1,928,427
	-----	-----	-----	-----	-----	-----	-----
Balance at June 30, 1998 .....	\$29,580	\$ 21,227,569	\$ 27,397,904	\$ 940,545	\$(417,150)	\$(6,292,273)	\$ 42,886,175
	=====	=====	=====	=====	=====	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

FIRST MIDWEST FINANCIAL, INC.  
AND SUBSIDIARIES  
Consolidated Statements of Cash Flows (Unaudited)

	Nine Months Ended June 30, 1998	1997
	-----	-----
Cash flows from operating activities:		
Net income .....	\$ 1,928,427	\$ 2,715,260
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation, amortization and accretion, net .....	1,039,637	864,167
Provision for loan losses .....	1,435,000	90,000
Provision for loss on foreclosed real estate .....	350,000	--
Gain on sales of securities available for sale, net .....	(308,443)	(91,340)
Gain on sales of office property, net .....	--	3,034
Loss on sales of real estate owned, net .....	9,899	--
Net change in accrued interest receivable .....	249,266	355,310
Net change in other assets .....	363,608	54,755
Net change in accrued interest payable .....	(170,120)	(386,819)
Net change in accrued expenses and other liabilities .....	329,716	(1,028,980)
	-----	-----
Net cash from operating activities .....	5,226,990	2,575,387
	-----	-----
Cash flows from investing activities:		
Purchase of securities available for sale .....	(47,132,678)	(27,189,098)
Purchase of mortgage-backed securities available for sale .....	(30,260,583)	--
Purchase of Federal Home Loan Bank stock .....	(112,900)	--
Proceeds from redemption of Federal Home Loan Bank stock .....	571,200	--
Proceeds from sales of securities available for sale .....	10,370,099	318,580
Proceeds from sales of mortgage-backed securities available for sale .....	6,319,853	--
Proceeds from maturities of securities available for sale .....	32,950,000	45,527,724
Proceeds from maturities of interest-bearing deposits in other financial institutions .....	100,000	--
Proceeds from principal repayment of mortgage-backed securities .....	11,053,292	5,664,622
Net change in loans receivable .....	15,614,151	6,889,213
Loans purchased .....	(21,142,296)	(20,381,672)
Proceeds from sales of foreclosed assets .....	284,116	79,488
Purchase of premises and equipment, net .....	(167,179)	(830,767)
	-----	-----
Net cash from investing activities .....	(21,552,925)	10,078,090
	-----	-----

FIRST MIDWEST FINANCIAL, INC.  
AND SUBSIDIARIES  
Consolidated Statements of Cash Flows (Unaudited)

	Nine Months Ended June 30, 1998	1997
	-----	-----
Cash flows from financing activities:		
Net change in non-interest bearing demand, savings, NOW and money market demand accounts .....	6,784,762	179,376
Net change in other time deposits .....	16,592,889	6,465,405
Proceeds from advances from Federal Home Loan Bank .....	105,750,000	97,000,000
Payments of advances from Federal Home Loan Bank .....	(113,059,390)	(115,858,585)
Net change in securities sold under agreements to repurchase .....	1,818,334	(879,918)
Net change in other borrowings .....	(900,000)	1,500,000
Net change in advances from borrowers for taxes and insurance .....	106,314	63,134
Cash dividends paid .....	(958,181)	(773,110)
Proceeds from exercise of stock options .....	28,695	335,992
Purchase of treasury stock .....	(2,071,950)	(3,602,623)
	-----	-----
Net cash from financing activities .....	14,091,473	(15,570,329)
	-----	-----
Net change in cash and cash equivalents .....	(2,234,462)	(2,916,852)
Cash and cash equivalents at beginning of period .....	12,852,426	14,328,652
	-----	-----
Cash and cash equivalents at end of period .....	\$ 10,617,964	\$ 11,411,800
	=====	=====
Supplemental disclosure of non-cash investing and financing activities:		
Loans transferred to foreclosed assets .....	\$ 1,571,930	--

The accompanying notes are an integral part of these consolidated financial statements.



**FIRST MIDWEST FINANCIAL, INC.  
AND SUBSIDIARIES**

Notes to consolidated Financial Statements (Unaudited)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting policies followed by First Midwest Financial, Inc. ("First Midwest" or the "Company") and its consolidated subsidiaries, First Federal Savings Bank of the Midwest ("First Federal"), Security State Bank ("Security"), First Services Financial Limited and Brookings Service Corporation, for interim reporting are consistent with the accounting policies followed for annual financial reporting. All adjustments that, in the opinion of management, are necessary for a fair presentation of the results for the periods reported have been included in the accompanying unaudited consolidated financial statements, and all such adjustments are of a normal recurring nature. The accompanying financial statements do not purport to contain all the necessary financial disclosures required by generally accepted accounting principles that might otherwise be necessary in the circumstances and should be read in conjunction with the Company's consolidated financial statements, and notes thereto, for the year ended September 30, 1997.

**2. EARNINGS PER SHARE**

Basic and diluted earnings per share are computed under a new accounting standard, which was effective in the quarter ended December 31, 1997. All prior amounts have been restated to be comparable. Basic earnings per share is based on net income divided by the weighted average number of shares outstanding during the period. Diluted earnings per share shows the dilutive effect of additional common shares issuable under stock options.

A reconciliation of the numerators and denominators of the basic earnings per common share and earnings per common share assuming dilution computations for the three months and nine months ended June 30, 1998 and 1997 is presented below.

	Three Months Ended June 30,		Nine Months Ended June 30,	
	1998	1997	1998	1997
Basic Earnings Per Share:				
Numerator:				
Net Income .....	\$ 893,056	\$ 912,504	\$ 1,928,427	\$2,715,260
	=====	=====	=====	=====
Denominator:				
Weighted average common shares outstanding .....	2,567,627	2,670,398	2,589,865	2,748,158
	=====	=====	=====	=====
Basic Earnings Per Share .....	\$ 0.35	\$ 0.34	\$ 0.74	\$ 0.99
	=====	=====	=====	=====

	Three Months Ended June 30,		Nine Months Ended June 30,	
	1998	1997	1998	1997
Earnings Per Share Assuming Dilution:				
Numerator:				
Net Income .....	\$ 893,056	\$ 912,504	\$1,928,427	\$2,715,260
	=====	=====	=====	=====
Denominator:				
Weighted average common shares outstanding .....	2,567,627	2,670,398	2,589,865	2,748,158
Dilutive effects of assumed exercises of stock options .....	179,131	126,035	171,846	127,019
	-----	-----	-----	-----
Weighted average common and dilutive potential common shares outstanding .....	2,746,758	2,796,433	2,761,711	2,875,177
	=====	=====	=====	=====
Earnings Per Share Assuming Dilution .....	\$ 0.33	\$ 0.33	\$ 0.70	\$ 0.94
	=====	=====	=====	=====

On November 25, 1996, the Company declared a 50% stock dividend payable on January 2, 1997 to stockholders of record December 16, 1996. The stock dividend is reflected in the balance sheet, and dividend and earnings per share data has been restated for all prior reported periods.

### 3. COMMITMENTS

At June 30, 1998 and September 30, 1997, the Company had outstanding commitments to originate and purchase loans totaling \$21.7 million and \$15.8 million, respectively, excluding undisbursed portions of loans in process. It is expected that outstanding loan commitments will be funded with existing liquid assets.

## Part I. Financial Information

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

#### **FIRST MIDWEST FINANCIAL, INC. AND SUBSIDIARIES**

##### **GENERAL**

First Midwest Financial, Inc. ("First Midwest" or the "Company") is a bank holding company whose primary assets are First Federal Savings Bank of the Midwest ("First Federal") and Security State Bank ("Security"). The Company was incorporated in 1993 as a unitary non-diversified savings and loan holding company and, on September 20, 1993, acquired all of the capital stock of First Federal in connection with First Federal's conversion from mutual to stock form of ownership. On September 30, 1996, the Company became a bank holding company in conjunction with the acquisition of Security.

The following discussion focuses on the consolidated financial condition of the Company and its subsidiaries, at June 30, 1998, compared to September 30, 1997, and the consolidated results of operations for the three months and nine months ended June 30, 1998, compared to the same periods in 1997. This discussion should be read in conjunction with the Company's consolidated financial statements, and notes thereto, for the year ended September 30, 1997.

##### **FINANCIAL CONDITION**

Total assets increased by \$16.7 million, or 4.1%, from \$404.6 million at September 30, 1997, to \$421.3 million at June 30, 1998. The increase is primarily attributable to an increase in the Company's balance of securities available for sale.

Cash and cash equivalents decreased \$2.3 million, or 17.4%, to \$10.6 million at June 30, 1998, from \$12.8 million at September 30, 1997. The decrease was due primarily to the use of liquid funds to fund loan commitments during the period.

The portfolio of securities available for sale increased \$16.9 million, or 14.6%, to \$132.9 million at June 30, 1998, from \$116.0 million at September 30, 1997. The increase is the result of securities purchased during the period in an amount greater than sales, maturities and principal repayments received on securities. Securities purchased during the period consist primarily of fixed-rate mortgage-backed securities and adjustable-rate trust preferred securities.

The portfolio of net loans receivable increased by \$2.6 million, or 1.0%, to \$257.2 million at June 30, 1998, from \$254.6 million at September 30, 1997. The increase in loan receivables was due to increases in the origination and purchase of commercial real estate and business loans during the period. The increase was partially offset by repayments received on residential real estate loans and the transfer of loans to foreclosed real estate.

Deposit balances increased by \$23.4 million, or 9.5%, to \$269.5 million at June 30, 1998, from \$246.1 million at September 30, 1997. The increase in deposit balances resulted from increases in all areas of retail deposits, including checking accounts, money market and savings accounts and certificates of

deposit, which increased \$1.3 million, \$5.5 million and \$16.6 million, respectively, between the comparable periods. A significant portion of the deposit growth resulted from the Company's continued emphasis on enhancement of its retail customer base in the Des Moines, Iowa market area.

The balance in advances from the Federal Home Loan Bank of Des Moines (FHLB) decreased by \$7.3 million, or 6.8%, to \$100.1 million at June 30, 1998 from \$107.4 million at September 30, 1997. The decrease in FHLB advances reflects the repayment of borrowings from the proceeds of loan repayments and from funds received as a result of deposit growth.

Other borrowings, consisting of short-term borrowings from the Federal Reserve Bank, decreased \$900,000, or 31.0%, to \$2.0 million at June 30, 1998 from \$2.9 million at September 30, 1997. The reduction was due to repayment on these short-term borrowings used primarily to fund seasonal loans to agricultural customers.

Total shareholders' equity decreased \$591,000, or 1.4%, to \$42.9 million at June 30, 1998 from \$43.5 million at September 30, 1997. The decrease in shareholder's equity was due to the purchase of treasury stock and the payment of cash dividends to shareholders in amounts that exceeded earnings during the period.

## NON-PERFORMING ASSETS AND ALLOWANCE FOR LOAN LOSSES

Generally, when a loan becomes delinquent 90 days or more, or when the collection of principal or interest becomes doubtful, the Company will place the loan on non-accrual status and, as a result of this action, previously accrued interest income on the loan is taken out of current income. The loan will remain on non-accrual status until the loan has been brought current, or until other circumstances occur that provide adequate assurance of full repayment of interest and principal.

The following table sets forth the Company's loan delinquencies by type, before allowance for loan losses, by amount and by percentage of type at June 30, 1998. At June 30, 1998, loans delinquent 30 days and over totaled 8.18% of total loans compared to 6.14% at September 30, 1997.

	Loans Delinquent For:								
	30-59 Days			60-89 Days			90 Days and Over		
	Number	Amount	Percent of Category	Number	Amount	Percent of Category	Number	Amount	Percent of Category
	(Dollars in Thousands)								
Real Estate:									
One-to-four family .....	69	\$ 2,718	3.59%	20	\$ 720	0.97%	11	\$ 522	0.71%
Commercial and multi-family	8	6,137	6.31	4	2,667	2.74	5	3,510	3.61
Agricultural real estate ..	2	150	1.31	1	38	0.33	5	535	4.69
Consumer .....	80	452	1.65	25	180	0.66	24	126	0.46
Agricultural operating .....	16	484	1.30	17	276	0.74	52	2,271	6.09
Commercial business .....	9	782	3.02	9	663	2.56	9	142	0.55
	---	-----		--	-----		---	-----	
 Total .....	184	\$10,723	3.92%	76	\$4,544	1.66%	106	\$7,106	2.60%
	===	=====		==	=====		===	=====	

At June 30, 1998, commercial and multi-family real estate loans delinquent 90 days and over totaled \$3.5 million, or 1.3% of the total loan portfolio as compared to \$1.6 million, or 0.6% of total loans at September 30, 1997. Multi-family and commercial real estate loans generally present a higher level of risk than loans secured by one- to four-family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effect of general economic conditions on income producing properties and the increased difficulty of evaluating and monitoring these types of loans. The majority of the Company's delinquent commercial and multi-family real estate loans have been purchased as participations with other lenders, are serviced by other lenders and are secured by properties outside the Company's primary market area. These loans are being closely monitored by management, however, there can be no assurance that all loans will be fully collectible.

At June 30, 1998, agricultural real estate and operating loans delinquent 90 days and over totaled \$2.8 million, or 1.0% of the total loan portfolio as compared to \$313,000, or 0.1% of total loans at September 30, 1997. Agricultural lending involves a greater degree of risk than one- to four-family residential mortgage loans because of the typically larger loan amounts. In addition, payments on loans are dependent on the successful operation or management of the farm property securing the loan or for which an operating loan is utilized. The success of the loan may also be affected by factors outside the control of the agricultural borrower, such as the weather and grain and livestock prices. Although management believes the Company's portfolio of agricultural real estate and operating loans is well structured and adequately secured, there can be no assurance that all loans will be fully collectible.

The table below sets forth the amounts and categories of non-performing assets in the Company's loan portfolio. Foreclosed assets include assets acquired in settlement of loans.

	June 30, 1998	September 30, 1997
	-----	-----
	(Dollars in Thousands)	
Non-accruing loans:		
One-to four family .....	\$ 481	\$ 444
Commercial and multi-family .....	778	1,692
Agricultural real estate .....	79	--
Consumer .....	123	246
Agricultural operating .....	2,510	289
Commercial business .....	143	204
	-----	-----
Total non-accruing loans .....	4,114	2,875
90 days or more .....	2,949	282
	-----	-----
Total non-performing loans .....	7,063	3,157
	-----	-----
Foreclosed assets:		
One- to four family .....	109	85
Commercial real estate .....	973	67
Consumer .....	18	--
Commercial business .....	--	4
	-----	-----
Total .....	1,100	156
	-----	-----
Total non-performing assets .....	\$8,163	\$3,313
	=====	=====
Total as a percentage of total assets .....	1.94%	.82%
	=====	=====

Included above in accruing loans delinquent 90 days or more at June 30, 1998 is a \$2.7 million commercial real estate loan secured by nursing homes located in Minnesota. This loan is in process of being restructured with an expected reduction in loan balance to approximately \$1.0 million and the payment of all previously accrued interest. After restructure, the loan will be fully secured by a nursing home located in Minnetoka, Minnesota.

For the nine months ended June 30, 1998, gross interest income which would have been recorded had the non-accruing loans been current in accordance with their original terms amounted to approximately \$442,000, of which none was included in interest income.

Other Loans of Concern. At June 30, 1998, there were loans totaling \$4.0 million not included in the table above where known information about the possible credit problems of borrowers caused management to have concern as to the ability of the borrower to comply with the present loan repayment terms. This amount consisted of four commercial real estate loans totaling \$1.3 million, six commercial business loans totaling \$1.0 million and twenty agricultural operating loans totaling \$1.7 million. At September 30, 1997, other loans of concern totaled \$7.2 million.

Classified Assets. Federal regulations provide for the classification of loans and other assets as "substandard", "doubtful" or "loss", based on the level of weakness determined to be inherent in the collection of the principal and interest. When loans are classified as either substandard or doubtful, the Company may establish general allowances for loan losses in an amount deemed prudent by management. General allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem loans. When assets are classified as loss, the Company is required either to establish a specific allowance for loan losses equal to 100% of that portion of the loan so classified, or to charge-off such amount. The Company's determination as to the classification of its loans and the amount of its valuation allowances are subject to review by its regulatory authorities, who may require the establishment of additional general or specific loss allowances.

On the basis of management's review of its loans and other assets, at June 30, 1998, the Company had classified a total of \$9.6 million of its assets as substandard, \$852,000 as doubtful and none as loss as compared to classifications at September 30, 1997 of \$5.6 million substandard, \$79,000 doubtful and none as loss.

Allowance for Loan Losses. The Company establishes its provision for possible loan losses, and evaluates the adequacy of its allowance for loan losses based upon a systematic methodology consisting of a number of factors including, among others, historic loss experience, the overall level of non-performing loans, the composition of its loan portfolio and the general economic environment within which the Bank and its borrowers operate.

During the quarter ended March 31, 1998, the Company determined that an agricultural loan officer located in a subsidiary branch office had, through abuse of position and misrepresentation to management, authorized the disbursement of funds on loans for which collateral was inadequate. In addition, the possibility of fraud exists related to self-dealing by the loan officer in the disbursement of loan proceeds to persons and entities with which the loan officer was affiliated. This mismanagement and possible fraud was discovered as a result of the Company's routine internal audit procedures. The loan officer involved is no longer with the Company. The Company has contacted authorities, and an investigation is in process at this time. A thorough review was performed by the Company of the accounts in which the loan officer was involved. Management believes it has identified all loans for which material weaknesses exist and has classified these loans accordingly.

Based on the resulting increase in classified assets, management considered it prudent to increase the allowance for losses through an additional charge to the provision for loan losses in the amount of \$1.3 million and a charge to provision for loss on foreclosed real estate in the amount of \$200,000. These amounts were charged against income during the quarter ended March 31, 1998. Future recoveries are dependent on the ultimate resolution of weaknesses found in the loans and any insurance proceeds that may be received, which can not be determined at this time.

At June 30, 1998, the Company has established an allowance for loan losses totaling \$3.1 million. The allowance represents approximately 43.9% of the total non-performing loans at June 30, 1998.

The following table sets forth an analysis of the activity in the Company's allowance for loan losses:

	(In Thousands)
Balance, September 30, 1997 .....	\$ 2,379
Charge-offs .....	(736)
Recoveries .....	21
Additions charged to operations .....	1,435
	-----
Balance, June 30, 1998 .....	\$ 3,099
	=====

Based on currently available information, management believes that the allowance for loan losses is adequate to absorb potential losses in the portfolio. Future additions to the allowance for loan losses may become necessary based upon changing economic conditions, increased loan balances or changes in the underlying collateral of the loan portfolio.

## RESULTS OF OPERATIONS

**General.** For the three months ended June 30, 1998, the Company recorded net income of \$893,000 compared to net income of \$913,000 for the same period in 1997. The decrease in net income was due primarily to a \$150,000 charge to provision for loss on foreclosed real estate taken during the 1998 period. For the nine months ended June 30, 1998, net income was \$1.9 million compared to \$2.7 million for the same period in 1997. The decrease reflects a non-recurring charge to provision for loan and foreclosed real estate losses in the amount of \$1.5 million, or \$940,000 net of income taxes, taken during the second quarter, and related to a determination by management that the Company's loss allowances should be increased, primarily as a result of mismanagement and possible fraud by one loan officer who is no longer with the Company. For the nine months ended June 30, 1998, excluding the non-recurring charge to provision for loan and foreclosed real estate losses, net income was \$2.9 million.

**Interest and Dividend Income.** Total interest and dividend income for the three months ended June 30, 1998 increased by \$665,000, or 9.1%, to \$8.00 million, compared to \$7.33 million during the same period in 1997. For the nine months ended June 30, 1998, interest and dividend income increased by \$2.21 million, or 10.3%, to \$23.73 million from \$21.52 million during 1997. The increase for both periods is due to higher average balances in interest earning assets during the 1998 periods compared to the previous year primarily as a result of increased purchases of securities available for sale, and to a lesser extent, the increased origination and purchase of loans.

**Interest Expense.** Total interest expense for the three months ended June 30, 1998 increased by \$459,000, or 10.5%, to \$4.82 million from \$4.36 million during the same period in 1997. For the nine months ended June 30, 1998, interest expense increased \$1.53 million, or 12.1%, to \$14.15 million from \$12.62 million for the same period in 1997. The increase in interest expense for both periods



reflects a higher average balance in deposit accounts during the 1998 periods due to internal growth of the deposit portfolio. In addition, the increase in interest expense for 1998 reflects an increased average balance of Federal Home Loan Bank advances used to fund the origination and purchase of loans and the purchase of securities available for sale.

**Net Interest Income.** Net interest income increased by \$206,000, or 6.9%, to \$3.18 million for the three months ended June 30, 1998 from \$2.98 million for the same period in 1997. For the nine months ended June 30, 1998, net interest income increased \$680,000, or 7.6%, to \$9.58 million from \$8.90 million for the same period in 1997. The increase in net interest income for both periods is due to the overall increase in net earning assets between the comparable periods that resulted from increases in average balances held in the loan portfolio and the portfolio of securities available for sale.

**Provision for Loan Losses.** For the three month period ended June 30, 1998, the provision for loan losses was \$55,000 compared to \$30,000 for the same period in 1997. The increase was due to management's determination that the allowance for loan losses should be increased to reflect changes in the level of classified assets and the composition of the loan portfolio. For the nine month period ended June 30, 1998, the provision for loan losses was \$1.44 million compared to \$90,000 for the same period in 1997. The increase reflects an increase in the level of classified assets and the related determination by management that the allowance for loan losses should be increased. The increase in classified assets is primarily the result of mismanagement and possible fraud by an agricultural loan officer (see "Allowance for Loan Losses").

**Non-Interest Income.** Non-interest income increased by \$101,000, or 23.5%, to \$528,000 for the three months ended June 30, 1998, from \$427,000 for the same period in 1997. For the nine months ended June 30, 1998, non-interest income increased \$259,000, or 21.2%, to \$1.48 million from \$1.22 million for the same period in 1997. The increase in non-interest income for both periods reflects the higher collection of fees on deposit accounts and, in addition for the nine month period, an increase in gain on sales of securities available for sale. The gain on sales of securities available for sale were primarily generated by sales of equity securities that had appreciated substantially over purchase cost.

**Non-Interest Expense.** Non-interest expense increased \$331,000, or 18.0%, to \$2.18 million for the three months ended June 30, 1998, from \$1.85 million for the same period in 1997. For the nine months ended June 30, 1998, non-interest expense increased \$791,000, or 14.4%, to \$6.28 million from \$5.49 million for the same period in 1997. The increase in non-interest expense for both periods reflects increased costs associated with the operation of an additional office facility that opened for operation during 1997 in Des Moines, Iowa and, in addition, reflects a charge to provision for loss on foreclosed real estate during the 1998 periods.

**Income Tax Expense.** Income tax expense decreased \$31,000, or 5.0%, to \$584,000 for the three months ended June 30, 1998, from \$615,000 for the same period in 1997. The decrease is due to a minimal reduction in taxable income between the comparable periods. For the nine months ended June 30, 1998, income tax expense decreased \$410,000, or 22.5%, to \$1.41 million from \$1.82 million for the comparable period in 1997. The decrease is due to reduced taxable income as a result of a non-recurring charge to provision for loan and foreclosed real estate losses which provided a reduction in tax expense of \$560,000 and resulted in the creation of a deferred tax asset in that amount during the second quarter. This reduction was partially offset by increased tax expense due to higher levels of taxable income from core operations during the comparable periods.

**LIQUIDITY AND CAPITAL RESOURCES**

The Company's primary sources of funds are deposits, borrowings, principal and interest payments on loans, investments and mortgage-backed securities, and funds provided by operations. While scheduled payments on loans, mortgage-backed securities and short-term investments are relatively predictable sources of funds, deposit flows and early loan repayments are greatly influenced by general interest rates, economic conditions and competition.

Federal regulations require First Federal to maintain minimum levels of liquid assets. Currently, First Federal is required to maintain liquid assets of at least 4% of the average daily balance of net withdrawable savings deposits and borrowings payable on demand in one year or less during the preceding calendar quarter. Liquid assets for purposes of this ratio include cash, certain time deposits, U.S. Government, government agency and corporate securities and obligations, unless otherwise pledged. First Federal has historically maintained its liquidity ratio at levels in excess of those required. First Federal's regulatory liquidity ratios at June 30, 1998 and September 30, 1997, were 24.7% and 9.8%, respectively.

The Company uses its capital resources principally to meet ongoing commitments to fund maturing certificates of deposits and loan commitments, to maintain liquidity and to meet operating expenses. At June 30, 1998, the Company had commitments to originate and purchase loans totalling \$21.7 million. The Company believes that loan repayment and other sources of funds will be adequate to meet its foreseeable short- and long-term liquidity needs.

Regulations require First Federal to maintain minimum amounts and ratios of tangible capital and leverage capital to average assets, and risk-based capital to risk-weighted assets. The following table sets forth First Federal's actual capital and required capital amounts and ratios at June 30, 1998 which, at that date, exceeded the capital adequacy requirements:

	Actual		Minimum Requirement For Capital Adequacy Purposes		Minimum Requirement To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	%	Amount	%	Amount	%
	-----	-	-----	-	-----	-
			(Dollars in Thousands)			
Total Capital (to risk weighted assets)	\$32,691	12.6%	\$20,772	8.0%	\$25,965	10.0%
Tier I (Core) Capital (to risk weighted assets)	\$30,212	11.6%	\$10,386	4.0%	\$15,579	6.0%
Tier I (Core) Capital (to adjusted total assets)	\$30,212	8.1%	\$11,170	3.0%	N/A	N/A
Tangible Capital (to adjusted total assets)	\$30,212	8.1%	\$ 5,585	1.5%	N/A	N/A
Tier I (Core) Capital (to average assets)	\$30,212	8.8%	\$13,738	4.0%	\$17,172	5.0%

Regulations require Security to maintain minimum amounts and ratios of total risk-based capital and Tier 1 capital to risk-weighted assets and a leverage ratio consisting of Tier 1 capital to average assets. The following table sets forth Security's actual capital and required capital amounts and ratios at June 30, 1998 which, at that date, exceeded the capital adequacy requirements:

	Actual		Minimum Requirement For Capital Adequacy Purposes		Minimum Requirement To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	%	Amount	%	Amount	%
	-----	----	-----	---	-----	----
			(Dollars in Thousands)			
Total Capital (to risk weighted assets) ....	\$4,062	16.2%	\$2,006	8.0%	\$2,508	10.0%
Tier I Capital (to risk weighted assets) ....	\$3,776	15.1%	\$1,003	4.0%	\$1,505	6.0%
Tier I Capital (to average assets) .	\$3,776	10.7%	\$1,407	4.0%	\$1,758	5.0%

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) established five regulatory capital categories and authorized the banking regulators to take prompt corrective action with respect to institutions in an undercapitalized category. At June 30, 1998, First Federal and Security exceeded minimum requirements for the well-capitalized category.

## **The Year 2000 Issue**

The Company is aware of the issues associated with the programming code in existing computer systems as the Year 2000 approaches. The "Year 2000" problem will affect virtually every computer operation in some way by the rollover of the two digit value to 00. The issue is whether computer systems will properly recognize date-sensitive information when the year changes to 2000. Systems that do not properly recognize such information could generate erroneous data or cause a system to fail.

The Company recognizes the need to ensure its operations will not be adversely impacted by Year 2000 software failures. The Company has established a process for evaluating and managing the risks associated with this issue. An assessment of the Year 2000 compliance of the Company's computer systems has been completed. No areas of material concern were identified as a result of this assessment. The Company is requiring its computer systems and software vendors to represent that their products are, or will be, Year 2000 compliant, and has planned a program for testing of compliance. The financial impact to the Company and its financial position or results of operations as a result of the Year 2000 issue cannot be estimated as of June 30, 1998, but is not considered to be material.

## Part I. Financial Information

### Item 3. Quantitative and Qualitative Disclosure About Market Risk

#### **Market Risk**

The Company is exposed to the impact of interest rate changes and changes in the market value of its investments.

The Company currently focuses lending efforts toward originating and purchasing competitively priced adjustable-rate loan products and fixed-rate loan products with relatively short terms to maturity. This allows the Company to maintain a portfolio of loans which will be sensitive to changes in the level of interest rates while providing a reasonable spread to the cost of liabilities used to fund the loans.

The Company's primary objective for its investment portfolio is to provide the liquidity necessary to meet loan funding needs. This portfolio is used in the ongoing management of changes to the Company's asset/liability mix, while contributing to profitability through earnings flow. The investment policy generally calls for funds to be invested among various categories of security types and maturities based upon the Company's need for liquidity, desire to achieve a proper balance between minimizing risk while maximizing yield, the need to provide collateral for borrowings, and to fulfill the Company's asset/liability management goals.

The Company's cost of funds responds to changes in interest rates due to the relatively short-term nature of its deposit portfolio. Consequently, the results of operations are generally influenced by the levels of short-term interest rates. The Company offers a range of maturities on its deposit products at competitive rates and monitors the maturities on an ongoing basis.

The Company emphasizes and promotes its savings, money market, demand and NOW accounts and, subject to market conditions, certificates of deposit with maturities of six months through five years, principally from its primary market area. The savings and NOW accounts tend to be less susceptible to rapid changes in interest rates.

In managing its asset/liability mix, the Company, at times, depending on the relationship between long- and short-term interest rates, market conditions and consumer preference, may place somewhat greater emphasis on maximizing its net interest margin than on strictly matching the interest rate sensitivity of its assets and liabilities. Management believes that the increased net income which may result from an acceptable mismatch in the actual maturity or repricing of its asset and liability portfolios can, during periods of declining or stable interest rates, provide sufficient returns to justify the increased exposure to sudden and unexpected increases in interest rates which may result from such a mismatch. The Company has established limits, which may change from time to time, on the level of acceptable interest rate risk. There can be no assurance, however, that in the event of an adverse change in interest rates the Company's efforts to limit interest rate risk will be successful.

Net Portfolio Value The Company uses a Net Portfolio Value ("NPV") approach to the quantification of interest rate risk. This approach calculates the difference between the present value of expected cash flows from assets and the present value of expected cash flows from liabilities, as well as cash flows from off-balance sheet contracts. Management of the Company's assets and liabilities is performed within the context of the marketplace, but also within limits established by the Board of Directors on the amount of change in NPV which is acceptable given certain interest rate changes.

Presented below, as of June 30, 1998, is an analysis of the Company's interest rate risk as measured by changes in NPV for an instantaneous and sustained parallel shift in the yield curve, in 100 basis point increments, up and down 200 basis points. As illustrated in the table, the Company's NPV is more sensitive to rising rate changes than declining rates. This occurs primarily because, as rates rise, the market value of fixed-rate loans declines due both to the rate increase and the related slowing of prepayments. When rates decline, the Company does not experience a significant rise in market value for these loans because borrowers prepay at relatively higher rates. The value of the Company's deposits and borrowings change in approximately the same proportion in rising and falling rate scenarios.

At June 30, 1998			
Change in Interest Rate (Basis Points)	Board Limit % Change	\$ Change	% Change
(Dollars in Thousands)			
+200 bp	(40)%	\$(15,222)	(30.6)%
+100 bp	(25)	( 8,152)	(16.4)
0 bp	-	-	-
- 100 bp	(10)	9,448	19.0
- 200 bp	(15)	19,841	39.9

Certain shortcomings are inherent in the method of analysis presented in the foregoing table. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets such as adjustable-rate mortgage loans, have features which restrict changes in interest rates on a short-term basis and over the life of the asset. Further, in the event of a change in interest rates, prepayments and early withdrawal levels would likely deviate from those assumed in calculating the tables. Finally, the ability of some borrowers to service their debt may decrease in the event of an interest rate increase. The Company considers all of these factors in monitoring its exposure to interest rate risk.

**FIRST MIDWEST FINANCIAL, INC.**

**PART II - OTHER INFORMATION**

**FORM 10-Q**

**Item 6. Exhibits and Reports on Form 8-K**

(a) Exhibits: None

(b) Reports on Form 8-K:

First Midwest Financial, Inc. filed Form 8-K dated April 17, 1998 to report the issuance of a press release announcing second quarter earnings, which included the effect of a \$1.5 million charge to provision for loan losses related to mismanagement and possible fraud by a former loan officer.

All other items have been omitted as not required or not applicable under the instructions.

**FIRST MIDWEST FINANCIAL, INC.**

**SIGNATURES**

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

**FIRST MIDWEST FINANCIAL, INC.**

*Date: August 13, 1998*  
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*By: /s/ James S. Haahr*  
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*James S. Haahr, Chairman of the Board,  
President and Chief Executive Officer*

*Date: August 13, 1998*  
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*By: /s/ Donald J. Winchell*  
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*Donald J. Winchell, Vice President,  
Treasurer and Chief Financial Officer*



## ARTICLE 9

PERIOD TYPE	9 MOS
FISCAL YEAR END	SEP 30 1998
PERIOD END	JUN 30 1998
CASH	869,188
INT BEARING DEPOSITS	9,148,776
FED FUNDS SOLD	700,000
TRADING ASSETS	0
INVESTMENTS HELD FOR SALE	132,947,454
INVESTMENTS CARRYING	0
INVESTMENTS MARKET	0
LOANS	260,295,677
ALLOWANCE	3,098,995
TOTAL ASSETS	421,258,434
DEPOSITS	269,493,349
SHORT TERM	44,068,334
LIABILITIES OTHER	3,143,741
LONG TERM	61,666,835
PREFERRED MANDATORY	0
PREFERRED	0
COMMON	29,580
OTHER SE	42,856,595
TOTAL LIABILITIES AND EQUITY	421,258,434
INTEREST LOAN	17,111,276
INTEREST INVEST	6,619,530
INTEREST OTHER	0
INTEREST TOTAL	23,730,806
INTEREST DEPOSIT	9,878,382
INTEREST EXPENSE	14,150,729
INTEREST INCOME NET	9,580,077
LOAN LOSSES	1,435,000
SECURITIES GAINS	308,443
EXPENSE OTHER	6,279,045
INCOME PRETAX	3,343,126
INCOME PRE EXTRAORDINARY	1,928,427
EXTRAORDINARY	0
CHANGES	0
NET INCOME	1,928,427
EPS PRIMARY	.74
EPS DILUTED	.70
YIELD ACTUAL	0
LOANS NON	4,113,948
LOANS PAST	2,949,538
LOANS TROUBLED	0
LOANS PROBLEM	3,985,900
ALLOWANCE OPEN	2,379,091
CHARGE OFFS	736,795
RECOVERIES	21,699
ALLOWANCE CLOSE	3,098,995
ALLOWANCE DOMESTIC	2,940,547
ALLOWANCE FOREIGN	0
ALLOWANCE UNALLOCATED	158,448

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