MidWestOne Financial Group, Inc.
Form 10-Q
May 05, 2011

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

FORM 10-Q

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

For the quarterly period ended March 31, 2011

OR

o 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 000-24630

MIDWESTONE FINANCIAL GROUP, INC.

102 South Clinton Street
Iowa City, IA 52240
(Address of principal executive offices, including Zip Code)

Registrant's telephone number: 319-356-5800

Iowa	42-1206172
(State of Incorporation)	(I.R.S. Employer Identification No.)

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

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

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

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

As of May 3, 2011, there were 8,627,971 shares of common stock, $1.00 par value per share, outstanding.

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PART I – FINANCIAL INFORMATION
Item 1. Financial Statements.

MIDWESTONE FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(dollars in thousands)	March 31, 2011 (unaudited)	December 31, 2010
ASSETS		
Cash and due from banks	$ 19,085	$ 13,720
Interest-bearing deposits in banks	4,318	6,077
Federal funds sold	264	726
Cash and cash equivalents	23,667	20,523
Investment securities:		
Available for sale	501,946	461,954
Held to maturity (fair value of $3,716 as of March 31, 2011 and $4,086 as of December 31, 2010)	3,672	4,032
Loans held for sale	279	702
Loans	938,523	938,035
Allowance for loan losses	(15,398)	(15,167)
Net loans	923,125	922,868
Loan pool participations, net	62,207	65,871
Premises and equipment, net	25,916	26,518
Accrued interest receivable	9,580	10,648
Other intangible assets, net	10,919	11,143
Bank-owned life insurance	27,001	26,772
Other real estate owned	3,874	3,850
Deferred income taxes	6,097	6,430
Other assets	19,948	19,948
Total assets	$ 1,618,231	$ 1,581,259
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest-bearing demand	$ 144,724	$ 129,978
Interest-bearing checking	472,257	442,878
Savings	75,439	74,826
Certificates of deposit under $100,000	379,326	380,082
Certificates of deposit $100,000 and over	191,412	191,564
Total deposits	1,263,158	1,219,328
Federal funds purchased	—	—
Securities sold under agreements to repurchase	46,325	50,194
Federal Home Loan Bank borrowings	117,200	127,200
Deferred compensation liability	3,698	3,712
Long-term debt	15,464	15,464
Accrued interest payable	1,964	1,872
Other liabilities	9,107	5,023
Total liabilities	1,456,916	1,422,793

Shareholders' equity:

Preferred stock, no par value, with a liquidation preference of $1,000 per share; authorized 500,000 shares; issued 16,000 shares as of March 31, 2011 and December 31, 2010	$ 15,784	$ 15,767
Common stock, $1 par value; authorized 15,000,000 shares at March 31, 2011 and December 31, 2010; issued 8,690,398 shares at March 31, 2011 and December 31, 2010; outstanding 8,624,392 share at March 31, 2011 and 8,614,790 shares at December 31, 2010	8,690	8,690
Additional paid-in capital	81,213	81,268
Treasury stock at cost, 66,006 shares as of March 31, 2011 and 75,608 shares at December 31, 2010	(918)	(1,052)
Retained earnings	57,876	55,619
Accumulated other comprehensive income (loss)	(1,330)	(1,826)
Total shareholders' equity	161,315	158,466
Total liabilities and shareholders' equity	$ 1,618,231	$ 1,581,259

See accompanying notes to consolidated financial statements.

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MIDWESTONE FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited) (dollars in thousands, except per share amounts)	Three Months Ended March 31, 2011	 2010
Interest income:		
Interest and fees on loans	$12,800	$13,704
Interest and discount on loan pool participations	354	899
Interest on bank deposits	8	10
Interest on federal funds sold	—	—
Interest on investment securities:		
Taxable securities	2,688	2,225
Tax-exempt securities	1,035	990
Total interest income	16,885	17,828
Interest expense:		
Interest on deposits:		
Interest-bearing checking	1,008	1,070
Savings	59	36
Certificates of deposit under $100,000	2,187	2,543
Certificates of deposit $100,000 and over	848	967
Total interest expense on deposits	4,102	4,616
Interest on federal funds purchased	—	1
Interest on securities sold under agreements to repurchase	74	76
Interest on Federal Home Loan Bank borrowings	945	1,207
Interest on notes payable	10	13
Interest on long-term debt	162	148
Total interest expense	5,293	6,061
Net interest income	11,592	11,767
Provision for loan losses	900	1,500
Net interest income after provision for loan losses	10,692	10,267
Noninterest income:		
Trust and investment fees	1,273	1,234
Service charges and fees on deposit accounts	851	864
Mortgage origination and loan servicing fees	877	500
Other service charges, commissions and fees	679	584
Bank-owned life insurance income	229	167
Investment securities losses, net:		
Impairment losses on investment securities	—	(189)
Less non-credit-related losses	—	—
Net impairment losses	—	(189)
Gain on sale of available for sale securities	—	237
Loss on sale of premises and equipment	(48)	(77)
Total noninterest income	3,861	3,320
Noninterest expense:		
Salaries and employee benefits	5,870	5,790

Net occupancy and equipment expense	1,617	1,776
Professional fees	677	749
Data processing expense	450	457
FDIC Insurance expense	597	692
Other operating expense	1,423	1,584
Total noninterest expense	10,634	11,048
Income before income tax expense	3,919	2,539
Income tax expense	1,014	535
Net income	$2,905	$2,004
Less: Preferred stock dividends and discount accretion	$217	$217
Net income available to common shareholders	$2,688	$1,787
Share and Per share information:		
Ending number of shares outstanding	8,624,392	8,609,804
Average number of shares outstanding	8,621,720	8,607,853
Diluted average number of shares	8,682,381	8,611,511
Earnings per common share - basic	$0.31	$0.21
Earnings per common share - diluted	0.31	0.21
Dividends paid per common share	0.05	0.05

See accompanying notes to consolidated financial statements.

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MIDWESTONE FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
AND OTHER COMPREHENSIVE INCOME (LOSS)

(unaudited) (dollars in thousands, except per share amounts)	Preferred Stock	Common Stock	Additional Paid-in Captial	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (loss)	Total
Balance at December 31, 2009	$ 15,699	$ 8,690	$ 81,179	$ (1,183)	$ 48,079	$ (256)	$ 152,208
Comprehensive income:							
Net income	—	—	—	—	2,004	—	2,004
Change in net unrealized gains arising during the period on securities available for sale, net of tax	—	—	—	—	—	510	510
Total comprehensive income	—	—	—	—	2,004	510	2,514
Dividends paid on common stock ($0.05 per share)	—	—	—	—	(430)	—	(430)
Dividends paid on preferred stock	—	—	—	—	(200)	—	(200)
Stock options exercised (1,945 shares)	—	—	(11)	27	—	—	16
Release/lapse of restriction on 2,546 RSUs	—	—	(35)	35	—	—	—
Preferred stock discount accretion	17	—	—	—	(17)	—	—
Stock compensation	—	—	50	—	—	—	50
Balance at March 31, 2010	$ 15,716	$ 8,690	$ 81,183	$ (1,121)	$ 49,436	$ 254	$ 154,158
Balance at December 31, 2010	$ 15,767	$ 8,690	$ 81,268	$ (1,052)	$ 55,619	$ (1,826)	$ 158,466
Comprehensive income:							
Net income	—	—	—	—	2,905	—	2,905
Change in net unrealized gains arising during the period on securities available for sale, net of tax	—	—	—	—	—	496	496
Total comprehensive income	—	—	—	—	2,905	496	3,401
Dividends paid on common stock ($0.05 per share)	—	—	—	—	(431)	—	(431)
Dividends paid on preferred stock	—	—	—	—	(200)	—	(200)
Stock options exercised (1,682 shares)	—	—	(6)	14	—	—	8
Release/lapse of restriction on 8,600 RSUs	—	—	(120)	120	—	—	—
Preferred stock discount accretion	17	—	—	—	(17)	—	—
Stock compensation	—	—	71	—	—	—	71
Balance at March 31, 2011	$ 15,784	$ 8,690	$ 81,213	$ (918)	$ 57,876	$ (1,330)	$ 161,315

See accompanying notes to consolidated financial statements.

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MIDWESTONE FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited) (dollars in thousands)	Three Months Ended March 31,	
	2011	2010
Cash flows from operating activities:		
Net income	$2,905	$2,004
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	900	1,500
Depreciation, amortization and accretion	1,447	1,576
Loss on sale of premises and equipment	48	77
Deferred income taxes	36	(8)
Stock-based compensation	71	50
Net gains on sale of available for sale securities	—	(237)
Net gains on sale of other real estate owned	(90)	(64)
Writedown of other real estate owned	—	12
Other-than-temporary impairment of investment securities	—	189
Decrease in loans held for sale	423	449
Decrease in accrued interest receivable	1,068	1,019
Decrease (increase) in other assets	—	(119)
Decrease in deferred compensation liability	(14)	(22)
(Decrease) increase in accounts payable, accrued expenses, and other liabilities	4,176	(147)
Net cash provided by operating activities	10,970	6,279
Cash flows from investing activities:		
Sales of available for sale securities	—	6,674
Maturities of available for sale securities	34,396	19,440
Purchases of available for sale securities	(74,236)	(38,091)
Maturities of held to maturity securities	361	1,810
Purchases of held to maturity securities	—	—
Loans made to customers, net of collections	(1,291)	11,328
Loan pool participations, net	3,664	1,534
Purchases of premises and equipment	(183)	(1,041)
Proceeds from sale of other real estate owned	200	1,217
Proceeds from sale of premises and equipment	154	544
Purchases of bank-owned life insurance	—	—
Increase in cash value of bank-owned life insurance	(229)	(167)
Net cash (used) provided in investing activities	(37,164)	3,248
Cash flows from financing activities:		
Net increase in deposits	43,830	13,417
Net decrease in federal funds purchased	—	(1,875)
Net decrease in securities sold under agreements to repurchase	(3,869)	(3,533)
Proceeds from Federal Home Loan Bank borrowings	10,000	10,000
Repayment of Federal Home Loan Bank borrowings	(20,000)	(12,500)
Stock options exercised	8	16
Payments on long-term debt	—	(12)
Dividends paid	(631)	(630)

Net cash provided by financing activities	29,338	4,883
Net increase in cash and cash equivalents	3,144	14,410
Cash and cash equivalents at beginning of period	20,523	27,588
Cash and cash equivalents at end of period	$23,667	$41,998
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest	$5,200	$6,238
Cash paid during the period for income taxes	$143	$600
Supplemental schedule of non-cash investing activities:		
Transfer of loans to other real estate owned	$134	$78

See accompanying notes to consolidated financial statements.

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MidWestOne Financial Group, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

1. Introductory Note
MidWestOne Financial Group, Inc. (“MidWestOne” or the “Company,” which is also referred to herein as “we,” “our” or “us”) is an Iowa corporation incorporated in 1983, a bank holding company under the Bank Holding Company Act of 1956 and a financial holding company under the Gramm-Leach-Bliley Act of 1999. Our principal executive offices are located at 102 South Clinton Street, Iowa City, Iowa 52240.
The Company owns 100% of the outstanding common stock of MidWestOne Bank, an Iowa state non-member bank chartered in 1934 with its main office in Iowa City, Iowa (the “Bank”), and 100% of the common stock of MidWestOne Insurance Services, Inc., Pella, Iowa. We operate primarily through our bank subsidiary, MidWestOne Bank, and MidWestOne Insurance Services, Inc., our wholly-owned subsidiary that operates an insurance agency business through three offices located in central and east-central Iowa.

2. Principles of Consolidation and Presentation
The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all the information and notes necessary for complete financial statements in conformity with generally accepted accounting principles. The information in this Quarterly Report on Form 10-Q is written with the presumption that the users of the interim financial statements have read or have access to the most recent Annual Report on Form 10-K of MidWestOne, which contains the latest audited financial statements and notes thereto, together with Management's Discussion and Analysis of Financial Condition and Results of Operations as of December 31, 2010 and for the year then ended. Management believes that the disclosures are adequate to make the information presented not misleading. In the opinion of management, the accompanying consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position as of March 31, 2011, and the results of operations and cash flows for the three months ended March 31, 2011 and 2010. All significant intercompany accounts and transactions have been eliminated in consolidation.
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. These estimates are based on information available to management at the time the estimates are made. Actual results could differ from those estimates. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments, consisting of normal recurring items, considered necessary for fair presentation. The results for the three months ended March 31, 2011 may not be indicative of results for the year ending December 31, 2011, or for any other period.
All significant accounting policies followed in the preparation of the quarterly financial statements are disclosed in the December 31, 2010 Annual Report on Form 10-K. In the consolidated statements of cash flows, cash and cash equivalents include cash and due from banks, interest-bearing deposits in banks, and federal funds sold.

3. Shareholders' Equity and Earnings per Common Share
Preferred Stock: On February 6, 2009, the Company issued 16,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A, together with a ten-year warrant to acquire 198,675 shares of common stock, to the U.S. Department of the Treasury (the “Treasury”) under the Capital Purchase Program (the “CPP”) for an aggregate purchase price of $16.0 million. Upon issuance, the fair values of the senior preferred stock and the common stock warrants were computed as if the securities were issued on a stand-alone basis. The value of the senior preferred stock was estimated based on the net present value of the future senior preferred stock cash flows using a discount rate of 12%. The allocated carrying value of the senior preferred stock and common stock warrants on the date of issuance (based on their relative fair values) were $15.6 million and $0.4 million, respectively. The preferred stock discount,

$358,000, is being accreted on a 5% level yield basis over 60 months. The senior preferred stock has no par value per share and a liquidation preference of $1,000 per share, or $16.0 million in the aggregate. Dividends are payable quarterly at the rate of 5% per annum until the fifth anniversary date of the issuance and at a rate of 9% per annum thereafter. The dividends are computed on the basis of a 360-day year consisting of twelve 30-day months. The dividends are payable quarterly in arrears on February 15, May 15, August 15, and November 15 of each year.
The senior preferred stock is non-voting, other than class voting rights on any authorization or issuance of shares ranking senior to the senior preferred stock, any amendment to the rights of senior preferred stock, or any merger, exchange, or

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similar transaction that would adversely affect the rights of the senior preferred stock. If dividends are not paid in full for six dividend periods, whether or not consecutive, the Treasury will have the right to elect two directors to the Company's Board. The right to elect directors would end when full dividends have been paid for four consecutive dividend periods. The Company has the option to repay the Treasury's investment under the CPP at any time without regard to whether the Company has raised new capital, subject to consultation with the Federal Reserve and the Federal Deposit Insurance Corporation (the “FDIC”). If the Company were to repay the Treasury's investment, it would be permitted to redeem the warrant issued to Treasury for an agreed upon fair market value.

The CPP requires that the Company be subject to specified standards for executive compensation and corporate governance as long as any obligation arising from financial assistance provided under the statute remains outstanding. The U.S. Congress and the Treasury may create additional provisions that could become retroactively applicable to the senior preferred stock.

Common Stock: The number of authorized shares of common stock for the Company is15,000,000.

Common Stock Warrant: In connection with the CPP described above, a warrant exercisable for 198,675 shares of Company common stock was issued to the Treasury. The warrant entitles the Treasury to purchase 198,675 shares of common stock at $12.08 per share at any time on or before February 6, 2019. As noted above, if the Company repays the Treasury's investment in full, the Company would be permitted to redeem the warrant issued to Treasury at its then current fair market value. If the warrant is not redeemed at such time, however, it will remain outstanding and transferable by the Treasury.

As holder of the common stock warrant, the Treasury is not entitled to vote, to receive dividends, or to exercise any other rights of common shareholders for any purpose until such warrants have been duly exercised. The Treasury has agreed not to exercise voting power with respect to any shares of common stock issued upon exercise. The Company has filed and will maintain at all times during the period the senior preferred stock is outstanding and during the period the warrant is exercisable, a “shelf” registration statement relating to the issuance of common shares underlying the warrant for the benefit of the warrant holder.

The fair value of the warrants was calculated using the Binomial Option Pricing Model. The inputs to the model are consistent with those utilized by the Company for a 10-year employee stock option.

Number of warrants granted	198,675	
Exercise price	$12.08	
Grant date fair market value	$7.32	
Estimated forfeiture rate	0%	
Risk-free interest rate	2.93	%
Expected life, in years	10	
Expected volatility	40.7	%
Expected dividend yield	3.86	%
Estimated fair value per warrant	$1.39	

Earnings per Common Share: Basic earnings per common share computations are based on the weighted average number of shares of common stock actually outstanding during the period. The weighted average number of shares outstanding for the three months ended March 31, 2011 and 2010 was 8,621,720 and 8,607,853, respectively. Diluted earnings per share amounts are computed by dividing net income available to common shareholders by the weighted average number of shares outstanding and all dilutive potential shares outstanding during the period. The computation of diluted earnings per share used a weighted average diluted number of shares outstanding of 8,682,381 and 8,611,511 for the three months ended March 31, 2011 and 2010, respectively.

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The following table presents the computation of earnings per common share for the respective periods:

Earnings per Share Information	Three Months Ended March 31,	
(dollars in thousands, except per share amounts)	2011	2010
Weighted average number of shares outstanding during the period	8,621,720	8,607,853
Weighted average number of shares outstanding during the period including all dilutive potential shares	8,682,381	8,611,511
Net income	$2,905	$2,004
Preferred stock dividend accrued and discount accretion	(217)	(217)
Net income available to common stockholders	$2,688	$1,787
Earnings per share - basic	$0.31	$0.21
Earnings per share - diluted	$0.31	$0.21

4. Investments

A summary of investment securities available for sale is as follows:

	As of March 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
(in thousands)				
U.S. Government agencies and corporations	$76,149	$1,147	$(269)	$77,027
State and political subdivisions	191,404	4,313	(1,020)	194,697
Mortgage-backed securities and collateralized mortgage obligations	219,645	3,066	(790)	221,921
Corporate debt securities	7,376	319	(836)	6,859
	494,574	8,845	(2,915)	500,504
Other equity securities	1,183	259	—	1,442
Total	$495,757	$9,104	$(2,915)	$501,946

	As of December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
(in thousands)				
U.S. Government agencies and corporations	$79,181	$1,492	$(339)	$80,334
State and political subdivisions	187,847	3,994	(1,753)	190,088
Mortgage-backed securities and collateralized mortgage obligations	177,453	2,743	(412)	179,784
Corporate debt securities	10,896	349	(973)	10,272
	455,377	8,578	(3,477)	460,478
Other equity securities	1,183	296	(3)	1,476
Total	$456,560	$8,874	$(3,480)	$461,954

A summary of investment securities held to maturity is as follows:

	As of March 31, 2011			
	Amortized Cost	Gross Unrealized	Gross Unrealized	Estimated Fair Value

		Gains	Losses	
(in thousands)				
State and political subdivisions	$2,756	$39	$—	$2,795
Mortgage-backed securities	48	5	—	53
Corporate debt securities	868	—	—	868
Total	$3,672	$44	$—	$3,716

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	As of December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
(in thousands)				
State and political subdivisions	$3,115	$49	$—	$3,164
Mortgage-backed securities	50	5	—	55
Corporate debt securities	867	—	—	867
Total	$4,032	$54	$—	$4,086

The summary of available for sale investment securities shows that some of the securities in the available for sale investment portfolio had unrealized losses, or were temporarily impaired, as of March 31, 2011 and December 31, 2010. This temporary impairment represents the estimated amount of loss that would be realized if the securities were sold on the valuation date. Securities which were temporarily impaired are shown below, along with the length of the impairment period.

The following presents information pertaining to securities with gross unrealized losses as of March 31, 2011 and December 31, 2010, aggregated by investment category and length of time that individual securities have been in a continuous loss position:

		As of March 31, 2011					
	Number of Securities	Less than 12 Months		12 Months or More		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(in thousands, except number of securities)							
U.S. Government agencies and corporations	3	$22,488	$ 269	$—	$ —	$22,488	$ 269
State and political subdivisions	75	45,110	1,019	112	1	45,222	1,020
Mortgage-backed securities and collateralized mortgage obligations	8	61,080	790	—	—	61,080	790
Corporate debt securities	4	—	—	936	836	936	836
Common stocks	—	—	—	—	—	—	—
Total	90	$128,678	$ 2,078	$1,048	$ 837	$129,726	$ 2,915

		As of December 31, 2010					
	Number of Securities	Less than 12 Months		12 Months or More		Total	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
(in thousands, except number of securities)							
U.S. Government agencies and corporations	2	$12,828	$ 339	$—	$ —	$12,828	$ 339
State and political subdivisions	93	53,326	1,750	112	3	53,438	1,753
Mortgage-backed securities and collateralized mortgage obligations	9	77,115	412	—	—	77,115	412

Corporate debt securities	4	799	973	—	—	799	973
Common stocks	1	71	3	—	—	71	3
Total	109	$144,139	$ 3,477	$112	$ 3	$144,251	$ 3,480

The Company's assessment of other-than-temporary impairment (“OTTI”) is based on its reasonable judgment of the specific facts and circumstances impacting each individual security at the time such assessments are made. The Company reviews and considers factual information, including expected cash flows, the structure of the security, the credit quality of the underlying assets and the current and anticipated market conditions. As of April 1, 2009, the Company adopted the amended provisions of FASB ASC Topic 320. This changed the accounting for OTTI of debt securities and separates the impairment into credit-related and other factors. In accordance with the new guidance, the noncredit-related portion of OTTI losses recognized in prior year earnings was reclassified as a cumulative effect adjustment that increased retained earnings and decreased accumulated other comprehensive income at the beginning of the quarter ended June 30, 2009. In 2008, $6.2 million in OTTI losses were recognized, of which $5.2 million related to non-credit-related impairment on debt securities. Therefore, the cumulative effect adjustment made to retained earnings at April 1, 2009 totaled $5.2 million, or $3.3 million net of tax.

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All of the Company's mortgage-backed securities are issued by government-sponsored agencies. The receipt of principal, at par, and interest on mortgage-backed securities is guaranteed by the respective government-sponsored agency guarantor, such that the Company believes that its mortgage-backed securities do not expose the Company to credit-related losses. The Company's mortgage-backed securities portfolio consisted of securities underwritten to the standards of, and guaranteed by, the government-sponsored agencies of FHLMC, FNMA and GNMA.

The Company believes that the decline in the value of certain obligations of state and political subdivisions was primarily related to an overall widening of market spreads for many types of fixed income products since 2008, reflecting, among other things, reduced liquidity and the downgrades on the underlying credit default insurance providers. At March 31, 2011, approximately 61% of the municipal obligations held by the Company were Iowa based. The Company does not intend to sell these municipal obligations, and it is more likely than not that the Company will not be required to sell them until the recovery of its cost at maturity. Due to the issuers' continued satisfaction of their obligations under the securities in accordance with their contractual terms and the expectation that they will continue to do so, management's intent and ability to hold these securities for a period of time sufficient to allow for any anticipated recovery in fair value, as well as the evaluation of the fundamentals of the issuers' financial condition and other objective evidence, the Company believes that the municipal obligations identified in the tables above were temporarily depressed as of March 31, 2011 and December 31, 2010.

At March 31, 2011, the Company owned six collateralized debt obligations backed by pools of trust preferred securities with an original cost basis of $9.75 million. They are secured by trust preferred securities of banks and insurance companies throughout the United States, and were rated as investment grade securities when purchased between March 2006 and December 2007. However, due to several impairment charges recognized since 2008, the book value of these securities at March 31, 2011 had been reduced to $1.8 million. Two of the securities have been written down to a value of zero, with the remaining four having an average cost basis of 29.5% of their original face value. All of the Company's trust preferred collateralized debt obligations are in mezzanine tranches and are currently rated less than investment grade by Moody's Investor Services. The market for these securities is considered to be inactive according to the guidance issued in FASB ASC Topic 820, “Fair Value Measurements and Disclosures,” which the Company adopted as of April 1, 2009. The Company used a discounted cash flow model to determine the estimated fair value of its pooled trust preferred collateralized debt obligations and to assess OTTI. The discounted cash flow analysis was performed in accordance with FASB ASC Topic 325. The assumptions used in preparing the discounted cash flow model include the following: estimated discount rates (using yields of comparable traded instruments adjusted for illiquidity and other risk factors), estimated deferral and default rates on collateral, and estimated cash flows. As part of its analysis of the collateralized debt obligations, the Company subjects the securities to a stress scenario which involves a level of deferrals or defaults in the collateral pool in excess of what the Company believes is likely.

At March 31, 2011, the analysis of the Company's six investments in pooled trust preferred securities indicated that the unrealized loss was temporary and that it is more likely than not that the Company would be able to recover the cost basis of these securities. The pace of new deferrals and/or defaults by the financial institutions underlying these pooled trust preferred securities has begun to slow in recent quarters, although they remain at high levels. The Company follows the provisions of FASB ASC Topic 320 in determining the amount of the OTTI recorded to earnings. The Company performed a discounted cash flow analysis, using the factors noted above, and determined that no additional OTTI existed for the three months ended March 31, 2011, thus no impairment loss was charged to earnings.

It is reasonably possible that the fair values of the Company's investment securities could decline in the future if the overall economy and the financial condition of some of the issuers deteriorate further and the liquidity of these securities remains low. As a result, there is a risk that additional OTTI may occur in the future and any such amounts could be material to the Company's consolidated statements of operations.

A summary of the contractual maturity distribution of debt investment securities at March 31, 2011 is as follows:

	Available For Sale		Held to Maturity	
	Amortized	Fair Value	Amortized	Fair Value

	Cost		Cost	
(in thousands)				
Due in one year or less	$19,883	$20,071	$910	$913
Due after one year through five years	111,852	114,569	1,846	1,882
Due after five years through ten years	96,045	97,507	—	—
Due after ten years	47,149	46,436	868	868
Mortgage-backed securities and collateralized mortgage obligations	219,645	221,921	48	53
Total	$494,574	$500,504	$3,672	$3,716

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For mortgage-backed securities, actual maturities will differ from contractual maturities because borrowers have the right to prepay obligations with or without prepayment penalties.

Other investment securities include investments in Federal Home Loan Bank ("FHLB") stock. The carrying value of the FHLB stock at March 31, 2011 and December 31, 2010 was $10.7 million and $10.6 million, respectively, which is included in the Other Assets line of the consolidated balance sheets. This security is not readily marketable and ownership of FHLB stock is a requirement for membership in the FHLB Des Moines. The amount of FHLB stock the Bank is required to hold is directly related to the amount of FHLB advances borrowed. Because there are no available market values, this security is carried at cost and evaluated for potential impairment each quarter. Redemption of this investment is at the option of the FHLB.

Realized gains and losses on sales are determined on the basis of specific identification of investments based on the trade date. Realized gains (losses) on investments, including impairment losses for the three months ended March 31, 2011 and 2010, are as follows:

	Three Months Ended March 31,	
	2011	2010
(in thousands)		
Available for sale fixed maturity securities:		
Gross realized gains	$—	$197
Gross realized losses	—	—
Other-than temporary impairment	—	(189)
	—	8
Equity securities:		
Gross realized gains	—	49
Gross realized losses	—	(9)
Other-than temporary impairment	—	—
	—	40
	$—	$48

5. Loans Receivable and the Allowance for Loan Losses

The composition of loans and loan pools, and changes in the allowance for loan losses by portfolio segment are as follows:

	Allowance for Loan Losses and Recorded Investment in Loan Receivables As of March 31, 2011 and December 31, 2010						
(in thousands)	Agricultural	Commercial and Financial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
March 31, 2011							
Allowance for loan losses:							
Ending balance	$1,448	$5,069	$ 5,450	$2,299	$250	$ 882	$15,398
Ending balance: Individually evaluated for impairment	276	614	768	163	9	—	$1,830
Ending balance: Collectively evaluated for impairment	1,172	4,455	4,682	2,136	241	882	$13,568

Ending balance: Loans acquired with deteriorated credit quality (loan pools)	13	316	658	244	139	764	$2,134
Loans receivable Ending balance	$80,406	$220,173	$ 392,035	$224,732	$21,177	$ —	$938,523
Ending balance: Individually evaluated for impairment	$1,723	$1,482	$ 3,591	$1,066	$27	$ —	$7,889
Ending balance: Collectively evaluated for impairment	$78,683	$218,691	$ 388,444	$223,666	$21,150	$ —	$930,634
Ending balance: Loans acquired with deteriorated credit quality (loan pools)	$256	$5,742	$ 38,181	$7,181	$248	$ 12,733	$64,341

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(in thousands)	Agricultural	Commercial and Financial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
December 31, 2010							
Allowance for loan losses:							
Ending balance	$ 827	$ 4,540	$ 5,255	$ 2,776	$ 323	$ 1,446	$ 15,167
Ending balance: Individually evaluated for impairment	$ —	$—	$ 100	$ 10	$—	$ —	$ 110
Ending balance: Collectively evaluated for impairment	$ 827	$ 4,540	$ 5,155	$ 2,766	$ 323	$ 1,446	$ 15,057
Ending balance: Loans acquired with deteriorated credit quality (loan pools)	$ 27	$ 368	$ 658	$ 259	$ 164	$ 658	$ 2,134
Loans receivable							
Ending balance	$ 84,590	$ 212,230	$ 393,242	$ 225,994	$ 21,979	$ —	$ 938,035
Ending balance: Individually evaluated for impairment	$ —	$—	$ 447	$ 16	$—	$ —	$ 463
Ending balance: Collectively evaluated for impairment	$ 84,590	$ 212,230	$ 392,795	$ 225,978	$ 21,979	$ —	$ 937,572
Ending balance: Loans acquired with deteriorated credit quality (loan pools)	$ 409	$ 6,611	$ 40,549	$ 7,376	$ 312	$ 12,748	$ 68,005

Allowance for Loan Loss Activity
For the Three Months Ended March 31, 2011 and 2010

(in thousands)	Agricultural	Commercial and Financial	Commercial Real Estate	Residential Real Estate	Consumer	Unallocated	Total
2011							
Beginning balance	$ 827	$ 4,540	$ 5,255	$ 2,776	$ 323	$ 1,446	$ 15,167
Charge-offs	(75)	(219)	(447)	(70)	(21)	—	(832)
Recoveries	—	143	1	15	4	—	163
Provision	696	605	641	(422)	(56)	(564)	900
Ending balance	$ 1,448	$ 5,069	$ 5,450	$ 2,299	$ 250	$ 882	$ 15,398

2010							
Beginning balance	$1,099	$3,468	$6,407	$2,412	$396	$175	$13,957
Charge-offs	(500)	(538)	—	(1)	(41)	—	(1,080)
Recoveries	5	12	94	55	10	—	176
Provision	652	757	(284)	(65)	100	340	1,500
Ending balance	$1,256	$3,699	$6,217	$2,401	$465	$515	$14,553

Loan Portfolio Segment Risk Characteristics

Agricultural - Agricultural loans, most of which are secured by crops and machinery, are provided to finance capital improvements and farm operations as well as acquisitions of livestock and machinery. The ability of the borrower to repay may be affected by many factors outside of the borrower's control including adverse weather conditions, loss of livestock due to disease or other factors, declines in market prices for agricultural products and the impact of government regulations. The ultimate repayment of agricultural loans is dependent upon the profitable operation or management of the agricultural entity. Collateral for these loans generally includes accounts receivable, inventory, equipment and real estate. However, depending on the overall financial condition of the borrower, some loans are made on an unsecured basis. The collateral securing these loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business.

Commercial and Financial - Commercial and financial loans are primarily made based on the reported cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. The collateral support provided by the borrower for most of these loans and the probability of repayment is based on the liquidation of the pledged collateral and enforcement of a personal guarantee, if any exists. The primary repayment risks of commercial and financial loans are that the cash flows of the borrower may be unpredictable, and the collateral securing these loans may fluctuate in value. The size of the loans the Company can offer to commercial customers is less than the size of the loans that competitors with larger lending limits can offer. This may limit the Company's ability to establish relationships with the area's largest businesses. As a result, the Company may assume greater lending risks than financial institutions that have a lesser concentration of such loans and tend to make loans to larger businesses. Collateral for these loans generally includes accounts receivable, inventory, equipment and real estate. However, depending on the overall financial condition of the borrower, some loans are made on an unsecured basis. The collateral securing these loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. In addition, a continued decline in the United States economy could harm or continue to harm the businesses of our commercial and financial customers and reduce the value of the collateral securing these loans.

Commercial Real Estate - The Company offers mortgage loans to commercial and agricultural customers for the acquisition of real estate used in their business, such as offices, warehouses and production facilities, and to real estate investors for the acquisition of apartment buildings, retail centers, office buildings and other commercial buildings. The market value of real estate securing commercial real estate loans can fluctuate significantly in a short period of time as a result of market conditions in the geographic area in which the real estate is located. Adverse developments affecting real estate values in one or more of the Company's markets could increase the credit risk associated with its loan portfolio. Additionally, real estate lending typically involves higher loan principal amounts and the repayment of the loans generally is dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. Economic events or governmental regulations outside of the control of the borrower or lender could negatively impact the future cash flow and market values of the affected properties.

Residential Real Estate - The Company generally retains short-term residential mortgage loans that are originated for its own portfolio but sells most long-term loans to other parties while retaining servicing rights on the majority of those. The market value of real estate securing residential real estate loans can fluctuate as a result of market conditions in the geographic area in which the real estate is located. Adverse developments affecting real estate values in one or more of the Company's markets could increase the credit risk associated with its loan portfolio. Additionally, real estate lending typically involves large loan principal amounts and the repayment of the loans generally is dependent, in large part, on the borrower's continuing financial stability, and are therefore more likely to be affected by adverse personal circumstances.

Consumer - Consumer loans typically have shorter terms, lower balances, higher yields and higher risks of default. Consumer loan collections are dependent on the borrower's continuing financial stability, and are therefore more likely to be affected by adverse personal circumstances. Collateral for these loans generally includes automobiles, boats, recreational vehicles, mobile homes, and real estate. However, depending on the overall financial condition of the borrower, some loans are made on an unsecured basis. The collateral securing these loans may depreciate over time, may be difficult to recover and may fluctuate in value based on condition. In addition, a continued decline in the United States economy could result in reduced employment, impacting the ability of customers to repay their obligations.

Loans acquired with deteriorated credit quality (loan pools) - The underlying loans in the loan pool participations include both fixed-rate and variable-rate instruments. No amounts for interest due are reflected in the carrying value of the loan pool participations. Based on historical experience, the average period of collectibility for loans underlying loan pool participations, many of which have exceeded contractual maturity dates, is approximately three to five years. Loan pool balances are affected by the payment and refinancing activities of the borrowers resulting in pay-offs of the underlying loans and reduction in the balances. Collections from the individual borrowers are managed by the loan pool servicer and are affected by the borrower's financial ability and willingness to pay, foreclosure and legal action, collateral value, and the economy in general.

Charge-off Policy

The Company requires a loan to be charged-off as soon as it becomes apparent that some loss will be incurred, or when its collectability is sufficiently questionable that it no longer is considered a bankable asset. The primary considerations when determining if and how much of a loan should be charged-off are as follows: (1) the potential for future cash flows; (2) the value of any collateral; and (3) the strength of any co-makers or guarantors.

When it is determined that a loan requires partial or full charge-off, a request for approval of a charge-off is submitted to the Bank's President, Executive Vice President of Lending, and the Senior Regional Loan officer. The Bank's Board of Directors formally approves all loan charge-offs retroactively at the next regularly scheduled meeting. Once a loan is charged-off, it cannot be restructured and returned to the Bank's books.

The Allowance for Loan and Lease Losses - Bank Loans

The Company requires the maintenance of an adequate allowance for loan and lease losses (“ALLL”) in order to cover estimated losses without impacting the Company's capital base. Calculations are done at each quarter end, or more frequently if warranted, to analyze the collectability of loans and to ensure the adequacy of the allowance. In line with FDIC directives, the ALLL calculation does not include consideration of loans held for sale or off-balance-sheet credit exposures (such as unfunded letters of credit). Determining the appropriate level for the ALLL relies on the informed judgment of management, and as such, is subject to inaccuracy. Given the inherently imprecise nature of calculating the necessary ALLL, the Company's policy permits an "unallocated" allowance between 15% above and 5% below the “indicated reserve.”

Loans Reviewed Individually for Impairment

During the first quarter of 2011, the Company expanded its procedure for reviewing individual loans for potential impairment and determining the necessary allocation of the allowance for loan losses to impaired loans. Previously, only loans already identified as impaired were individually reviewed each quarter for further impairment. Effective March 31, 2011, in addition to loans already identified as impaired, all non-accrual and troubled debt restructures are evaluated for potential impairment due to collateral deficiency or insufficient cash-flow using an individual discounted cash-flow analysis at the loan's effective interest rate. Loans that are deemed fully collateralized or have been charged down to a level corresponding with either of the measurements require no assignment of reserves from the ALLL.

All loans deemed troubled debt restructure or “TDR” are considered impaired, and are evaluated for collateral and cash-flow sufficiency. A loan is considered a TDR when the Bank, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to the borrower that the Bank would not otherwise consider. All of the following factors are indicators that the Bank has granted a concession (one or multiple items may be present):

- The borrower receives a reduction of the stated interest rate for the remaining original life of the debt.
- The borrower receives an extension of the maturity date or dates at a stated interest rate lower than the current market interest rate for new debt with similar risk characteristics.
- The borrower receives a reduction of the face amount or maturity amount of the debt as stated in the instrument or other agreement.
- The borrower receives a deferral of required payments (principal and/or interest).
- The borrower receives a reduction of the accrued interest.

As of March 31, 2011, the Company had 15 loans classified as TDRs with an outstanding balance of $6.7 million.

Loans Reviewed Collectively for Impairment

All loans not evaluated individually for impairment are grouped together by type (i.e. commercial, agricultural, consumer, etc.) and further segmented within each subset by risk classification (i.e. pass, special mention, and substandard). Loans past due 60-89 days and 90+ days, are classified special mention and substandard, respectively, for allocation purposes.

The Company's historical loss experiences for each loan type segment are calculated using the fiscal year end data for the most recent five years as a starting point for estimating losses. In addition, other prevailing qualitative or environmental factors likely to cause estimated losses to vary from historical data are to be incorporated in the form of adjustments to increase or decrease the loss rate applied to a group(s). These adjustments are required to be documented, and fully explain how the current information, events, circumstances, and conditions impact the historical loss measurement assumptions.

Although not a comprehensive list, the following are considered key factors and are evaluated with each calculation of the ALLL to determine if adjustments to estimated loss rates are warranted:

- Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses.
- Changes in international, national, regional, and local economic and business conditions and developments that affect the collectability of the portfolio, including the condition of various market segments.
- Changes in the nature and volume of the portfolio and in the terms of loans.
- Changes in the experience, ability and depth of lending management and other relevant staff.
- Changes in the volume and severity of past due loans, the volume of nonaccrual loans, and the volume and severity of adversely classified or graded loans.
- Changes in the quality of the institution's loan review system.
- Changes in the value of underlying collateral for collateral-dependent loans.
- The existence and effect of any concentrations of credit, and changes in the level of such concentrations.
- The effect of other external factors such as competition and legal and regulatory requirements, on the level of estimated credit losses in the bank's existing portfolio.

The items discussed above are used to determine the pass percentage for loans evaluated collectively and, as such, are applied to the loans risk rated pass. Due to the inherent risks associated with special mention risk rated loans (i.e. early stages of financial deterioration, technical exceptions, etc.), an allocation factor of two times that of the pass allocation is applied to this subset to reflect this increased risk exposure. In addition, loans classified as substandard carry an even greater level of risk than special mention loans, and an allocation factor of six times that of the pass allocation is applied to this subset of loans. Further, loans classified as substandard and are "performing collateral deficient" have an allocation factor of 12 times that of the pass allocation applied due to the perceived additional risk for these credits.

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The Allowance for Loan and Lease Losses - Loan Pools

The Company requires that the loan pool ALLL will be at least sufficient to cover the next quarter's estimated charge-offs as presented by the servicer. Currently, charge-offs are netted against the income the Company receives, thus the balance in the loan pool reserve is not affected and remains stable. In essence, a provision for loan losses is made that is equal to the quarterly charge-offs, which is deducted from income received from the loan pools. By maintaining a sufficient reserve to cover the next quarter charge-offs, the Company will have sufficient reserves in place should no income be collected from the loan pools during the quarter. In the event the estimated charge-offs provided by the servicer is greater than the loan pool ALLL, an additional provision to cover the difference between the current ALLL and the estimated charge-offs provided by the servicer is made.

Loans Reviewed Individually for Impairment

The loan servicer reviews the portfolio quarterly on a loan-by-loan basis, and loans that are deemed to be impaired are charged-down to their estimated value during the next calendar quarter. All loans that are to be charged-down are reserved against in the ALLL adequacy calculation. Loans that continue to have an investment basis that have been charged-down are monitored, and if additional impairment is noted the reserve requirement is increased on the individual loan.

Loans Reviewed Collectively for Impairment

The Company utilizes the annualized average of portfolio loan (not loan pool) historical loss per risk category over a two year period of time. Supporting documentation for the technique used to develop the historical loss rate for each group of loans is required to be maintained. It is management's assessment that the two year rate is most reflective of the estimated credit losses in the current loan pool portfolio.

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The following table sets forth the composition of the Company's loans by internally assigned credit quality indicators at March 31, 2011 and December 31, 2010:

	Pass	Special Mention/ Watch	Substandard	Doubtful	Loss	Total
(in thousands)						
March 31, 2011						
Agricultural	$66,638	$2,436	$11,332	$—	$—	$80,406
Commercial and financial	182,122	18,210	18,485	—	—	218,817
Credit cards	896	—	—	—	—	896
Overdrafts	440	121	77	—	—	638
Commercial real estate:						
Construction & development	50,754	6,296	14,539	—	—	71,589
Farmland	59,958	3,456	5,556	—	—	68,970
Multifamily	33,548	332	180	—	—	34,060
Commercial real estate-other	188,919	18,561	9,936	—	—	217,416
Total commercial real estate	333,179	28,645	30,211	—	—	392,035
Residential real estate:						
One- to four- family first liens	146,738	7,099	5,241	—	—	159,078
One- to four- family junior liens	64,849	414	391	—	—	65,654
Total residential real estate	211,587	7,513	5,632	—	—	224,732
Consumer	20,703	51	245	—	—	20,999
Total	$815,565	$56,976	$65,982	$—	$—	$938,523
Loans acquired with deteriorated credit quality (loan pools)	$37,551	$—	$26,688	$—	$102	