National CineMedia, Inc.
Form 10-Q
August 09, 2016

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, 2016

Commission file number: 001-33296

NATIONAL CINEMEDIA, INC.

(Exact name of registrant as specified in its charter)

Delaware	20-5665602
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

9110 East Nichols Avenue, Suite 200

Centennial, Colorado	80112-3405
(Address of Principal Executive Offices)	(Zip Code)

Registrant's telephone number, including area code: (303) 792-3600

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

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

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 definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o
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). Yes o No x

As of August 3, 2016, 62,378,026 shares of the registrant’s common stock (including unvested restricted shares), par value of $0.01 per share, were outstanding.

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PART I

Item 1. Financial Statements

NATIONAL CINEMEDIA, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions, except share and per share data)

(UNAUDITED)

	June 30, 2016	December 31, 2015
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 17.4	$ 31.7
Short-term marketable securities	18.5	13.2
Receivables, net of allowance of $6.1 and $5.6, respectively	126.3	148.9
Prepaid expenses	4.0	2.8
Income tax receivable	2.7	2.5
Current portion of notes receivable - founding members	4.2	4.2
Other current assets	0.6	0.3
Total current assets	173.7	203.6
NON-CURRENT ASSETS:		
Property and equipment, net of accumulated depreciation of $62.8 and $64.1, respectively	27.6	25.1
Intangible assets, net of accumulated amortization of $105.2 and $91.9, respectively	574.8	566.7
Deferred tax assets	219.1	217.1
Long-term notes receivable, net of current portion - founding members	12.5	12.5
Other investments	6.8	5.4
Long-term marketable securities	28.5	40.5
Debt issuance costs, net	2.2	2.3
Other assets	0.5	0.5
Total non-current assets	872.0	870.1
TOTAL ASSETS	$ 1,045.7	$ 1,073.7
LIABILITIES AND EQUITY/(DEFICIT)		
CURRENT LIABILITIES:		
Amounts due to founding members	$ 12.4	$ 35.5
Payable to founding members under tax receivable agreement	13.7	26.2
Accrued expenses	20.2	19.8
Accrued payroll and related expenses	9.9	18.1
Accounts payable	11.7	14.9
Deferred revenue	14.3	10.2
Total current liabilities	82.2	124.7
NON-CURRENT LIABILITIES:		
Long-term debt, net of debt issuance costs of $9.6 and $10.6, respectively	932.4	925.4
Deferred tax liability	48.9	50.1

Income tax payable	5.0	4.9
Payable to founding members under tax receivable agreement	143.6	140.3
Total non-current liabilities	1,129.9	1,120.7
Total liabilities	1,212.1	1,245.4
COMMITMENTS AND CONTINGENCIES (NOTE 7)		
EQUITY/(DEFICIT):		
NCM, Inc. Stockholders' Equity/(Deficit):		
Preferred stock, $0.01 par value; 10,000,000 shares authorized, none issued and outstanding, respectively	—	—
Common stock, $0.01 par value; 175,000,000 shares authorized, 59,836,399 and 59,239,154 issued and outstanding, respectively	0.6	0.6
Additional paid in capital/(deficit)	(213.1)	(221.5)
Retained earnings (distributions in excess of earnings)	(210.3)	(186.1)
Total NCM, Inc. stockholders' equity/(deficit)	(422.8)	(407.0)
Noncontrolling interests	256.4	235.3
Total equity/(deficit)	(166.4)	(171.7)
TOTAL LIABILITIES AND EQUITY/DEFICIT	$ 1,045.7	$ 1,073.7

See accompanying notes to Condensed Consolidated Financial Statements.

NATIONAL CINEMEDIA, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In millions, except share and per share data)

(UNAUDITED)

	Three Months Ended		Six Months Ended	
	June 30, 2016	July 2, 2015	June 30, 2016	July 2, 2015
REVENUE (including revenue from founding members of $7.2, $9.0, $14.5 and $16.7, respectively)	$115.4	$121.5	$191.6	$198.4
OPERATING EXPENSES:				
Advertising operating costs	8.3	8.3	13.3	14.1
Network costs	4.3	4.2	8.8	8.7
Theatre access fees—founding members	18.9	19.2	37.6	36.4
Selling and marketing costs	19.1	17.0	37.7	33.0
Merger termination fee and related merger costs	—	0.9	—	34.3
Administrative and other costs	9.4	8.3	24.3	17.0
Depreciation and amortization	8.9	8.2	17.6	16.2
Total	68.9	66.1	139.3	159.7
OPERATING INCOME	46.5	55.4	52.3	38.7
NON-OPERATING EXPENSES:				
Interest on borrowings	13.5	13.1	26.9	26.2
Interest income	(0.4)	(0.3)	(1.0)	(0.9)
Accretion of interest on the discounted payable to founding members under tax receivable agreement	3.4	3.5	7.0	7.1
Amortization of terminated derivatives	—	—	—	1.6
Other non-operating expense	—	—	—	0.1
Total	16.5	16.3	32.9	34.1
INCOME BEFORE INCOME TAXES	30.0	39.1	19.4	4.6
Income tax expense	4.5	5.8	2.4	1.5
CONSOLIDATED NET INCOME	25.5	33.3	17.0	3.1
Less: Net income attributable to noncontrolling interests	18.7	23.2	14.5	2.0
NET INCOME ATTRIBUTABLE TO NCM, INC.	$6.8	$10.1	$2.5	$1.1
NET INCOME PER NCM, INC. COMMON SHARE:				
Basic	$0.11	$0.17	$0.04	$0.02
Diluted	$0.11	$0.17	$0.04	$0.02
WEIGHTED AVERAGE SHARES OUTSTANDING:				
Basic	59,831,675	58,974,581	59,721,270	58,931,628
Diluted	60,556,539	59,595,019	60,314,112	59,360,245

Dividends declared per common share	$0.22	$0.22	$0.44	$0.44

See accompanying notes to Condensed Consolidated Financial Statements.

NATIONAL CINEMEDIA, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)

(UNAUDITED)

	Three Months Ended		Six Months Ended	
	June 30, 2016	July 2, 2015	June 30, 2016	July 2, 2015
CONSOLIDATED NET INCOME, NET OF TAX OF $4.5, $5.8, $2.4 AND $1.5, RESPECTIVELY	$25.5	$33.3	$17.0	$ 3.1
OTHER COMPREHENSIVE INCOME, NET OF TAX:				
Amortization of terminated derivatives, net of tax of $0.0, $0.0, $0.0 and $0.3, respectively	—	—	—	1.3
CONSOLIDATED COMPREHENSIVE INCOME	25.5	33.3	17.0	4.4
Less: Comprehensive income attributable to noncontrolling interests	18.7	23.2	14.5	2.9
COMPREHENSIVE INCOME ATTRIBUTABLE TO NCM, INC.	$6.8	$10.1	$2.5	$ 1.5

See accompanying notes to Condensed Consolidated Financial Statements.

NATIONAL CINEMEDIA, INC. AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

(UNAUDITED)

	Six Months Ended	
	June 30, 2016	July 2, 2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Consolidated net income	$17.0	3.1
Adjustments to reconcile consolidated net income to net cash provided by operating activities:		
Deferred income tax expense	2.1	1.0
Depreciation and amortization	17.6	16.2
Non-cash share-based compensation	10.3	5.9
Excess tax benefit from share-based compensation	—	(0.1)
Accretion of interest on the discounted payable to founding members under tax receivable agreement	7.0	7.1
Impairment on investment	0.7	—
Amortization of terminated derivatives	—	1.6
Amortization of debt issuance costs	1.3	1.3
Other	(0.1)	0.6
Changes in operating assets and liabilities:		
Receivables, net	20.6	(12.0)
Accounts payable and accrued expenses	(9.7)	(1.8)
Amounts due to founding members	0.3	1.0
Payment to founding members under tax receivable agreement	(23.5)	(17.2)
Deferred revenue	4.1	4.9
Income taxes and other	(1.8)	(1.4)
Net cash provided by operating activities	45.9	10.2
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(6.6)	(4.8)
Purchases of marketable securities	(25.9)	(40.8)
Proceeds from sale and maturities of marketable securities	32.8	49.9
Purchases of intangible assets from network affiliates	(1.1)	(0.9)
Net cash (used in) provided by investing activities	(0.8)	3.4
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment of dividends	(28.2)	(26.4)
Proceeds from borrowings	93.0	113.0
Repayments of borrowings	(87.0)	(70.0)
Payment of debt issuance costs	(0.3)	—
Founding member integration payments	1.0	1.1

Distributions to founding members	(33.5)	(32.9)	
Excess tax benefit from share-based compensation	—	0.1	
Proceeds from stock option exercises	0.3	1.1	
Repurchase of stock for restricted stock tax withholding	(4.7)	(1.2)	
Net cash used in financing activities	(59.4)		44,360

Total assets	$ 1,527,170			$ 1,504,685		
Average interest-bearing liabilities:						
Savings and interest-bearing demand deposits	$ 468,409	$ 1,106	0.96%	$ 434,879	1,199	1.12%
Time Certificates of deposit	569,336	3,510	2.50	562,659	4,488	3.23
Total deposits	1,037,745	4,616	1.80	997,538	5,687	2.31
Federal funds purchased and repurchase agreements	40,661	77	0.77	50,978	134	1.07
Federal Home Loan Bank borrowings	128,689	1,207	3.80	159,321	916	2.33
Long-term debt and other	16,446	161	3.97	16,590	189	4.62
Total interest-bearing liabilities	$ 1,223,541	$ 6,061	2.01%	$ 1,224,427	$ 6,926	2.29%
Net interest spread			3.21%			3.28%
Demand deposits	135,771			130,826		
Other liabilities	14,060			8,280		
Shareholders equity	153,798			141,152		
Total liabilities and shareholders equity	$ 1,527,170			$ 1,504,685		
Interest income/earning assets (2)	$ 1,433,850	$ 18,446	5.22%	$ 1,418,015	$ 19,500	5.58%
Interest expense/earning assets	$ 1,433,850	$ 6,061	1.71%	$ 1,418,015	$ 6,926	1.98%
Net interest margin (2)(5)		$ 12,385	3.50%		$ 12,574	3.60%
Non-GAAP to GAAP Reconciliation:						
Tax Equivalent Adjustment:						
Loans		$ 85			$ 97	
Securities		533			523	
Total tax equivalent adjustment		618			620	
Net Interest Income		$ 11,767			$ 11,954	

(1) Loan fees included in interest income are not material.
(2) Computed on a tax-equivalent basis, assuming a federal income tax rate of 34%.
(3) Non-accrual loans have been included in average loans, net of unearned discount.
(4) Includes interest income and discount realized on loan pool participations.
(5) Net interest margin is tax-equivalent net interest income as a percentage of average earning assets.

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The following table sets forth an analysis of volume and rate changes in interest income and interest expense on our average earning assets and average interest-bearing liabilities reported on a fully tax-equivalent basis assuming a 34% tax rate. The table distinguishes between the changes related to average outstanding balances (changes in volume holding the initial interest rate constant) and the changes related to average interest rates (changes in average rate holding the initial outstanding balance constant). The change in interest due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

	Three Months Ended March 31, 2010 Compared to 2009 Change due to		
(in thousands)	Volume	Rate/Yield	Net
Increase (decrease) in interest income			
Loans (tax equivalent)	$ (800)	$ (419)	$ (1,219)
Loan pool participations	(133)	17	(116)
Investment securities:			
Taxable investments	495	(245)	250
Tax exempt investments	92	(62)	30
Total investment securities	587	(307)	280
Federal funds sold and interest-bearing balances	(1)	2	1
Change in interest income	(347)	(707)	(1,054)
Increase (decrease) in interest expense			
Savings and interest-bearing demand deposits	108	(201)	(93)
Time Certificates of deposit	54	(1,032)	(978)
Total deposits	162	(1,233)	(1,071)
Federal funds purchased and repurchase agreements	(24)	(33)	(57)
Federal Home Loan Bank borrowings	(127)	418	291
Other long-term debt	(2)	(26)	(28)
Change in interest expense	9	(874)	(865)
Increase (decrease) in net interest income	$ (356)	$ 167	$ (189)
Percentage decrease in net interest income over prior period			(1.50)

Interest income and fees on loans on a tax-equivalent basis decreased $1.2 million, or 8.1%, in the first quarter of 2010 compared to the same period in 2009. Average loans were $55.1 million, or 5.4%, lower in the first quarter of 2010 compared with 2009. The decrease in average loan volume was attributable to the volume of refinancing activity, which resulted in a large amount of adjustable rate residential real estate loans that were held in our portfolio being refinanced into fixed-rate loans that are sold in the secondary market rather than held in our portfolio. The yield on our loan portfolio is affected by the amount of nonaccrual loans (which do not earn interest income), the mix of the portfolio (real estate loans generally have a lower overall yield than commercial and agricultural loans), the effects of competition and the interest rate environment on the amounts and volumes of new loan originations, and the mix of variable rate versus fixed rate loans in our portfolio. The average rate on loans decreased slightly from 6.00% in the first quarter of 2009 to 5.83% in first quarter of 2010.

Interest and discount income on loan pool participations was $0.9 million for the first quarter of 2010 compared with $1.0 million for the first quarter of 2009, a decrease of $0.1 million. Former MidWest*One* had engaged in this business since 1988 and we continued the business following the merger. These loan pool participations are pools of performing, sub-performing and nonperforming loans purchased at varying discounts from the aggregate outstanding principal amount of the underlying loans. The loan pools are held and serviced by a third-party independent servicing corporation. We invest in the pools that are purchased by the servicer from nonaffiliated banking organizations and from the FDIC acting as receiver of failed banks and savings associations. We have very minimal exposure in the loan pools to consumer real estate, subprime credit or construction and real estate development loans. Currently, we hold $83.7 million in loan pool participations.

Income is derived from this investment in the form of interest collected and the repayment of principal in excess of the purchase cost, which is referred to as discount recovery. The loan pool participations were historically a high-yield activity, but this yield has fluctuated from period to period based on the amount of cash collections, discount recovery, and net collection expenses of the servicer in any given period. The net all-in yield on loan pool participations was 4.98% for the first quarter of 2010, down from 5.48% for the same period of 2009. The net yield was lower in the first quarter of 2010 than for the first quarter of 2009 primarily due to elevated charge-off levels in the portfolio as well as slowed collections, as borrowers saw their ability to refinance debt decline due to the continued tightness in the credit markets.

The income and yield on loan pool participations may vary in future periods due to the volume and accretable yield on loan pools purchased.

Interest income on investment securities on a tax-equivalent basis totaled $3.7 million in the first quarter of 2010 compared with $3.5 million for the first quarter of 2009, an increase of $280,000, or 8.1%, mainly due to a higher investment balance, and despite a lower yield on investments in 2010. The average balance of investments in the first quarter of 2010 was $378.6 million compared with $291.0 million in the first quarter of 2009. The tax-equivalent yield on our investment portfolio in the first quarter of 2010 decreased to 4.01% from 4.83% in the comparable period of 2009 reflecting reinvestment of maturing securities and purchases of new securities at lower market interest rates.

Interest expense on deposits was $1.1 million, or 18.8%, lower in the first quarter of 2010 compared with the same period in 2009 mainly due to the decrease in interest rates during 2009. The weighted average rate paid on interest-bearing deposits was 1.80% in the first quarter of 2010 compared with 2.31% in the first quarter of 2009. This decline reflects the overall reduction in market interest rates on deposits throughout the markets in which we operate. Average interest-bearing deposits for the first quarter of 2010 were $40.2 million, or 4.0%, greater compared with the same period in 2009.

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Interest expense on borrowed funds was $206,000 higher in the first quarter of 2010 compared with the same period in 2009. Interest on borrowed funds totaled $1.4 million for the first quarter of 2010. Average borrowed funds for the first quarter of 2010 were $41.1 million lower compared to the same period in 2009. The majority of the difference was due to a reduction in the level of federal funds purchased, repurchase agreements, and FHLB borrowings. Elimination of the purchase accounting benefit on FHLB borrowings related to the March 2008 merger in the first quarter of 2009 led to the weighted average rate on borrowed funds increasing to 3.15% for the first quarter of 2010 compared with 2.21% for the first quarter of 2009.

Provision for Loan Losses

The provision for loan losses is a current charge against income and represents an amount which management believes is sufficient to maintain an adequate allowance for known and probable losses. In assessing the adequacy of the allowance for loan losses, management considers the size and quality of the loan portfolio measured against prevailing economic conditions, regulatory guidelines, historical loan loss experience and credit quality of the portfolio. When a determination is made by management to charge off a loan balance, such write-off is charged against the allowance for loan losses.

We recorded a provision for loan losses of $1.5 million in the first quarter of 2010 compared with a $2.4 million provision in the first quarter of 2009. Net loans charged off in the first quarter of 2010 totaled $0.9 million compared with net loans charged off of $0.4 million in the first quarter of 2009. The decrease in the provision in the first quarter of 2010 compared with the same period in 2009 reflects our belief that existing identified potential problem credits have been adequately reserved for. We continue to increase our loan loss allowance by maintaining a provision for loan losses that is greater than out net charge-off activity. We determine an appropriate provision based on our evaluation of the adequacy of the allowance for loan losses in relationship to a continuing review of problem loans, current economic conditions, actual loss experience and industry trends. We believe that the allowance for loan losses was adequate based on the inherent risk in the portfolio as of March 31, 2010; however, there is no assurance losses will not exceed the allowance and any growth in the loan portfolio, and the uncertainty of the general economy may require that management continue to evaluate the adequacy of the allowance for loan losses and make additional provisions in future periods as deemed necessary.

Sensitive assets include nonaccrual loans, loans on the Bank s watch loan reports and other loans identified as having more than reasonable potential for loss. We review sensitive assets on at least a quarterly basis for changes in the customers ability to pay and changes in valuation of underlying collateral in order to estimate probable losses. We also periodically review a watch loan list which is comprised of loans that have been restructured or involve customers in industries which have been adversely affected by market conditions. The majority of these loans are being repaid in conformance with their contracts.

Noninterest Income

	Three months ended March 31,		
	2010	**2009**	**% Change**
(dollars in thousands)			
Trust and investment fees	$ 1,234	$ 1,107	11.5%
Service charges and fees on deposit accounts	864	911	(5.2)
Mortgage origination and loan servicing fees	500	771	(35.1)
Other service charges, commissions and fees	584	525	11.2
Bank owned life insurance income	167	224	(25.4)
Impairment losses on investment securities, net	(189)		NM
Gain on sale of available for sale securities	237		NM
Loss on sale of premises and equipment	(77)		NM
Total noninterest income	$ 3,320	$ 3,538	(6.2)%

NM - Percentage change not considered meaningful.

Total noninterest income decreased $0.2 million for the first quarter of 2010 compared to the same period for 2009. The decrease in 2010 is largely due to the $0.3 million decline in mortgage origination and servicing fees between the two comparative periods. Other than temporary impairment charges on investment securities of $0.2 million was more than offset by gains of the sale of available for sale investment securities. The impairment charge recognized in 2010 resulted from our investment in collateralized debt obligations backed by groups of trust preferred securities issued by multiple banks and insurance companies.

Mortgage origination and loan servicing fees were $0.5 million in the quarter ended March 31, 2010, a decline of $0.3 million from $0.8 million at March 31, 2009. The decrease in mortgage origination fees was attributable to lower refinancing volume of single family residential loans, as the bulk of creditworthy borrowers had already taken advantage of the historically low interest rates before the start of 2010. Trust and investment fees increased $0.1 million, or 11.5%, to $1.2 million for the three months ended March 31, 2010, compared to $1.1 million for the same period of 2009. The sale of an unused bank office building in Oskaloosa during the first quarter of 2010 resulted in

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a net loss of $77,000. Management s strategic goal is for noninterest income to constitute 30% of total revenues (net interest income plus noninterest expense) over time. As of March 31, 2010 noninterest income comprised 22.0% of total revenues, compared to 22.8% as of March 31, 2009.

Noninterest Expense

	Three months ended March 31,		
	2010	2009	% Change
(dollars in thousands)			
Salaries and employee benefits	$ 5,790	$ 5,753	0.6%
Net occupancy and equipment expense	1,776	1,707	4.0
Professional fees	749	1,082	(30.8)
Data processing expense	457	516	(11.4)
FDIC insurance expense	692	898	(22.9)
Other operating expense	1,584	1,967	(19.5)
Total noninterest expense	$ 9,464	$ 9,956	(4.9)%

NM - Percentage change not considered meaningful.

Noninterest expense for the first quarter of 2010 was $11.0 million compared with $11.9 million for the first quarter of 2009, a decrease of $0.9 million, or 7.3%. Noninterest expense includes salaries and employee benefits, occupancy and equipment expense, FDIC insurance premiums, professional fees and data processing expense. The primary reason for the decrease in noninterest expense was the drop in all categories of noninterest expense, with the exception of small increases in salaries and employee benefits and net occupancy, for the three months ended March 31, 2010, compared to the same period in 2009. Professional fees decreased by $0.3 million from $1.1 million to $0.8 million for the quarter ended March 31, 2009 and 2010, respectively, due to lower costs associated with Sarbanes Oxley compliance efforts. FDIC insurance also saw a moderate decline of $0.2 million to $0.7 million from $0.9 million for the first quarter of 2010 compared to the same period in 2009. Salaries and employee benefits and net occupancy and equipment expenses both saw small increases between the comparative periods.

We are currently evaluating the potential for restructuring our branch footprint in 2010 and decreasing associated expenses to further reduce operating costs.

Income Tax Expense

Our effective tax rate, or income taxes divided by income before taxes, was 21.1% for the first quarter of 2010, and 3.5% for the same period of 2009. The increase in the effective rate in 2010 was primarily due to the relative amount of tax-exempt income on tax-exempt bonds to total net income. Income tax expense increased $492,000 to $535,000 in the first quarter of 2010 compared to $43,000 for the same period of 2009.

FDIC Assessments

On November 12, 2009, the FDIC adopted a final rule that required insured depository institutions to prepay on December 30, 2009, their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011, and 2012. On December 31, 2009, the Bank paid the FDIC $9.2 million in prepaid assessments. The FDIC determined each institution s prepaid assessment based on the institution s: (i) actual September 30, 2009 assessment base, increased quarterly by a five percent annual growth rate through the fourth quarter of 2012; and (ii) total base assessment rate in effect on September 30, 2009, increased by an annualized three basis points beginning in 2011. The FDIC began to offset prepaid assessments on March 31, 2010, representing payment of the regular quarterly risk-based deposit insurance assessment for the fourth quarter of 2009. Any prepaid assessment not exhausted after collection of the amount due on June 30, 2013, will be returned to the institution.

FINANCIAL CONDITION

Our total assets increased slightly to $1.54 billion as of March 31, 2010 from $1.53 billion on December 31, 2009. This growth resulted primarily from increased interest-bearing deposits in banks and investment in securities, somewhat offset by a decrease in loans due to refinancing activity of portfolio loans, mostly consisting of single family residential loans that are then sold on the secondary market. The asset growth was funded by an increase in deposits. Total deposits at March 31, 2010 were $1.19 billion compared with $1.18 billion at December 31, 2009, up $13.4 million, or 1.1%, primarily due to increased consumer and public fund deposits.

Investment Securities

Investment securities available for sale totaled $375.2 million as of March 31, 2010. This was an increase of $12.3 million, or 3.4%, from December 31, 2009. The increase was primarily due to net purchases of $12.0 million during the period. Investment securities classified as held to maturity decreased to $6.2 million as of March 31, 2010 as a result of security maturities. The investment portfolio consists mainly of U.S. government agency securities, mortgage-backed securities and obligations of states and political subdivisions.

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As of March 31, 2010, we owned $1.8 million of collateralized debt obligations that were backed by pools of trust preferred securities issued by various commercial banks (approximately 80%) and insurance companies (approximately 20%). No real estate holdings secure these debt securities. We continue to monitor the values of these debt securities for purposes of determining other-than-temporary impairment in future periods given the instability in the financial markets and continue to obtain updated cash flow analysis as required.

Loans

The following table shows the composition of the bank loans (before deducting the allowance for loan losses), as of the periods shown:

	March 31, 2010		December 31, 2009	
	Balance	% of Total	Balance	% of Total
(in thousands)				
Agricultural	$ 89,825	9.4%	$ 92,727	9.6%
Commercial and financial	201,637	21.1	203,539	21.0
Real estate:				
Construction, one- to four- family residential	21,063	2.2	20,785	2.1
Construction, land development and commercial	56,389	5.9	58,652	6.1
Mortgage, farmland	87,947	9.2	88,747	9.2
Mortgage, one- to four- family first liens	157,005	16.4	161,065	16.7
Mortgage, one- to four- family junior liens	71,733	7.5	73,665	7.6
Mortgage, multifamily	31,745	3.3	32,455	3.4
Mortgage, commercial	198,667	20.8	196,025	20.3
Loans to individuals	23,074	2.4	23,262	2.4
Obligations of state and political subdivisions	15,604	1.6	16,076	1.7
Total loans	$ 954,689	100.0%	$ 966,998	100.0%

Total bank loans (excluding loan pool participations and loans held for sale) decreased by $12.3 million, to $954.7 million as of March 31, 2010 as compared to December 31, 2009. We experienced a $4.8 million, or 1.6%, decrease in the commercial, financial and agricultural sectors, along with a $4.9 million, or 0.9%, decrease in real estate mortgage loans, which resulted primarily from the continued refinancing activity seen due to historically low interest rates, which resulted in adjustable rate residential real estate loans that were held in our portfolio being refinanced into fixed-rate loans that are sold in the secondary market rather than held in our portfolio. Additionally, construction real estate decreased $2.0 million, or 2.5%; loans to individuals decreased $0.2 million, or 0.8%, and; and obligations of state and political subdivisions declined $0.5 million, or 2.9%. As of March 31, 2010, our bank loan (excluding loan pool participations) to deposit ratio was 80.0% compared with a year-end 2009 bank loan to deposit ratio of 82.0%. We anticipate that the loan to deposit ratio will continue to decline in future periods, as loans continue to pay down and deposits remain steady or increase. As of March 31, 2010, our largest category of bank loans was commercial real estate, comprising 42% of the portfolio, of which 9% was farmland, 8% construction, and 3% multifamily. Residential real estate loans was the next largest category at 24%, commercial loans 23%, agricultural loans 9%, and consumer loans 2%. All of these percentages relate to our direct loans and do not include loan pool participations.

We have minimal direct exposure to subprime mortgages in our loan portfolio. Our loan policy provides a guideline that real estate mortgage borrowers have a Beacon score of 640 or greater. Exceptions to this guideline have been noted but the overall exposure is deemed minimal by management. Mortgages we originate and sell on the secondary market are typically underwritten according to the guidelines of secondary market investors. These mortgages are sold on a non-recourse basis.

Loan Pool Participations

As of March 31, 2010, we had loan pool participations, net, totaling $81.5 million, down from $83.1 million at December 31, 2009. Loan pools are participation interests in performing, sub-performing and nonperforming loans that have been purchased from various non-affiliated banking organizations. Former MidWest*One* had engaged in this activity since 1988, and we continued this line of business following the merger. We have identified a maximum for loan pool participation balances of not more than $110.0 million. The most recently purchased pools have performed well and we believe the business still has merit over the long term. The loan pool investment balances shown as an asset on our Consolidated Balance Sheets represent the discounted purchase cost of the loan pool participations. We acquired no new loan pool participations during the first quarter of 2010. As of March 31, 2010, the categories of loans by collateral type in the loan pools were commercial real estate - 54%, commercial loans - 11%, agricultural and agricultural real estate 10%, single-family residential real estate - 11% and other loans - 14%.

We have minimal exposure in the loan pools to consumer real estate subprime credit or to construction and real estate development loans.

Our overall cost basis in the loan pool participations represents a discount from the aggregate outstanding principal amount of the loans underlying the pools. For example, as of March 31, 2010, such cost basis was $83.2 million, while the contractual outstanding principal amount of the underlying loans as of such date was approximately $177.3 million. The discounted cost basis inherently reflects the assessed collectability of the underlying loans. We do not include any amounts related to the loan pool participations in our totals of nonperforming loans.

The loans in the pools provide some geographic diversification to our balance sheet. As of March 31, 2010, loans in the southeast region of the United States represented approximately 40% of the total. The northeast was the next largest area with 32%, the central region with 19%, the southwest region with 8% and northwest represented a minimal amount of the portfolio at 1%. The highest concentration of assets is in Florida at approximately 18% of the basis total, with the next highest state level being Ohio at 11%, then Pennsylvania at

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approximately 7%, followed by Colorado and New Jersey both at 6%. As of March 31, 2010, approximately 56% of the loans were contractually current or less than 90 days past-due, while 44% were contractually past-due 90 days or more. It should be noted that many of the loans were acquired in a contractually past due status, which is reflected in the discounted purchase price of the loans. Performance status is monitored on a monthly basis. The 44% contractually past-due includes loans in litigation and foreclosed property. As of March 31, 2010, loans in litigation totaled approximately $17.6 million, while foreclosed property was approximately $11.4 million. As of March 31, 2010, our investment basis in our loan pool participations was approximately 46.9% of the face amount of the underlying loans.

Other Intangible Assets

Other intangible assets decreased to $11.9 million as of March 31, 2010 from $12.2 million as of December 31, 2009 as a result of normal amortization. Amortization of intangible assets is recorded using an accelerated method based on the estimated life of the intangible. The following table summarizes the amounts and carrying values of intangible assets as of March 31, 2010.

(in thousands)	Gross Carrying Amount	Accumulated Amortization	Unamortized Intangible Assets
March 31, 2010			
Other intangible assets:			
Insurance agency intangible	1,320	292	1,028
Core deposit premium	5,433	1,858	3,575
Trade name intangible	7,040		7,040
Customer list intangible	330	57	273
Total	$ 14,123	$ 2,207	$ 11,916

Deposits

Total deposits as of March 31, 2010 were $1.19 billion compared with $1.18 billion as of December 31, 2009, an increase of $13.4 million. Certificates of deposit were the largest category of deposits at March 31, 2010, representing approximately 48.1% of total deposits. Total certificates of deposit were $573.9 million at March 31, 2010, down $7.7 million, or 1.3%, from $581.6 million at December 31, 2009. Included in total certificates of deposit at March 31, 2010 was $23.9 million of brokered deposits in the Certificate of Deposit Account Registry Service (CDARS) program, a decrease of $0.5 million, or 2.0%, from the $24.4 million at December 31, 2009. Based on historical experience, management anticipates that many of the maturing certificates of deposit will be renewed upon maturity. Maintaining competitive market interest rates will facilitate our retention of certificates of deposit. Interest-bearing checking deposits were $423.7 million at March 31, 2010, an increase of $22.4 million, or 5.6%, from $401.3 million at December 31, 2009. The increased balances were primarily in our Power Checking account product. Approximately 84.6% of our total deposits are considered core deposits.

Federal Home Loan Bank Borrowings

FHLB borrowings totaled $127.7 million as of March 31, 2010 compared with $130.2 million as of December 31, 2009. We utilize FHLB borrowings as a supplement to customer deposits to fund earning assets and to assist in managing interest rate risk.

Long-term Debt

Long-term debt in the form of junior subordinated debentures that have been issued to a statutory trust that issued trust preferred securities was $15.6 million as of March 31, 2010, unchanged from December 31, 2009. These junior subordinated debentures were assumed by us from Former MidWest*One* in the merger. Former MidWest*One* had issued these junior subordinated debentures on September 20, 2007, to MidWest*One* Capital Trust II. The junior subordinated debentures mature on December 15, 2037, do not require any principal amortization and are callable at par at our option on the fifth anniversary of the date of issuance. The interest rate is fixed at 6.48% for five years on $7.7 million of the issuance and is variable quarterly at the three month LIBOR plus 1.59% on the remainder.

Nonperforming Assets

Our nonperforming assets totaled $18.9 million as of March 31, 2010, up $1.4 million compared to December 31, 2009. This increase was due to an increase in nonperforming loans of $2.5 million coupled with a decrease in other real estate owned of $1.1 million. The balance of other real estate owned at March 31, 2010 was $2.5 million compared to $3.6 million at year-end 2009. Nonperforming loans totaled $16.3 million (1.71% of total bank loans) as of March 31, 2010, compared to $13.9 million (1.44% of total bank loans) as of December 31, 2009. See Note 8 Allowance for Loan Losses and Nonperforming Assets for additional information related to nonperforming assets.

The nonperforming loans consisted of $10.8 million in nonaccrual loans, $3.6 million in troubled debt restructures and $2.0 million in loans past due 90 days or more and still accruing. This compares with $9.9 million, $2.6 million and $1.4 million, respectively, as of December 31, 2009. The Company experienced a $1.0 million increase in restructured loans, which grew from $2.6 million at December 31, 2009 to $3.6 million at March 31, 2010. This increase stems from the restructuring of one consumer loan, three residential real estate loans totaling $0.4 million and two commercial real estate loans totaling $0.5 million. During the same period, loans and leases past due 90 days or more and still accruing interest increased by $0.6 million from $1.4 million at December 31, 2009 to $2.0 million at March 31, 2010.

Additionally, loans past-due 30 to 89 days (not included in the nonperforming loan totals) were $11.1 million as of March 31, 2010 compared with $10.1 million as of December 31, 2009. Other real estate owned totaled $2.5 million as of March 31, 2010 and $3.6 million at December 31, 2009.

All of the other real estate property was acquired through foreclosures and we are actively working to sell all properties held as of March 31, 2010. Other real estate is carried at appraised value less estimated cost of disposal at date of acquisition. Additional discounts could be required to market and sell the properties, resulting in a write down through expense.

Allowance for Loan Losses

Our allowance for loan losses as of March 31, 2010 was $14.6 million, which was 1.52% of total bank loans (excluding loan pools) as of that date. This compares with an allowance for loan losses of $14.0 million as of December 31, 2009, which was 1.44% of total bank loans. Gross charge-offs for the first quarter of 2010 totaled $1.1 million, while recoveries of previously charged-off loans totaled $0.2 million. Annualized net loan charge offs to average bank loans as of March 31, 2010 was 0.38% compared to 0.48% for the year ended December 31, 2009. As of March 31, 2010, the allowance for loan losses was 89.1% of nonperforming bank loans compared with 100.6% as of December 31, 2009. While nonperforming loan levels increased during the first quarter, the increase has been primarily in credits that our management had already identified as weak and for which we believe adequate provisions already had been made. Based on the inherent risk in the loan portfolio, we believe that as of March 31, 2010, the allowance for loan losses was adequate; however, there is no assurance losses will not exceed the allowance and any growth in the loan portfolio and the uncertainty of the general economy may require that management continue to evaluate the adequacy of the allowance for loan losses and make additional provisions in future periods as deemed necessary. See Note 8 Allowance for Loan Losses and Nonperforming Assets for additional information related to the allowance for loan losses.

During the first quarter of 2010, we updated the Allowance for Loan Losses (ALLL) calculation to reflect current historical net charge-offs. We use a five year average percentage in the historical charge-off portion of the ALLL calculation. The historical charge-off portion is one of six factors used in establishing our pass percentage factor for each loan type. There were no changes to the other five factors during the first quarter of 2010. Classified loans are reviewed per the requirements of FASB ASC Topics 310 and 450. All classified loans are reviewed for impairment per FASB ASC Topic 310.

We currently track the loan to value (LTV) ratio of loans in our portfolio, and those loans in excess of internal and supervisory guidelines are presented to the Bank s Board of Directors on a quarterly basis. At March 31, 2010, there were six owner occupied 1-4 family loans with a LTV of 100% or greater. In addition, there are 44 home equity lines of credit without credit enhancement that have LTV of 100% or greater. We have the first lien on three of these equity lines and other financial institutions have the first lien on the remaining 41.

We monitor and report our troubled debt restructuring on a quarterly basis. At March 31, 2010, reported troubled debt restructurings were not a material portion of the loan portfolio. We review loans 90+ days past due that are still accruing interest no less than quarterly to determine if there is a strong reason that the credit should not be placed on non-accrual. All commercial and agricultural lenders are required to review their portfolios on a monthly basis and document that either no downgrades are necessary or report credits that they feel warrant a downgrade to loan review for inclusion in the allowance for loan loss calculation.

Capital Resources

Total shareholders equity was 10.00% of total assets as of March 31, 2010 and was 9.92% as of December 31, 2009. Tangible common equity to tangible assets was 8.26% as of March 31, 2010 and 8.16% as of December 31, 2009. Our Tier 1 capital to risk-weighted assets ratio was 13.06% as of March 31, 2010 and was 12.66% as of December 31, 2009. Risk-based capital guidelines require the classification of assets and some off-balance-sheet items in terms of credit-risk exposure and the measuring of capital as a percentage of the risk-adjusted asset totals. We believe that, as of March 31, 2010, the Company and the Bank met all capital adequacy requirements to which we are subject. As of that date, the Bank was well capitalized under regulatory prompt corrective action provisions.

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We have traditionally disclosed certain non-GAAP ratios to evaluate and measure our financial condition, including our tangible common equity to tangible assets and Tier 1 capital to risk-weighted assets ratios. We believe these ratios provide investors with information regarding our financial condition and how we evaluate our financial condition internally. The following table provides a reconciliation of the non-GAAP measure to the most comparable GAAP equivalent.

(in thousands)		At March 31, 2010	At December 31, 2009
Tangible Common Equity:			
Total shareholders equity		$ 154,158	$ 152,208
Less:	Preferred stock	(15,716)	(15,699)
	Goodwill and intangibles	(12,016)	(12,272)
Tangible common equity		126,426	124,237
Tangible Assets:			
Total assets		$ 1,542,061	$ 1,534,783
Less:	Goodwill and intangibles	(12,016)	(12,272)
Tangible assets		1,530,045	1,522,511
Tangible common equity to tangible assets		**8.26%**	**8.16%**

(in thousands)		At March 31, 2010	At December 31, 2009
Tier 1 capital			
Total shareholders equity		$ 154,158	$ 152,208
Plus:	Long term debt (qualifying restricted core capital)	15,464	15,464
Less:	Net unrealized gains on securities available for sale	(2,016)	(1,505)
	Disallowed goodwill and intangibles	(11,789)	(12,286)
Tier 1 capital		155,817	153,881
Risk-weighted assets		1,193,520	1,215,240
Tier 1 capital to risk-weighted assets		**13.06%**	**12.66%**

The preferred stock has no par value per share and a liquidation preference of $1,000 per share, or $16.0 million in the aggregate. 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 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 U.S. 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. In addition, on February 6, 2009, we issued to the U.S. Treasury a warrant to purchase 198,675 shares of our common stock at a strike price of $12.08 per share at any time on or before February 6, 2019. If we repay the U.S. Treasury s investment in full, we would be permitted to redeem the warrant issued to the U.S. 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 U.S. Treasury. All of the capital from Treasury was treated as Tier 1 capital for regulatory purposes.

On January 21, 2010, 33,000 restricted stock units were granted to certain directors and officers. During the first quarter of 2010, 2,546 shares were issued in connection with the vesting of previously awarded grants of restricted stock units, of which 20 shares were surrendered by a grantee to satisfy tax requirements. In addition, 1,945 shares were issued in connection with the exercise of previously issued stock options.

On February 11, 2010, we filed a universal shelf-registration statement registering for future sale up to $25.0 million of securities from time to time in one or more offerings. Given the growth opportunities and the difficult credit market, we believe that it is prudent to have all options available to raise additional capital. On April 22, 2010, the Company s Board of Directors declared a quarterly dividend for the second quarter of 2010 of $0.05 per common share, which is consistent with the dividend per common share paid in the first quarter of 2010.

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Capital levels and minimum required levels:

(dollars in thousands)	Actual Amount	Actual Ratio	Minimum Required for Capital Adequacy Purposes Amount	Minimum Required for Capital Adequacy Purposes Ratio	Minimum Required to be Well Capitalized Amount	Minimum Required to be Well Capitalized Ratio
March 31, 2010:						
Total capital to risk-weighted assets:						
Consolidated	$ 154,158	12.92%	$ 95,482	8.00%	N/A	N/A
MidWestOne Bank	157,281	13.46%	93,460	8.00%	$ 116,825	10.00%
Tier 1 capital to risk-weighted assets:						
Consolidated	155,817	13.06%	47,741	4.00%	N/A	N/A
MidWestOne Bank	144,137	12.34%	46,730	4.00%	70,095	6.00%
Tier 1 capital to average assets:						
Consolidated	155,817	10.28%	60,615	4.00%	N/A	N/A
MidWestOne Bank	144,137	9.56%	60,325	4.00%	75,407	5.00%
December 31, 2009:						
Total capital to risk-weighted assets:						
Consolidated	$ 169,149	13.92%	$ 97,219	8.00%	N/A	N/A
MidWestOne Bank	156,413	12.94%	96,727	8.00%	$ 120,909	10.00%
Tier 1 capital to risk-weighted assets:						
Consolidated	153,881	12.66%	48,610	4.00%	N/A	N/A
MidWestOne Bank	141,287	11.69%	48,363	4.00%	72,545	6.00%
Tier 1 capital to average assets:						
Consolidated	153,881	10.01%	61,505	4.00%	N/A	N/A
MidWestOne Bank	141,287	9.23%	61,215	4.00%	76,518	5.00%

Liquidity

Liquidity management involves meeting the cash flow requirements of depositors and borrowers. We conduct liquidity management on both a daily and long-term basis; and adjust our investments in liquid assets based on expected loan demand, projected loan maturities and payments, estimated cash flows from the loan pool participations, expected deposit flows, yields available on interest-bearing deposits, and the objectives of its asset/liability management program. We had liquid assets (cash and cash equivalents) of $42.0 million as of March 31, 2010, compared with $27.6 million as of December 31, 2009. Investment securities classified as available for sale, totaling $375.2 million and $362.9 million as of March 31, 2010 and December 31, 2009, respectively, could be sold to meet liquidity needs if necessary. Additionally, our bank subsidiary maintains unsecured lines of credit with several correspondent banks and secured lines with the Federal Reserve Bank discount window and the Federal Home Loan Bank of Des Moines that would allow it to borrow federal funds on a short-term basis, if necessary. Management believes that the Company had sufficient liquidity as of March 31, 2010 to meet the needs of borrowers and depositors.

Our principal sources of funds were deposits, FHLB borrowings, principal repayments on loans, proceeds from the sale of loans, proceeds from the maturity and sale of investment securities, and funds provided by operations. While scheduled loan amortization and maturing interest-bearing deposits are relatively predictable sources of funds, deposit flows and loan prepayments are greatly influenced by economic conditions, the general level of interest rates, and competition. We utilized particular sources of funds based on comparative costs and availability. This included fixed-rate FHLB borrowings that were obtained at a more favorable cost than deposits. We generally managed the pricing of our deposits to maintain a steady deposit base but had from time to time decided not to pay rates on deposits as high as its competition.

As of March 31, 2010, we had $15.6 million of long-term debt outstanding. This amount represents indebtedness payable under junior subordinated debentures issued to a subsidiary trust that issued trust preferred securities in a pooled offering. The junior subordinated debentures have a 35-year term. One-half of the balance has a fixed interest rate of 6.48 percent until December 15, 2012; the other one-half has a variable rate of three-month LIBOR plus 1.59 percent.

Critical Accounting Policies

We have identified the following critical accounting policies and practices relative to the reporting of our results of operation and financial condition. These accounting policies relate to the allowance for loan losses, participation interests in loan pools, application of purchase accounting, goodwill and intangible assets, and fair value of available for sale investment securities.

Allowance for Loan Losses

The allowance for loan losses is based on our estimate. We believe the allowance for loan losses is adequate to absorb probable losses in the existing portfolio. In evaluating the portfolio, we take into consideration numerous factors, including current economic conditions, prior loan loss experience, the composition of the loan portfolio, and management s estimate of probable credit losses. The allowance for loan losses is established through a provision for loss based on our evaluation of the risk inherent in the loan portfolio, the composition of the portfolio, specific impaired loans, and current economic conditions. Such evaluation, which includes a review of all loans on which full collectability may not be reasonably assured, considers, among other matters, the estimated net realizable value or the fair value of the

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underlying collateral, economic conditions, historical loss experience, and other factors that warrant recognition in providing for an adequate allowance for loan losses. In the event that our evaluation of the level of the allowance for loan losses is inadequate, we would need to increase our provision for loan losses.

Participation Interests in Loan Pools

The loan pool accounting practice relates to our estimate that the investment amount reflected on our financial statements does not exceed the estimated net realizable value or the fair value of the underlying collateral securing the purchased loans. In evaluating the purchased loan pool, we take into consideration many factors, including the borrowers current financial situation, the underlying collateral, current economic conditions, historical collection experience, and other factors relative to the collection process. If the estimated net realizable value of the loan pool participations is overstated, our yield on the loan pools would be reduced.

Application of Purchase Accounting

During 2008, we completed the acquisition of the Former Midwest*One* Financial Group, Inc., which generated significant amounts of goodwill and intangible assets and related amortization. The values assigned to goodwill and intangibles, as well as their related useful lives, are subject to judgment and estimation by our management. Goodwill and intangibles related to acquisitions are determined and based on purchase price allocations. Valuation of intangible assets is generally based on the estimated cash flows related to those assets, while the initial value assigned to goodwill is the residual of the purchase price over the fair value of all identifiable assets acquired and liabilities assumed. If the carrying value of the goodwill exceeded the implied fair value of the goodwill, an impairment loss would be recorded in an amount equal to that excess. Performing such a discounted cash flow analysis involves the use of estimates and assumptions. Useful lives are determined based on the expected future period of the benefit of the asset, the assessment of which considers various characteristics of the asset, including the historical cash flows. Due to the number of estimates involved related to the allocation of purchase price and determining the appropriate useful lives of intangible assets, we have identified purchase accounting as a critical accounting policy.

Goodwill and Intangible Assets

Goodwill and intangible assets arise from purchase business combinations. During 2008, we completed our merger with the Former MidWest*One*. We were deemed to be the purchaser for accounting purposes and thus recognized goodwill and other intangible assets in connection with the merger. The goodwill was assigned to our one reporting unit, banking. As a general matter, goodwill and other intangible assets generated from purchase business combinations and deemed to have indefinite lives are not subject to amortization and are instead tested for impairment at least annually. Core deposit and customer relationship intangibles arising from acquisitions are being amortized over their estimated useful lives of up to 10 years.

In 2008, the extreme volatility in the banking industry that first started to surface in the latter part of 2007 had a significant impact on banking companies and the price of banking stocks, including our common stock. At December 31, 2008, our market capitalization was less than our total shareholders equity, providing an indication that goodwill may be impaired as of such date. Thus, we performed an impairment analysis as a result of the significant decline in our stock price. Based on this analysis, we wrote off $27.3 million of goodwill in the fourth quarter of 2008, which represented all of the goodwill that resulted from the Merger. Such charge had no effect on the Company s or the Bank s cash balances or liquidity. In addition, because goodwill and other intangible assets are not included in the calculation of regulatory capital, the Company s and the Bank s December 31, 2008 regulatory ratios were not adversely affected by this non-cash expense and exceeded the minimum amounts required to be considered well-capitalized.

Our other intangible assets are core deposit premium, insurance agency, trade name, and customer list intangibles. The establishment and subsequent amortization of these intangible assets involves the use of significant estimates and assumptions. These estimates and assumptions include, among other things, the estimated cost to service deposits acquired discount rates, estimated attrition rates and useful lives, future economic and market conditions, comparison of our market value to book value and determination of appropriate market comparables. Actual future results may differ from those estimates. We assess these intangible assets for impairment annually or more often if conditions indicate a possible impairment. Each quarter we evaluate the estimated useful lives of intangible assets and whether events or changes in circumstances warrant a revision to the remaining periods of amortization. In accordance with FASB ASC 350, *Accounting for the Impairment or Disposal of Long-Lived Assets*, recoverability of these assets is measured by comparison of the carrying amount of the asset to the future undiscounted cash flows the asset is expected to generate. If the asset is considered to be impaired, the amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset.

Fair Value of Available for Sale Securities

Securities available for sale are reported at fair value, with unrealized gains and losses reported as a separate component of accumulated other comprehensive income, net of deferred income taxes. Declines in fair value of individual securities, below their amortized cost, are evaluated by management to determine whether the decline is temporary or other-than-temporary. Declines in the fair value of available for sale securities below their cost that are deemed other-than-temporary are reflected in earnings as impairment losses. In determining whether other-than-temporary impairment exists, management considers whether: (1) we have the intent to sell the security, (2) it is more likely than not that we will be required to sell the security before recovery of the amortized cost basis and (3) we do not expect to recover the entire amortized cost basis of the security.

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Off-Balance-Sheet Arrangements

We are a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of our customers, which include commitments to extend credit. Our exposure to credit loss in the event of nonperformance by the other party to the commitments to extend credit is represented by the contractual amount of those instruments. We use the same credit policies in making commitments as we do for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We evaluate each customer s creditworthiness on a case-by-case basis. As of March 31, 2010, outstanding commitments to extend credit totaled approximately $175.0 million.

Commitments under standby and performance letters of credit outstanding aggregated $3.9 million as of March 31, 2010. We do not anticipate any losses as a result of these transactions.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

In general, market risk is the risk of change in asset values due to movements in underlying market rates and prices. Interest rate risk is the risk to earnings and capital arising from movements in interest rates. Interest rate risk is the most significant market risk affecting MidWest*One* as other types of market risk, such as foreign currency exchange rate risk and commodity price risk, do not arise in the normal course of our business activities.

In addition to interest rate risk, the current challenging economic environment, particularly the severe dislocations in the credit markets that prevailed throughout 2008 and 2009, and continued during the first quarter of 2010, has made liquidity risk (namely, funding liquidity risk) a more prevalent concern among financial institutions. In general, liquidity risk is the risk of being unable to fund an entity s obligations to creditors (including, in the case of banks, obligations to depositors) as such obligations become due and/or fund its acquisition of assets.

Liquidity Risk

Liquidity refers to our ability to fund operations, to meet depositor withdrawals, to provide for our customers credit needs, and to meet maturing obligations and existing commitments. Our liquidity principally depends on cash flows from operating activities, investment in and maturity of assets, changes in balances of deposits and borrowings, and our ability to borrow funds.

Net cash inflows from operating activities were $6.3 million in the first quarter of 2010, compared with $6.9 million in the first quarter of 2009. Proceeds from sale of loans held for sale, net of funds used to originate loans held for sale, were a source of inflow for the first quarter of 2010, as was a net change in accrued interest receivable of $1.0 million.

Net cash inflows from investing activities were $3.2 million in the three months ended March 31, 2010, compared to net cash outflows of $7.8 million in the comparable three-month period of 2009. In the first three months of 2010, securities transactions accounted for a net outflow of $10.2 million, and net principal received on loans accounted for net inflows of $11.3 million. Cash inflows for loan pool participations were $1.5 million during the first three months of 2010 compared to a $2.3 million outflow during the same period of 2009.

Net cash provided by financing activities in the first three months of 2010 was $4.9 million. The largest cash outflow from financing activities in the first quarter of 2010 consisted of $3.5 million in net decrease in securities sold under agreements to repurchase. The largest financing cash inflow during the three months ended March 31, 2010 was the $13.4 million increase in deposits. Cash inflows from financing activities in the first quarter of 2009 were $35.0 million, which included the $16.0 million that we received from our issuance of shares of senior preferred stock and a warrant to purchase common stock to the U.S. Treasury pursuant to the Capital Purchase Program. In addition, net increases occurred in deposits and securities sold under agreements to repurchase of $22.0 million and $10.3 million, respectively.

To further mitigate liquidity risk, the Bank has several sources of liquidity in place to maximize funding availability and increase the diversification of funding sources. The criteria for evaluating the use of these sources include - volume concentration (percentage of liabilities), cost, volatility, and the fit with the current Asset/Liability management plan. These acceptable sources of liquidity include:

- Fed Funds Lines
- FHLB Borrowings
- Brokered Repurchase Agreements
- Federal Reserve Bank Discount Window

Fed Funds Lines:

Routine liquidity requirements are met by fluctuations in the Bank s Fed Funds position. The principal function of these funds is to maintain short-term liquidity. Unsecured Fed Funds purchased lines are viewed as a volatile liability and are not used as a long-term funding solution, especially when used to fund long-term assets. Multiple correspondent relationships are preferable and Fed Funds sold exposure to any one customer is continuously monitored. The current Fed Funds purchased limit is 10% of total assets, or the amount of established Fed Funds lines, whichever is smaller. Currently, our subsidiary bank has unsecured Fed Fund lines totaling $55 million, which are tested annually to ensure availability.

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FHLB Borrowings:

FHLB borrowings provide both a source of liquidity and long-term funding for the Bank. Use of this type of funding is coordinated with both the strategic balance sheet growth projections and the current and future interest rate risk profile of the Bank. Factors that are taken into account when contemplating use of FHLB borrowings are the effective interest rate, the collateral requirements, community investment program credits, and the implications and cost of having to purchase incremental FHLB stock. The current FHLB advance limit is 25% of total assets. Currently, the Bank has a $205.2 million advance limit with $127.7 million in outstanding borrowings, leaving $77.5 million available for liquidity needs. These borrowings are secured by various real estate loans (residential, commercial and agricultural).

Brokered Repurchase Agreements:

Brokered repurchase agreements may be established with approved brokerage firms and banks. Repurchase agreements create rollover risk (the risk that a broker will discontinue the relationship due to market factors) and are not used as a long-term funding solution, especially when used to fund long-term assets. Collateral requirements and availability are evaluated and monitored. The current policy limit for brokered repurchase agreements is 10% of total assets. There were no outstanding brokered repurchase agreements at March 31, 2010.

Federal Reserve Bank Discount Window:

The FRB Discount Window is another source of liquidity, particularly during difficult economic times. The Bank has a borrowing capacity with the Federal Reserve Bank of Chicago limited only by the amount of municipal securities pledged against the line. Currently, the Bank owns municipal securities with an approximate market value of $13.5 million available for liquidity purposes.

Interest Rate Risk

The nature of the banking business, which involves paying interest on deposits at varying rates and terms and charging interest on loans at other rates and terms, creates interest rate risk. As a result, net interest margin and earnings and the market value of assets and liabilities are subject to fluctuations arising from the movement of interest rates. We manage several forms of interest rate risk, including asset/liability mismatch, basis risk and prepayment risk. A key management objective is to maintain a risk profile in which variations in net interest income stay within the limits and guidelines of the Bank s Asset/Liability Management Policy.

Like most financial institutions, our net income can be significantly influenced by a variety of external factors, including: overall economic conditions, policies and actions of regulatory authorities, the amounts of and rates at which assets and liabilities reprice, variances in prepayment of loans and securities other than those that are assumed, early withdrawal of deposits, exercise of call options on borrowings or securities, competition, a general rise or decline in interest rates, changes in the slope of the yield-curve, changes in historical relationships between indices (such as LIBOR and prime), and balance sheet growth or contraction. Our asset and liability committee (ALCO) seeks to manage interest rate risk under a variety of rate environments by structuring our balance sheet and off-balance sheet positions. The risk is monitored and managed within approved policy limits.

We use a third-party computer software simulation modeling program to measure our exposure to potential interest rate changes. For various assumed hypothetical changes in market interest rates, numerous other assumptions are made, such as prepayment speeds on loans and securities backed by mortgages, the slope of the Treasury yield curve, the rates and volumes of our deposits, and the rates and volumes of our loans. This analysis measures the estimated change in net interest income in the event of hypothetical changes in interest rates. The following table presents our projected changes in net interest income for the various interest rate shock levels at March 31, 2010.

Analysis of Net Interest Income Sensitivity

	Immediate Change in Rates			
	-200	**-100**	**+100**	**+200**
(dollars in thousands)				
March 31, 2010				
Dollar change	$ 835	$ 1,125	$ (1,716)	$ (2,366)
Percent change	1.7%	2.3%	-3.5%	-4.9%
December 31, 2009				

Dollar change	$ 885	$ 1,373	$ (1,995)	$ (3,310)
Percent change	1.8%	2.8%	-4.1%	-6.8%

As shown above, at March 31, 2010, the effect of an immediate and sustained 200 basis point increase in interest rates would decrease our net interest income by approximately $2.4 million. The effect of an immediate and sustained 200 basis point decrease in rates would increase our net interest income by approximately $0.8 million. An increase in interest rates would cause our interest-bearing liabilities to reprice more quickly than interest-earning assets, thus reducing net interest income. Conversely, a decrease in interest rates would cause an increase in net interest income as interest-bearing liabilities would decline more rapidly than interest-earning assets. In the current low interest rate environment, model results of a 200 basis point drop in interest rates are of questionable value as many interest bearing liabilities and interest earning assets cannot re-price significantly lower than current levels.

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Computations of the prospective effects of hypothetical interest rate changes were based on numerous assumptions. Actual values may differ from those projections set forth above. Further, the computations do not contemplate any actions we could have undertaken in response to changes in interest rates.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

Under supervision and with the participation of certain members of our management, including the chief executive officer and the chief financial officer, we completed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in SEC Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of March 31, 2010. Based on this evaluation, our chief executive officer and chief financial officer believe that the disclosure controls and procedures were effective as of the end of the period covered by this Report with respect to timely communication to them and other members of management responsible for preparing periodic reports and material information required to be disclosed in this Report as it relates to the Company and our consolidated subsidiaries.

The effectiveness of the Company s or any system of disclosure controls and procedures is subject to certain limitations, including the exercise of judgment in designing, implementing, and evaluating the controls and procedures, the assumptions used in identifying the likelihood of future events, and the inability to eliminate misconduct completely. As a result, there can be no assurance that our disclosure controls and procedures will prevent all errors or fraud or ensure that all material information will be made known to appropriate management in a timely fashion. By their nature, our or any system of disclosure controls and procedures can provide only reasonable assurance regarding management s control objectives.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Cautionary Note Regarding Forward-Looking Statements

Statements made in this report, other than those concerning historical financial information, may be considered forward-looking statements, which speak only as of the date of this document and are based on current expectations and involve a number of assumptions. These include, among other things, statements regarding future results or expectations. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and is including this statement for purposes of these safe harbor provisions. The Company s ability to predict results, or the actual effect of future plans or strategies, is inherently uncertain. Factors that could cause actual results to differ from those set forth in the forward-looking statements or that could have a material effect on the operations and future prospects of the Company include, but are not limited to: (1) the strength of the local and national economy; (2) changes in interest rates, legislative/regulatory changes, monetary and fiscal policies of the U.S. government, including policies of the U.S. Treasury and the Federal Reserve Board; (3) the loss of key executives or employees; (4) changes in the quality and composition of the Company s loan and securities portfolios; demand for loan products; deposit flows; competition; demand for financial services in the Company s respective market areas; implementation of new technologies; ability to develop and maintain secure and reliable electronic systems; and accounting principles, policies, and guidelines; (5) expected revenue synergies and cost savings from the merger may not be fully realized or realized within the expected time frame; and (6) other risk factors detailed from time to time in filings made by the Company with the SEC.

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

The Company and its subsidiaries are from time to time parties to various legal actions arising in the normal course of business. The Company believes that there are no threatened or pending proceedings against the Company or its subsidiaries, which, if determined adversely, would have a material adverse effect on the business or financial condition of the Company.

Item 1A. Risk Factors.

There have been no material changes from the risk factors set forth in Part I, Item 1A, Risk Factors of our Form 10-K for the annual period ended December 31, 2009. Please refer to that section of our Form 10-K for disclosures regarding the risks and uncertainties related to our business.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

We did not repurchase any of our equity securities during the quarter covered by this report. As of March 31, 2010, we did not have in effect an approved share repurchase program.

As discussed above, on February 6, 2009, we consummated the sale of $16.0 million of senior preferred stock to the Treasury pursuant to the Capital Purchase Program. The terms of the senior preferred stock place certain restrictions on our ability to pay dividends on our

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common stock. First, no dividends on our common stock may be paid unless all accrued dividends on Treasury s senior preferred stock have been paid in full. Second, until the third anniversary of the date of Treasury s investment, we may not increase the dividends paid on its common stock beyond $0.1525 per share without first obtaining the consent of Treasury.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. [Removed and Reserved].

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit Number	Description	Incorporated by Reference to:
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a)	Filed herewith
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a)	Filed herewith
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith

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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.

MidWest*One* Financial Group, Inc.

Dated: May 5, 2010

By: /s/ Charles N. Funk
Charles N. Funk
President and Chief Executive Officer

By: /s/ Gary J. Ortale
Gary J. Ortale
Executive Vice President and Chief Financial Officer