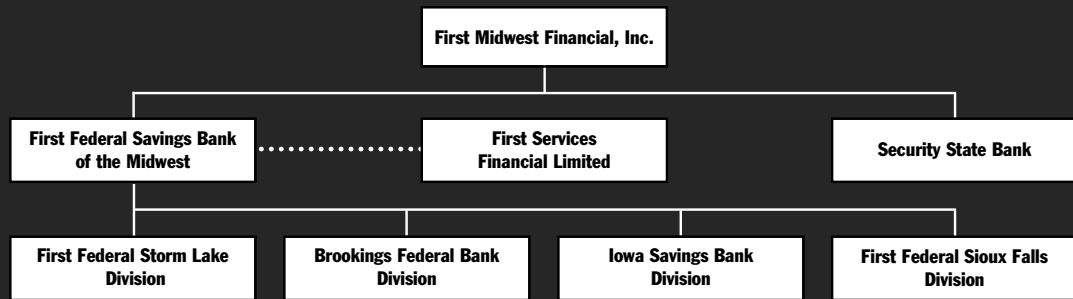


The sign of  
better banking

[fmfincash.com](http://fmfincash.com)

A black and white photograph of a woman's hand holding a sign that says 'fmfincash.com'. The woman's face is blurred in the background. The sign is held in the palm of her hand, and the text is in a bold, sans-serif font. The background is a soft, out-of-focus light gray.



## Company Profile

First Midwest Financial, Inc. is a \$506 million bank holding company for First Federal Savings Bank of the Midwest and Security State Bank. Headquartered in Storm Lake, Iowa, the Company converted from mutual ownership to stock ownership in 1993. Its primary business is marketing financial deposit and loan products to meet the needs of retail bank customers.

First Midwest operates under a super-community banking philosophy that allows the Company to grow while maintaining its community bank roots, with local decision making and customer service. Administrative functions, transparent to the customer, are centralized to enhance the banks' operational efficiencies and to improve customer service capabilities.

First Federal Savings Bank of the Midwest operates as a thrift with four divisions: First Federal

Storm Lake, Brookings Federal Bank, Iowa Savings Bank, and First Federal Sioux Falls. Security State Bank operates as a state-chartered commercial bank. Fifteen offices support customers in Brookings and Sioux Falls, South Dakota, and throughout central and northwest Iowa. Plans are underway to begin construction of a new Iowa Savings Bank main office in the city of Urbandale, Iowa.

First Services Financial Limited, a subsidiary of First Federal Savings Bank, is a full-service brokerage operation that offers a wide range of noninsured investment products to customers through LaSalle St. Securities, Inc.

First Midwest Financial, Inc.'s common stock is listed under the trading symbol "CASH" on the Nasdaq National Market.

Banks are members FDIC and Equal Housing Lenders.

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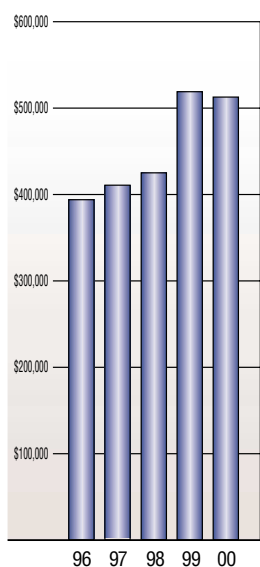


"We invite you to invest in us, bank with us, and experience the difference of better banking."  
 —Bryce Loring  
 Vice President of Lending

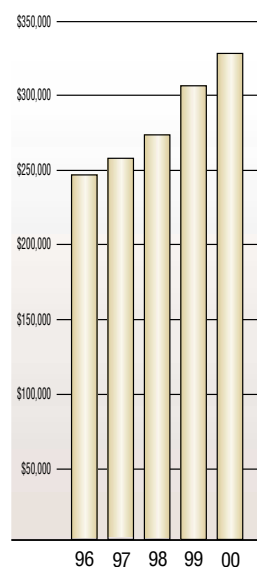
## Financial Highlights

(Dollars in Thousands except Per Share Data)	2000	1999	1998	1997	1996
<b>At September 30</b>					
Total assets	\$505,590	\$511,213	\$418,380	\$404,589	\$ 388,008
Total loans, net	324,703	303,079	270,286	254,641	243,534
Total deposits	318,654	304,780	283,858	246,116	233,406
Shareholders' equity	40,035	39,771	42,286	43,477	43,210
Book value per common share <sup>(1)</sup>	\$ 16.48	\$ 15.86	\$ 16.56	\$ 16.11	\$ 14.81
Total equity to assets	7.93%	7.78%	10.11%	10.75%	11.14%
<b>For the Fiscal Year</b>					
Net interest income	\$ 13,832	\$ 13,197	\$ 12,829	\$ 11,946	\$ 10,359
Net income	2,328	2,641	2,785	3,642	2,414 <sup>(2)</sup>
Diluted earnings per share <sup>(1)</sup>	\$ 0.93	\$ 1.04	\$ 1.03	\$ 1.28	\$ 0.90 <sup>(2)</sup>
Return on average assets	.46%	.54%	.68%	.98%	.77% <sup>(2)</sup>
Return on average equity	5.98%	6.35%	6.43%	8.41%	6.22% <sup>(2)</sup>
Net yield on interest-earning assets	2.79%	2.83%	3.26%	3.38%	3.47%
Cash earnings <sup>(3)</sup>	\$ 2,696	\$ 3,006	\$ 3,150	\$ 4,006	\$ 2,584 <sup>(2)</sup>
Cash earnings per share diluted <sup>(1) (3)</sup>	\$ 1.08	\$ 1.18	\$ 1.17	\$ 1.40	\$ 0.96 <sup>(2)</sup>
Cash return on average assets <sup>(3)</sup>	.53%	.61%	.77%	1.08%	.82% <sup>(2)</sup>
Cash return on average equity <sup>(3)</sup>	6.93%	7.23%	7.27%	9.25%	6.66% <sup>(2)</sup>

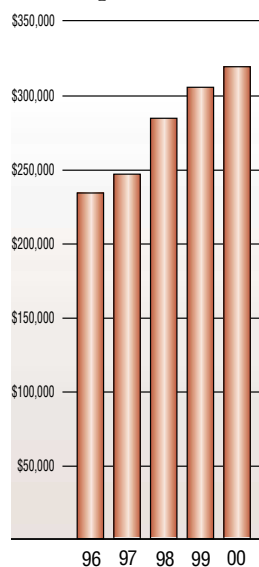
**Total Assets**



**Total Loans, Net**



**Total Deposits**



(1) Amounts reported have been adjusted for the three for two stock split paid January 2, 1997 in the form of a 50 percent stock dividend.

(2) Reflects the one-time, industry-wide special assessment to recapitalize the Savings Association Insurance Fund. Excluding the special assessment, Net income, Diluted earnings per share, Return on average assets, and Return on average equity would have been \$3,209,000, \$1.19, 1.01%, and 8.22%, respectively.

(3) Cash earnings exclude the amortization of goodwill from net income, net of related income taxes.  
The Company and its subsidiaries exceed regulatory capital requirements.

## Letter to Shareholders

### To Our Shareholders:

This was a year of continued progress for First Midwest Financial, Inc. Our total deposits and loans climbed to record levels, while our credit quality measures outperformed national averages.

We have increased demand deposit balances 109 percent over the past five years. The Company will continue its strategies to attract profitable checking and money market accounts, and reduce our cost of funds.

Deposits reached an all-time high of \$318.7 million in 2000, a 5 percent increase from 1999, and an 85 percent increase over the past five years. Our company outpaced the average national deposit percent growth trends for commercial banks,

savings banks, and total FDIC-insured domestic deposits during the past three years.<sup>(1)</sup>

In addition, the number of demand deposit accounts climbed 5 percent this year. Over the past five years we have

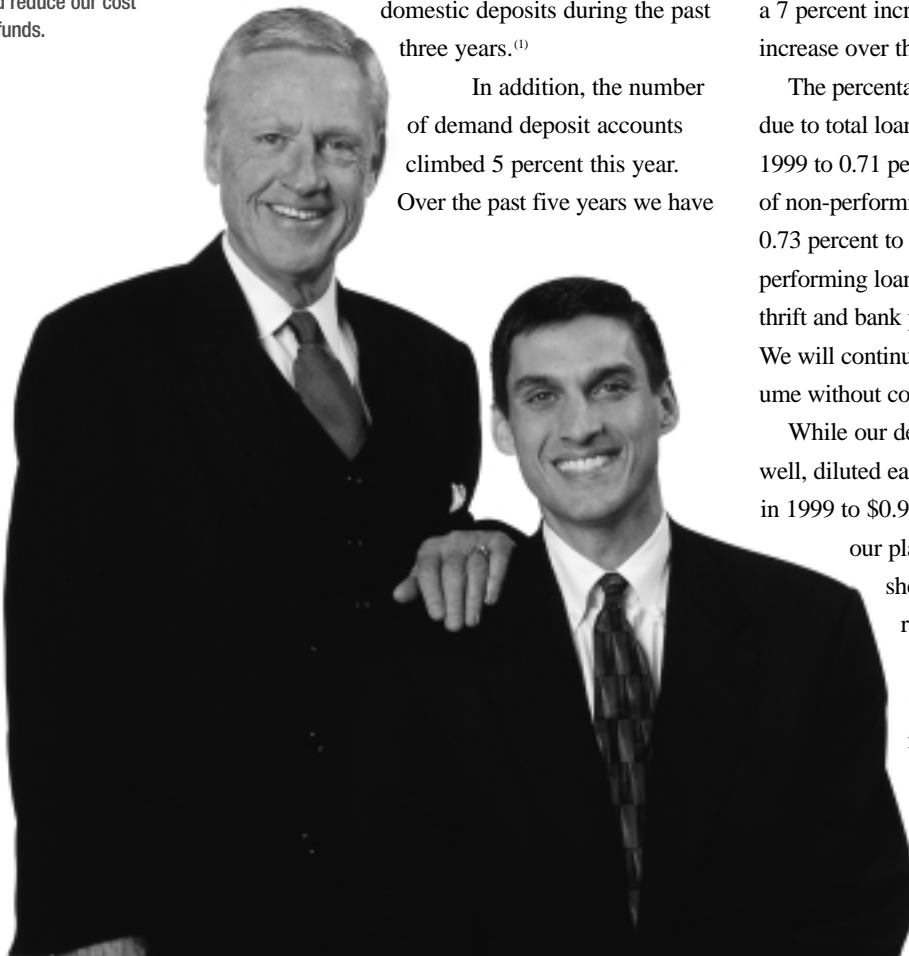
increased demand deposit balances 109 percent. The Company will continue its strategies to attract profitable checking and money market accounts, and reduce our cost of funds.

Lending performance was also notable this past year. Net loans rose to a record \$324.7 million, a 7 percent increase from 1999, and an 82 percent increase over the past five years.

The percentage of loans greater than 30 days past due to total loans dropped from 1.59 percent in 1999 to 0.71 percent in 2000, while the percentage of non-performing loans to total loans dropped from 0.73 percent to 0.09 percent. Our percentage of non-performing loans is well below the average national thrift and bank percentages for our peer group.<sup>(1)</sup>

We will continue our strategies to increase loan volume without compromising credit quality standards.

While our deposit and loan operations performed well, diluted earnings per share declined from \$1.04 in 1999 to \$0.93 in 2000. This is primarily due to our planned restructuring of our balance sheet. We sold lower yielding assets, reinvested funds into higher yielding assets, and repaid borrowings. We expect that these transactions will increase long-term shareholder value and profitability for the Company.



**LOOKING AHEAD**

The future of First Midwest Financial is its people – people who care about our customers, their communities, our shareholders, and each other. Therefore, the most important investment we make is in our people. Each person’s unique talents and contributions allow us to implement strategies and achieve goals. Formalized employee training programs are being implemented to build consistent customer service standards and to support our employee development program. After all, it is our people who provide our real competitive advantage, and who are the real sign of better banking.

Resources are also dedicated to technology and product development. This past year we added *QUICKbank 24-Hour Telebanking* and additional services to our product mix. We also improved our information systems with upgraded networks and streamlined communication tools to help our people be more effective. An interactive website for each bank is scheduled for introduction in early 2001. On-line banking will follow later in the year.

First Midwest’s website is now available with up-to-date investor information. Visit us at [www.fmficash.com](http://www.fmficash.com), and bookmark us for future reference.

While many competitors use technology to replace one-on-one service, we use it to enhance our personalized service. We believe that we can build better long-term relationships if we get to know our customers. To us, that is what being a super-community bank is all about – hometown service with larger bank resources.

We will continue to dedicate resources to expand our branch network into metropolitan areas that provide additional opportunities for growth. In September 2000, the doors to a temporary facility opened in Sioux Falls, South Dakota. We expect the construction of our permanent building to be completed in Spring 2001. Building plans are progressing for Iowa Saving Bank division’s new main office in Urbandale, Iowa.

We have never been more optimistic about First Midwest Financial than we are today, and we believe our stock remains an attractive investment. The First Midwest team remains dedicated to increasing shareholder value and enhancing your investment. Thank you for your continuing support.

Sincerely,



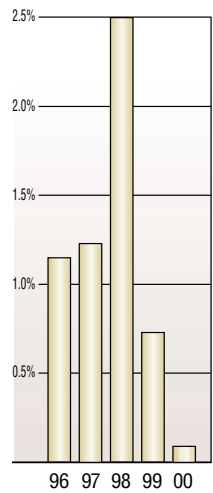
**JAMES S. HAAHR**  
*Chairman of the Board,  
President & CEO*



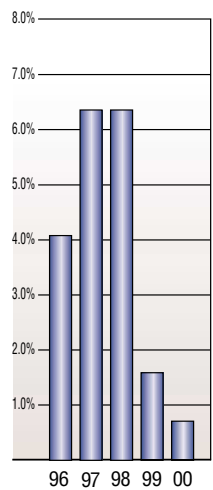
**J. TYLER HAAHR**  
*Senior Vice President,  
Secretary & COO*

Our focus on credit quality produces first-rate performance trends.

*Non-Performing Loans to Total Loans*



*Delinquent loans > 30 Days to Total Loans*



(1) Based on reports distributed by the FDIC.

“Our people are the heart of our mission, and our entire organization.”

—Sandra Hegland,  
Vice President of  
Human Resources



# OUR MISSION STATEMENT

**Have a professional, knowledgeable team that cost effectively provides value-added financial products and services that benefit our customers.**

## **Tradition**

**We have a tradition of providing financial solutions that help our customers achieve their goals.**

In fact, First Federal Savings Bank, our founding bank, was established 46 years ago to help people buy homes and earn a fair return on their savings. While our company has grown and our mission has expanded, we are still dedicated to building long-term customer relationships based on trust, respect, and integrity.

Our company's 1993 conversion to stock ownership enabled us to become a “super-community bank.” We used the capital raised to acquire and build additional banks and broaden our branch network. We have also invested in technology to provide additional services for our customers and to streamline operations. The holding company structure is good for our customers, and is good for our banks.

Together, we are driven toward one vision: Be the bank of choice for financial services in our market areas. We believe that providing our customers with personalized service from knowledgeable financial experts will help differentiate us from our competition.

Today we have fifteen bank locations, with a new building planned for construction this year. Our assets have grown from \$161 million in 1993 to \$506 million in 2000. And, we now provide a wide range of financial services that help over 25,000 customers throughout the Midwest. Loyal customers are a strong indication of our success, and we look forward to earning more business in coming years.

## Teamwork and Results

# Our people make the difference. We work together every day to do the right things right.

That is why each year we review our past performance, update our strategies, and develop specific action plans to achieve our goals. Employees participate in the business planning process so that we all understand how we affect results.

This past year we accomplished many of our goals. We introduced new products and improved our use of technology. Employee and customer programs were established to reinforce our personalized, needs-based service. We achieved record deposit and loan balances without compromising credit quality standards. And, we expanded operations into a new market.

Our First Federal Sioux Falls division opened the doors to its temporary facility on September 6, 2000. Tony Trussell, Division President, and our top-quality customer service team are developing new customer relationships as the 12,000-square-foot permanent building is under construction. Thanks to the contributions from employees across the Company, we have enjoyed a smooth transition into the Sioux Falls community.

None of these accomplishments would be realized without the hard work of talented people. We are proud of our team and are optimistic about the years to come.

“People helping people” is a core philosophy that helps our team do the right things right. Employees pictured left to right: Susan Mesenbrink, Deposit Account Specialist; Bradley Reichter, Branch Manager; Susanne McLaughlin, Personal Banker; (cont. below)



Jean Engen, Assistant Vice President and Savings Manager; and John Grundmeier, Vice President of Lending.

## Innovation

The only way to move ahead of the competition is to embrace change and strive toward continuous improvement in everything we do.

Our employees constantly strive to improve processes and services that benefit our customers and our company. We believe that the implementation of innovative ideas fosters healthy growth.

We view technology as an opportunity to improve operating efficiencies and to provide 24-hour service options for our customers. This year we upgraded our computer network to improve internal and external communication. We introduced *QUICKbank 24-Hour Telebanking* and made other additions to our product mix. We also launched [fmficash.com](http://fmficash.com) so investors can easily access up-to-date information about our company. Watch for individual bank websites in mid-January and on-line banking introductions in late 2001.

Our products and services include:

*Better than Free* Timeless Checking | Business and Commercial Checking | Photo *QUICKcard Cash & Check* | Money Market Accounts | Certificates of Deposit | *QUICKbank 24-Hour Telebanking* | Savings Accounts | Mortgage Lending | Business and Commercial Lending | Agricultural Lending | Consumer Lending | Lines of Credit | Credit Life Insurance | Crop Insurance | Credit Cards | Retirement and Trust Services | Ready Reserve | Overdraft Protection | Automated Clearing House Origination | Direct Deposit | Automatic Payment | Investments<sup>(1)</sup>

(1) Non-traditional bank products offered through LaSalle St. Securities, Inc. are not FDIC insured, nor are they guaranteed by the banks of First Midwest or any affiliate.

Technology provides us with opportunities to enhance our customer service and internal operations. Employees pictured left to right: Doug Waller, Assistant Vice President of Information Systems; Sandy Eickholt, Technical Services Representative; and Charles Friedrichs, Vice President and Director of Information Systems.







Our service scores a perfect “10” with our customers. Employee: Tracee Dierenfield, Assistant Vice President and Loan Officer; Customers: Patricia Colburn, German Instructor and Certification Officer at Buena Vista University; Matthew Huddleston, Interpreter for Arrowhead Education Agency; Sara M. Huddleston, Victim Advocate for Social Agency; and daughter Alexis N.; Kent Mauck, President of Mauck + Associates; and Darrel Hinkeldey, Farmer.

### **Real People. Real Service. Real Value.**

Our banks truly believe in *people helping people*. It is that simple. We listen and work with our customers to provide financial solutions that help them succeed.

And unlike many national banks, our customers always talk with a real person when they call or visit one of our offices. We believe that, by getting to know our customers, we can provide better service to help them reach their goals.

We are also dedicated to being good corporate citizens. That means encouraging our people to become actively involved in their communities. This year our banks partnered with General Colin Powell and the American Bankers Association to become Banks of Promise. We dedicated financial resources and thousands of employee hours to help youth and charitable organizations. We also

initiated a “Volunteer of the Year” program to recognize our people for their community orientation.

Community involvement is just one area we recognize. Our sales and service program has been rewarding our employees for their customer service, continuous improvement, great work environment, and result efforts for years. We encourage our people to expand their financial knowledge and skills. We believe that when employees are empowered to become their best, it will lead to first-rate customer service. After all, a satisfied customer is a true sign of better banking.

## **Company Vision and Mission**

### **Vision of First Midwest Financial, Inc.**

Build the best super-community bank system in the Midwest.

### **Vision of First Midwest Financial Banks**

Be the bank of choice for financial services in our market area.

### **Mission**

Have a professional, knowledgeable team that cost effectively provides value-added financial products and services that benefit our customers.

## **Company Values**

### **Customer Service**

Outstanding internal and external customer service are the foundation of our success. Meeting customer financial needs and exceeding expectations contribute to customer satisfaction and long-term relationships.

### **Continuous Improvement**

We embrace change to improve the quality and productivity of our product offerings, business operations, and customer service.

### **Great Work Environment**

We embrace an atmosphere of open communication and mutual respect where people are treated fairly, have fulfilling career opportunities and challenges, and are able to make a difference in the communities we serve.

### **Results**

We are results oriented. Meeting goals allows the company to earn a fair profit while servicing our customers in an efficient and professional manner.



“I am proud to be part of a growing organization – one that truly cares about its people and customers.”  
—Sandra Castillo  
Bilingual Customer Service Representative

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# FINANCIAL CONTENTS

## Selected Consolidated Financial Information

September 30,	2000	1999	1998	1997	1996
<b>SELECTED FINANCIAL CONDITION DATA</b>					
<small>(In Thousands)</small>					
Total assets	\$ 505,590	\$ 511,213	\$ 418,380	\$ 404,589	\$ 388,008
Loans receivable, net	324,703	303,079	270,286	254,641	243,534
Securities available for sale	147,479	178,489	120,610	115,985	109,492
Excess of cost over net assets acquired, net	3,768	4,133	4,498	4,863	5,091
Deposits	318,654	304,780	283,858	246,116	233,406
Total borrowings	143,993	164,369	89,888	112,126	106,478
Shareholders' equity	40,035	39,771	42,286	43,477	43,210
<b>Year Ended September 30,</b>					
<b>SELECTED OPERATIONS DATA</b>					
<small>(In Thousands, Except Per Share Data)</small>					
Total interest income	\$ 38,410	\$ 35,373	\$ 32,059	\$ 29,005	\$ 24,337
Total interest expense	24,578	22,176	19,230	17,059	13,978
Net interest income	13,832	13,197	12,829	11,946	10,359
Provision for loan losses	1,640	1,992	1,663	120	100
Net interest income after provision for loan losses	12,192	11,205	11,166	11,826	10,259
Total noninterest income	566	1,918	1,875	1,700	1,419
Total noninterest expense	9,408	8,645	8,253	7,382	7,568 <sup>(2)</sup>
Income before income taxes and extraordinary items	3,350	4,478	4,788	6,144	4,110
Income tax expense	1,374	1,837	2,003	2,502	1,696
Income before extraordinary items	1,976	2,641	2,785	3,642	2,414
Extraordinary items, net of income tax	352	-	-	-	-
Net income	<u>\$ 2,328</u>	<u>\$ 2,641</u>	<u>\$ 2,785</u>	<u>\$ 3,642</u>	<u>\$ 2,414<sup>(2)</sup></u>
Earnings per common and common equivalent share:					
Income before extraordinary items <sup>(1)</sup>					
Basic earnings per share	\$ 0.81	\$ 1.07	\$ 1.08	\$ 1.34	\$ 0.95 <sup>(2)</sup>
Diluted earnings per share	\$ 0.79	\$ 1.04	\$ 1.03	\$ 1.28	\$ 0.90 <sup>(2)</sup>
Net income <sup>(1)</sup>					
Basic earnings per share	\$ 0.95	\$ 1.07	\$ 1.08	\$ 1.34	\$ 0.95 <sup>(2)</sup>
Diluted earnings per share	\$ 0.93	\$ 1.04	\$ 1.03	\$ 1.28	\$ 0.90 <sup>(2)</sup>
<b>Year Ended September 30,</b>					
<b>SELECTED FINANCIAL RATIOS AND OTHER DATA</b>					
<b>PERFORMANCE RATIOS</b>					
Return on average assets	0.46%	0.54%	0.68%	0.98%	0.77% <sup>(2)</sup>
Return on average shareholders' equity	5.98	6.35	6.43	8.41	6.22 <sup>(2)</sup>
Interest rate spread information:					
Average during the year	2.39%	2.43%	2.76%	2.80%	2.83%
End of year	2.32	2.40	2.74	2.78	2.84
Net yield on average interest-earning assets	2.79	2.83	3.26	3.38	3.47
Ratio of operating expense to average total assets	1.85	1.80	2.00	2.00	2.40
<b>QUALITY RATIOS</b>					
Non-performing assets to total assets at end of year	0.15%	0.47%	1.94%	0.82%	0.75%
Allowance for loan losses to non-performing loans	1,156.13	137.16	41.15	75.36	83.49
<b>CAPITAL RATIOS</b>					
Shareholders' equity to total assets at end of period	7.93%	7.78%	10.11%	10.75%	11.14%
Average shareholders' equity to average assets	7.67	8.65	10.51	11.62	12.44
Ratio of average interest-earning assets to average interest-bearing liabilities	108.02	108.39	110.22	112.00	113.72
<b>OTHER DATA</b>					
Cash earnings (in thousands) <sup>(3)</sup>	\$ 2,696	\$ 3,006	\$ 3,150	\$ 4,006	\$ 2,584 <sup>(2)</sup>
Cash earnings per share - diluted <sup>(1)(3)</sup>	\$ 1.08	\$ 1.18	\$ 1.17	\$ 1.40	\$ 0.96 <sup>(2)</sup>
Cash return on average assets <sup>(3)</sup>	0.53%	0.61%	0.77%	1.08%	0.82% <sup>(2)</sup>
Cash return on average equity <sup>(3)</sup>	6.93	7.23	7.27	9.25	6.66 <sup>(2)</sup>
Book value per common share outstanding <sup>(1)</sup>	\$ 16.48	\$ 15.86	\$ 16.56	\$ 16.11	\$ 14.81
Dividends declared per share <sup>(1)</sup>	\$ 0.52	\$ 0.52	\$ 0.48	\$ 0.36	\$ 0.29
Dividend payout ratio	54.83%	48.24%	44.05%	26.41%	30.90%
Number of full-service offices	14	13	13	13	12

(1) Amounts reported have been adjusted for the three-for-two stock split paid January 2, 1997 in the form of a 50% stock dividend.

(2) Reflects the one-time industry-wide special assessment to recapitalize the Savings Association Insurance Fund.

(3) Cash earnings excludes from net income the amortization of goodwill, net of related income taxes.

## Management's Discussion and Analysis

### General

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

The Company focuses on establishing and maintaining long-term relationships with customers, and is committed to serving the financial service needs of the communities in its market area. The Company's primary market area includes the following counties: Adair, Buena Vista, Calhoun, Ida, Guthrie, Pocahontas, Polk, and Sac located in Iowa, and the counties of Brookings and Minnehaha located in east central South Dakota. The Company attracts retail deposits from the general public and uses those deposits, together with other borrowed funds, to originate and purchase residential and commercial mortgage loans, to make consumer loans, and to provide financing for agricultural and other commercial business purposes.

The Company's basic mission is to maintain and enhance core earnings while serving its primary market area. As such, the Board of Directors has adopted a business strategy designed to (i) maintain the Company's tangible capital in excess of regulatory requirements, (ii) maintain the quality of the Company's assets, (iii) control operating expenses, (iv) maintain and, as possible, increase the Company's interest rate spread, and (v) manage the Company's exposure to changes in interest rates.

### Financial Condition

The following discussion of the Company's consolidated financial condition should be read in conjunction with the Selected Consolidated Financial Information and Consolidated Financial Statements and the related notes included elsewhere herein.

The Company's total assets at September 30, 2000 were \$505.6 million, a decrease of \$5.6 million, or 1.1%, from \$511.2 million at September 30, 1999.

The decrease in assets was due primarily to the reduction in securities available for sale, which was partially offset by an increase in net loans receivable.

The Company's portfolio of securities available for sale decreased \$31.0 million, or 17.4%, to \$147.5 million at September 30, 2000 from \$178.5 million at September 30, 1999. The decrease was due to the sale of securities available for sale in a planned restructuring of the balance sheet and, in addition, was due to the normal repayment of mortgage-backed securities. The balance sheet restructuring involved the sale of lower yielding securities, the reinvestment of proceeds into higher yielding assets, and the repayment of borrowings.

The Company's portfolio of net loans receivable increased by \$21.6 million, or 7.1%, to \$324.7 million at September 30, 2000 from \$303.1 million at September 30, 1999. Net loans receivable increased as a result of increased origination and purchase of commercial and multi-family real estate loans on existing and newly constructed properties. In addition, the increase resulted from increased origination of consumer loans and agricultural real estate loans. Conventional one to four family residential mortgage loans declined as existing originated and purchased loans repaid in amounts greater than new originations during the period. Agricultural business loans also declined as a result of repayments in excess of new originations during the period.

Customer deposit balances increased by \$13.9 million, or 4.6%, from \$304.8 million at September 30, 1999 to \$318.7 million at September 30, 2000. The increase in deposits resulted from management's continued effort to enhance deposit product design and marketing programs. Deposit balances increased for noninterest-bearing demand accounts and time certificates of deposit in the amounts of \$360,000 and \$16.0 million, respectively. Interest-bearing transaction accounts, which include savings, NOW and money market demand accounts, declined \$2.5 million as higher interest rates during the period provided incentive for the movement of funds to fixed-term certificates of deposit.

The Company's borrowings from the FHLB decreased by \$21.6 million, or 13.4%, from \$161.3 million at September 30, 1999 to \$139.7 million at September 30, 2000. The reduction in borrowings was the result of increased deposit balances and proceeds from the sale of securities available for sale.

## First Midwest Financial, Inc. and Subsidiaries

Shareholders' equity increased \$264,000, or 0.7%, to \$40.0 million at September 30, 2000 from \$39.8 million at September 30, 1999. The increase in shareholders' equity is the result of net earnings during the period, which were partially offset by the effect of stock repurchases and the payment of cash dividends on common stock.

### Results of Operations

The following discussion of the Company's results of operations should be read in conjunction with the Selected Consolidated Financial Information and Consolidated Financial Statements and the related notes included elsewhere herein.

The Company's results of operations are primarily dependent on net interest income, noninterest income and the Company's ability to manage operating expenses. Net interest income is the difference, or spread, between the average yield on interest-earning assets and the average rate paid on interest-bearing liabilities. The interest rate spread is affected by regulatory, economic, and competitive factors that influence interest rates, loan demand, and deposit flows. The Company, like other financial institutions, is subject to interest rate risk to the extent that its interest-earning assets mature or reprice at different times, or

on a different basis, than its interest-bearing liabilities.

The Company's noninterest income consists primarily of fees charged on transaction accounts and for the origination of loans, both of which help offset the costs associated with establishing and maintaining deposit and loan accounts. In addition, noninterest income is derived from the activities of First Federal's wholly-owned subsidiaries, First Services Financial Limited and Brookings Service Corporation. Both engage in the sale of various non-insured investment products. Historically, the Company has not derived significant income as a result of gains on the sale of securities and other assets. During the year ended September 30, 2000, the Company recorded a loss on the sale of securities available for sale in the amount of \$1,021,000 resulting from the planned restructuring of the balance sheet that involved the sale of lower yielding securities, the reinvestment of funds into higher yielding assets, and the repayment of borrowings. The loss on sale of securities was partially offset by a \$561,000 gain on the transfer of Federal Home Loan Bank advances. For the years ended September 30, 1999 and 1998, gains were recorded in the amounts of \$332,000 and \$399,000, respectively, as a result of the sale of securities available for sale.

The following table sets forth the weighted average effective interest rate on interest-earning assets and interest-bearing liabilities at the end of each of the years presented.

At September 30	2000	1999	1998
<b>WEIGHTED AVERAGE YIELD ON</b>			
Loans receivable	8.47%	8.09%	8.80%
Mortgage-backed securities available for sale	6.66	6.38	7.15
Securities available for sale	6.92	6.14	6.40
FHLB stock	7.10	6.25	6.75
Combined weighted average yield on interest-earning assets	7.91	7.39	8.13
<b>WEIGHTED AVERAGE RATE PAID ON</b>			
Demand, NOW and money market demand deposits	3.50	3.24	3.00
Savings deposits	3.05	2.50	2.48
Time deposits	6.02	5.32	5.80
FHLB advances	5.99	5.38	5.91
Other borrowed money	6.32	5.28	5.68
Combined weighted average rate paid on interest-bearing liabilities	5.59	4.99	5.39
Spread	2.32%	2.40%	2.74%

### Rate/Volume Analysis

The following schedule presents the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. It distinguishes between the increase related to higher outstanding balances and that due to the levels and volatility of interest rates. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes

attributable to (i) changes in volume (i.e., changes in volume multiplied by old rate) and (ii) changes in rate (i.e., changes in rate multiplied by old volume). For purposes of this table, changes attributable to both rate and volume, which cannot be segregated have been allocated proportionately to the change due to volume and the change due to rate.

Year Ended September 30,	2000 vs. 1999			1999 vs. 1998		
	Increase (Decrease) Due to Volume	Increase (Decrease) Due to Rate	Total Increase (Decrease)	Increase (Decrease) Due to Volume	Increase (Decrease) Due to Rate	Total Increase (Decrease)
In Thousands						
<b>INTEREST-EARNING ASSETS</b>						
Loans receivable	\$ 2,081	\$ 391	\$ 2,472	\$ 2,399	\$ (1,658)	\$ 741
Mortgage-backed securities available for sale	651	55	706	4,088	(262)	3,826
Securities available for sale	(354)	129	(225)	(1,276)	(72)	(1,348)
FHLB stock	62	22	84	114	(19)	95
Total interest-earning assets	<u>\$ 2,440</u>	<u>\$ 597</u>	<u>\$ 3,037</u>	<u>\$ 5,325</u>	<u>\$ (2,011)</u>	<u>\$ 3,314</u>
<b>INTEREST-BEARING LIABILITIES</b>						
Demand, NOW and money market deposits	\$ 269	\$ 146	\$ 415	\$ 587	\$ 210	\$ 797
Savings deposits	(46)	76	30	(65)	10	(55)
Time deposits	514	171	685	997	(665)	332
FHLB advances	819	433	1,252	2,233	(343)	1,890
Other borrowed money	7	13	20	(7)	(11)	(18)
Total interest-bearing liabilities	<u>\$ 1,563</u>	<u>\$ 839</u>	<u>\$ 2,402</u>	<u>\$ 3,745</u>	<u>\$ (799)</u>	<u>\$ 2,946</u>
Net effect on net interest income	<u>\$ 877</u>	<u>\$ (242)</u>	<u>\$ 635</u>	<u>\$ 1,580</u>	<u>\$ (1,212)</u>	<u>\$ 368</u>

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**Average Balances, Interest Rates and Yields**

The following table presents for the periods indicated the total dollar amount of interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed both in dollars and rates. No tax equivalent adjustments have been made. All average balances are quarterly average balances. Non-accruing loans have been included in the table as loans carrying a zero yield.

Year Ended September 30,	2000			1999			1998		
	Average Outstanding Balance	Interest Earned /Paid	Yield /Rate	Average Outstanding Balance	Interest Earned /Paid	Yield /Rate	Average Outstanding Balance	Interest Earned /Paid	Yield /Rate
<i>(Dollars in Thousands)</i>									
<b>INTEREST-EARNING ASSETS</b>									
Loans receivable <sup>(1)</sup>	\$ 309,768	\$ 26,268	8.48%	\$ 285,232	\$ 23,796	8.34%	\$ 256,482	\$ 23,055	8.99%
Mortgage-backed securities available for sale	125,749	8,210	6.53	115,784	7,504	6.48	52,722	3,678	6.98
Securities available for sale	52,672	3,379	6.42	58,190	3,604	6.19	78,789	4,952	6.29
FHLB stock	8,190	553	6.75	7,278	469	6.44	5,514	374	6.78
Total interest-earning assets	496,379	\$ 38,410	7.74%	466,484	\$ 35,373	7.58%	393,507	\$ 32,059	8.15%
Noninterest-earning assets	10,879			14,719			18,415		
Total assets	\$ 507,258			\$ 481,203			\$ 411,922		
<b>INTEREST-BEARING LIABILITIES</b>									
Demand, NOW and money market demand deposits	\$ 59,199	\$ 2,145	3.62%	\$ 51,778	\$ 1,730	3.34%	\$ 34,202	\$ 933	2.73%
Savings deposits	15,986	477	2.98	17,528	447	2.55	20,090	502	2.50
Time deposits	230,992	13,015	5.63	221,873	12,330	5.56	203,932	11,998	5.88
FHLB advances	149,896	8,735	5.83	135,846	7,483	5.51	95,328	5,593	5.87
Other borrowed money	3,460	206	5.95	3,348	186	5.56	3,473	204	5.87
Total interest-bearing liabilities	459,533	\$ 24,578	5.35%	430,373	\$ 22,176	5.15%	357,025	\$ 19,230	5.39%
Noninterest-bearing:									
Deposits	5,639			5,749			5,646		
Liabilities	3,178			3,451			5,956		
Total liabilities	468,350			439,573			368,627		
Shareholders' equity	38,908			41,630			43,295		
Total liabilities and shareholders' equity	\$ 507,258			\$ 481,203			\$ 411,922		
Net interest-earning assets	\$ 36,846			\$ 36,111			\$ 36,482		
Net interest income		\$ 13,832			\$ 13,197			\$ 12,829	
Net interest rate spread			2.39%			2.43%			2.76%
Net yield on average interest-earning assets			2.79%			2.83%			3.26%
Average interest-earning assets to average interest-bearing liabilities	108.02%			108.39%			110.22%		

(1) Calculated net of deferred loan fees, loan discounts, loans in process and allowance for loan losses.



### Comparison of Operating Results for the Years Ended September 30, 2000 and September 30, 1999

**GENERAL** Net income for the year ended September 30, 2000 decreased \$313,000, or 11.9%, to \$2,328,000, from \$2,641,000 for the same period ended September 30, 1999. The decrease in net income reflects the loss on sale of securities available for sale and an increase in noninterest expenses, which were partially offset by an increase in net interest income, a decrease in the provision for loan losses and a gain on the transfer of FHLB advances.

**NET INTEREST INCOME** Net interest income for the year ended September 30, 2000 increased by \$635,000, or 4.8%, to \$13,832,000 compared to \$13,197,000 for the same period ended September 30, 1999. The increase in net interest income reflects an overall increase in the average balance of interest-earning assets during the period, which was partially offset by a decrease in the net interest rate spread between interest-earning assets and interest-bearing liabilities. The net yield on average earning assets decreased to 2.79% for the period ended September 30, 2000 from 2.83% for the same period in 1999. The decrease in net yield is primarily due the decrease in net interest rate spread between interest-earning assets and interest-bearing liabilities.

**INTEREST INCOME** Interest income for the year ended September 30, 2000 increased \$3,037,000, or 8.6%, to \$38,410,000 from \$35,373,000 for the same period in 1999. The increase reflects an increase in interest income from net loans receivable of \$2,472,000 due to an increase in the average balance outstanding and, to a lesser extent, an increase in the overall yield during the period. In addition, the increase in interest income reflects an increase in interest income from the portfolio of securities available for sale of \$481,000 due to an increase in the portfolio yield and an increase in the average portfolio balance during the period.

**INTEREST EXPENSE** Interest expense increased \$2,402,000, or 10.8%, to \$24,578,000 for the year ended September 30, 2000 from \$22,176,000 for the same period in 1999. The increase in interest expense is due to increases in the average outstanding balance of demand deposits, time deposits, and FHLB advances during the year ended September 30, 2000 as compared to the same period in 1999. The increase in the average balance of demand and time deposits resulted from

internal growth of the deposit portfolio. The average balance of FHLB advances increased due to borrowing activity throughout the period used to fund growth of the loan portfolio. The increase in interest expense also reflects higher interest rates paid on interest-bearing liabilities during the year ended September 30, 2000, as market interest rates generally trended upward during the period.

**PROVISION FOR LOAN LOSSES** The provision for loan losses for the year ended September 30, 2000 was \$1,640,000 compared to \$1,992,000 for the same period in 1999. Management believes that, based on a detail review of the loan portfolio, historic loan losses, current economic conditions, and other factors, the current level of provision for loan losses, and the resulting level of the allowance for loan losses, reflects an adequate reserve against potential losses from the loan portfolio.

Current economic conditions in the agricultural sector of the Company's market area indicate potential weakness due to a continuation of historically low commodity prices. The agricultural economy is accustomed to commodity price fluctuations and is generally able to handle such fluctuations without significant problem. However, an extended period of low commodity prices could result in additional weakness of the Company's agricultural loan portfolio and could create a need for the Company to increase its allowance for loan losses through increased charges to provision for loan losses.

During recent years, the Company has increased its origination and purchase of multi-family and commercial real estate loans and has increased its origination of commercial business loans. The Company anticipates activity in this type of lending to continue in future years. This lending activity is considered to carry a higher level of risk due to the nature of the collateral and the size of individual loans. As such, the Company anticipates continued increases in its allowance for loan losses as a result of this lending activity.

Although the Company maintains its allowance for loan losses at a level that it considers to be adequate, there can be no assurance that future losses will not exceed estimated amounts, or that additional provisions for loan losses will not be required in future periods. In addition, the Company's determination of the allowance for loan losses is subject to review by its regulatory agencies, which can require the establish-

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ment of additional general or specific allowances.

**NONINTEREST INCOME** Noninterest income for the year ended September 30, 2000 decreased \$1,352,000, or 70.5%, to \$566,000 from \$1,918,000 for the same period in 1999. The decrease in noninterest income reflects a \$1,021,000 loss on sale of securities available for sale for the year ended September 30, 2000 as compared to a gain of \$332,000 the previous year. The fiscal 2000 loss on sale of securities available for sale resulted primarily from the planned restructuring of the balance sheet that involved the sale of lower yielding securities, the reinvestment of proceeds into higher yielding assets, and the repayment of borrowings. Noninterest income reflects an increase for fiscal 2000 in brokerage commissions received from sales of non-insured investment products through First Federal's subsidiaries.

**NONINTEREST EXPENSE** Noninterest expense increased by \$763,000, or 8.8%, to \$9,408,000 for the year ended September 30, 2000 as compared to \$8,645,000 for the same period in 1999. The increase in noninterest expense for fiscal 2000 reflects a \$695,000 increase in employee compensation and benefits expense due to normal wage and benefit cost increases and the addition of personnel related to the opening of a new office facility. In addition, occupancy and equipment expense and data processing expense increased for fiscal 2000 by \$142,000 and \$32,000, respectively, due to expenditures related to the opening of a new office facility and to expenditures on technological enhancements to the Company's computer and product delivery systems designed to provide continued efficient customer service.

**INCOME TAX EXPENSE** Income tax expense decreased by \$463,000, or 25.2%, to \$1,374,000 for the year ended September 30, 2000 from \$1,837,000 for the same period in 1999. The decrease in income tax expense reflects the decrease in the level of taxable income for the period ended September 30, 2000 compared to the same period in 1999.

**EXTRAORDINARY ITEM** The extraordinary item for the year ended September 30, 2000 was \$352,000, which is net of the income tax effect. The extraordinary item reflects the gain on the transfer of FHLB advances resulting from the planned restructuring of the balance sheet that involved the sale of lower yielding securities, the reinvestment of proceeds into higher yielding assets, and the repayment of borrowings. There was no such extraordinary item in the previous year.

### **Comparison of Operating Results for the Years Ended September 30, 1999 and September 30, 1998**

**GENERAL** Net income for the year ended September 30, 1999 decreased \$144,000, or 5.2%, to \$2,641,000, from \$2,785,000 for the same period ended September 30, 1998. The decrease in net income reflects increases in the provision for loan losses and noninterest expense, which were partially offset by increases in net interest income and noninterest income.

**NET INTEREST INCOME** Net interest income for the year ended September 30, 1999 increased by \$368,000, or 2.9%, to \$13,197,000 compared to \$12,829,000 for the same period ended September 30, 1998. The increase in net interest income reflects an overall increase in the balance of average interest-earning assets during the period. The net yield on average earning assets decreased to 2.83% for the period ended September 30, 1999 from 3.26% for the same period in 1998. The decrease in net yield is primarily due to interest rates remaining generally at historically low levels throughout the period, which resulted in the continued refinance and repayment of relatively higher yielding loans and mortgage-backed securities. These earning assets were replaced through the origination and purchase of loans and mortgage-backed securities at comparatively lower yields. The reduction in yield on earning assets was partially offset by a reduction in the cost of interest-bearing liabilities.

**INTEREST INCOME** Interest income for the year ended September 30, 1999 increased \$3,314,000, or 10.3%, to \$35,373,000 from \$32,059,000 for the same period in 1998. The increase reflects a \$2,478,000 increase in interest earned on the portfolio of securities available for sale, which increased to \$11,108,000 for the year ended September 30, 1999 from \$8,630,000 in 1998. The increase in interest income from securities resulted from a higher average securities portfolio balance, which was partially offset by a lower average yield on the securities portfolio during fiscal 1999 compared to 1998. In addition, interest income was higher due to a \$741,000 increase in interest earned on the loan portfolio as a result of a higher average loan portfolio balance which was partially offset by a lower average yield during fiscal 1999 compared to 1998.

**INTEREST EXPENSE** Interest expense increased \$2,946,000, or 15.3%, to \$22,176,000 for the year ended September 30, 1999 from \$19,230,000 for the same period in 1998. The increase in interest expense

is due to increases in the average outstanding balance of demand deposits, time deposits, and FHLB advances during the year ended September 30, 1999 as compared to the same period in 1998. The increase in the average balance of demand and time deposits resulted from internal growth of the deposit portfolio. The average balance of FHLB advances increased due to borrowing activity throughout the period used to fund growth of the loan portfolio and the purchase of securities available for sale. The increase in interest expense was partially offset by lower interest rates paid on time deposits and FHLB borrowings during the year ended September 30, 1999 as compared to the previous year, as market interest rates have generally trended downward.

**PROVISION FOR LOAN LOSSES** The provision for loan losses for the year ended September 30, 1999 was \$1,992,000 compared to \$1,662,000 for the same period in 1998. Management believes that, based on a detail review of the loan portfolio, historic loan losses, current economic conditions, and other factors, the current level of provision for loan losses, and the resulting level of the allowance for loan losses, reflects an adequate reserve against potential losses from the loan portfolio.

**NONINTEREST INCOME** Noninterest income for the year ended September 30, 1999 increased \$43,000, or 2.3%, to \$1,918,000 from \$1,875,000 for the same period in 1998. The increase in noninterest income reflects an increase in loan fees and deposit service charges of \$83,000 for fiscal 1999 compared to the same period in 1998 as a result of increased lending activity and increased activity on transaction accounts subject to service charges. Noninterest income also increased due to an increase in brokerage commissions from sales of non-insured investment products through First Federal's subsidiaries and increased as a result of a net gain on sales of foreclosed real estate compared to a net loss on sales in 1998. Noninterest income reflects lower net gain on the sales of securities available for sale for fiscal 1999 compared to 1998.

**NONINTEREST EXPENSE** Noninterest expense increased by \$392,000, or 4.7%, to \$8,645,000 for the year ended September 30, 1999 compared to \$8,253,000 for the same period in 1998. The increase in noninterest expense for fiscal 1999 reflects a \$491,000 increase in employee compensation and benefits expense primarily due to the addition of personnel and the upgrade of expertise in existing positions to support current and anticipated growth of the

Company. In addition, other noninterest expense increased for fiscal 1999 by \$123,000 compared to 1998 due primarily to expenses related to the recruitment of new personnel. Noninterest expense for fiscal 1998 included a \$300,000 charge to provision for losses on foreclosed real estate for which there was no comparable charge in fiscal 1999.

**INCOME TAX EXPENSE** Income tax expense decreased by \$167,000, or 8.3%, to \$1,837,000 for the year ended September 30, 1999 from \$2,004,000 for the same period in 1998. The decrease in income tax expense reflects the decrease in the level of taxable income for the period ended September 30, 1999 compared to the same period in 1998.

## **Asset/Liability Management and Market Risk**

**QUALITATIVE ASPECTS OF MARKET RISK** As stated above, the Company derives its income primarily from the excess of interest collected over interest paid. The rates of interest the Company earns on assets and pays on liabilities generally are established contractually for a period of time. Market interest rates change over time. Accordingly, the Company's results of operations, like those of many financial institution holding companies and financial institutions, are impacted by changes in interest rates and the interest rate sensitivity of its assets and liabilities. The risk associated with changes in interest rates and the Company's ability to adapt to these changes is known as interest rate risk and is the Company's only significant market risk.

**QUANTITATIVE ASPECTS OF MARKET RISK** In an attempt to manage the Company's exposure to changes in interest rates and comply with applicable regulations, we monitor the Company's interest rate risk. In monitoring interest rate risk, we continually analyze and manage assets and liabilities based on their payment streams and interest rates, the timing of their maturities, and their sensitivity to actual or potential changes in market interest rates.

An asset or liability is interest rate sensitive within a specific time period if it will mature or reprice within that time period. If the Company's assets mature or reprice more rapidly or to a greater extent than its liabilities, then net portfolio value and net interest income would tend to increase during periods of rising rates and decrease during periods of falling interest rates. Conversely, if the Company's assets mature or reprice more slowly or to a lesser extent than its liabilities, then net portfolio value and net interest income would

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tend to decrease during periods of rising interest rates and increase during periods of falling interest rates.

The Company currently focuses lending efforts toward originating and purchasing competitively priced adjustable-rate and fixed-rate loan products with relatively short terms to maturity, generally 15 years or less. This allows the Company to maintain a portfolio of loans that will be sensitive to changes in the level of interest rates while providing a reasonable spread to the cost of liabilities used to fund the loans.

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

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

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

In managing its asset/liability mix, the Company, at times, depending on the relationship between long-

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

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

Presented below, as of September 30, 2000 and 1999, is an analysis of the Company's interest rate risk as measured by changes in NPV for an instantaneous and sustained parallel shift in the yield curve, in 100 basis point increments, up and down 200 basis points. As illustrated in the table, the Company's NPV is generally more sensitive to rising rate changes than declining rates. This occurs primarily because, as rates rise, the market value of fixed-rate loans and mortgage-backed securities declines due to both the rate increase and the related slowing of prepayments on

Change in Interest Rate (Basis Points)	Board Limit % Change	At September 30, 2000		At September 30, 1999	
		\$ Change	% Change	\$ Change	% Change
(Dollars in Thousands)					
+200 bp	(40)%	\$(7,202)	(18)%	\$(10,597)	(26)%
+100 bp	(25)	(3,323)	(8)	(5,029)	(12)
0	-	—	—	—	—
- 100 bp	(10)	2,659	6	3,535	9
- 200 bp	(15)	1,657	4	3,875	9

loans. When rates decline, the Company does not experience a significant rise in market value for these loans and mortgage-backed securities because borrowers prepay at relatively higher rates. The value of the Company's deposits and borrowings change in approximately the same proportion in rising and falling rate scenarios. The Company experienced a decrease in interest rate sensitivity at September 30, 2000 as compared to the end of the previous year due to the reduction, through sale and repayment, of fixed-rate mortgage-backed securities with longer expected terms to maturity and, in addition, the lengthening of the average maturity of FHLB advances.

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

Management reviews the OTS measurements and related peer reports on NPV and interest rate risk on a quarterly basis. In addition to monitoring selected measures of NPV, management also monitors the effects on net interest income resulting from increases or decreases in interest rates. This measure is used in conjunction with NPV measures to identify excessive interest rate risk.

**ASSET QUALITY** It is management's belief, based on information available, that the Company's current asset quality is satisfactory. At September 30, 2000, non-performing assets, consisting of non-accruing loans, accruing loans delinquent 90 days or more, real estate owned, and repossessed consumer property, totaled \$755,000, or 0.15% of total assets, compared to \$2,381,000, or 0.47% of total assets, for the fiscal year ended 1999. The decrease in non-performing assets during fiscal 2000 reflects management's contin-

ued effort to strengthen the quality of its loan portfolio through adherence to written underwriting guidelines, an on-going credit review program, and diligent collection practices.

The Company maintains an allowance for loan losses because of the potential that some loans may not be repaid in full. At September 30, 2000, the Company had an allowance for loan losses in the amount of \$3,590,000 as compared to \$3,093,000 at September 30, 1999. Management's periodic review of the adequacy of the allowance for loan losses is based on various subjective and objective factors including the Company's past loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and current economic conditions. While management may allocate portions of the allowance for specifically identified problem loan situations, the majority of the allowance is based on judgmental factors related to the overall loan portfolio and is available for any loan charge-offs that may occur.

In determining the allowance for loan losses, the Company specifically identifies loans that it considers to have potential collectibility problems. Based on criteria established by SFAS No. 114, some of these loans are considered to be "impaired" while others are not considered to be impaired, but possess weaknesses that the Company believes merit additional analysis in establishing the allowance for loan losses. All other loans are evaluated by applying estimated loss ratios to various pools of loans. The Company then analyzes other factors (such as economic conditions) in determining the aggregate amount of the allowance needed.

At September 30, 2000, \$734,000 of the allowance for loan losses was allocated to impaired loans (See Note 4 of Notes to Consolidated Financial Statements), \$500,000 was allocated to identified problem loan situations, and \$2,356,000 was allocated as a reserve against losses from the overall loan portfolio. At September 30, 1999, \$438,000 of the allowance for loan losses was allocated to impaired loans, \$670,000 was allocated to identified problem loan situations, and \$1,985,000 was allocated as a reserve against losses from the overall loan portfolio.

The September 30, 2000 allowance for loan losses that was allocated to impaired loans was \$734,000, which is 12.9% of impaired loans as of that date. The September, 30 1999 allowance allocated to impaired loans was \$438,000, which is 10.9% of impaired loans at that date. The increase in the dollar amount of the

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allocated allowance is due to the relative increase in total impaired loans between the periods and the increase in the allocated allowance as a percentage of total impaired loans is a result of the specific analysis performed on a loan-by-loan basis as described above.

The September 30, 2000 allowance allocated to other identified problem loan situations was \$500,000 as compared to \$670,000 at September 30, 1999, a decrease of \$170,000. This change is a result of the specific analysis performed on a loan-by-loan basis as described above.

The portion of the September 30, 2000 allowance that was not specifically allocated was \$2,356,000 as compared to \$1,985,000 at September 30, 1999, an increase of \$371,000. This increase was primarily due to an increase in the size of the loan portfolio and a shift in the mix of the loan portfolio from single-family loans to commercial and multi-family real estate loans.

**LIQUIDITY AND SOURCES OF FUNDS** The Company's primary sources of funds are deposits, borrowings, principal and interest payments on loans and mortgage-backed securities, and maturing investment securities. While scheduled loan repayments and maturing investments are relatively predictable, deposit flows and early loan repayments are influenced by the level of interest rates, general economic conditions, and competition.

Federal regulations require First Federal to maintain minimum levels of liquid assets. Currently, First Federal is required to maintain liquid assets of at least 4% of the average daily balance of net withdrawable savings deposits and borrowings payable on demand in one year or less during the preceding calendar quarter. Liquid assets for purposes of this ratio include cash, certain time deposits, U.S. Government, governmental agency, and corporate securities and obligations, unless otherwise pledged. First Federal has historically maintained its liquidity ratio at levels in excess of those required. First Federal's regulatory liquidity ratios were 8.7%, 9.1% and 15.4% at September 30, 2000, 1999 and 1998, respectively.

Liquidity management is both a daily and long-term function of the Company's management strategy. The Company adjusts its investments in liquid assets based upon management's assessment of (i) expected loan demand, (ii) the projected availability of purchased loan products, (iii) expected deposit flows, (iv) yields available on interest-bearing deposits, and (v)

the objectives of its asset/liability management program. Excess liquidity is generally invested in interest-earning overnight deposits and other short-term government agency obligations. If the Company requires funds beyond its ability to generate them internally, it has additional borrowing capacity with the Federal Home Loan Bank of Des Moines and has collateral eligible for use with reverse repurchase agreements.

The primary investing activities of the Company are the origination and purchase of loans and the purchase of securities. During the years ended September 30, 2000, 1999 and 1998, the Company originated loans totaling \$104.3 million, \$143.3 million and \$147.2 million, respectively. Purchases of loans totaled \$55.6 million, \$77.3 million and \$36.9 million during the years ended September 30, 2000, 1999 and 1998, respectively. During the years ended September 30, 2000, 1999 and 1998, the Company purchased mortgage-backed securities and other securities available for sale in the amount of \$515,000, \$125.4 million and \$89.9 million, respectively.

At September 30, 2000, the Company had outstanding commitments to originate and purchase loans of \$14.8 million. (See Note 14 of Notes to Consolidated Financial Statements.) Certificates of deposit scheduled to mature in one year or less from September 30, 2000 total \$132.3 million. Based on its historical experience, management believes that a significant portion of such deposits will remain with the Company, however, there can be no assurance that the Company can retain all such deposits. Management believes that loan repayment and other sources of funds will be adequate to meet the Company's foreseeable short- and long-term liquidity needs.

During fiscal year 2000, the Company began construction of a new office facility in Sioux Falls, South Dakota. The construction of this office is expected to be completed during the second quarter of the 2001 fiscal year. In addition, the Company has initiated plans to construct a new office to be located in Urbandale, Iowa, which is anticipated to be completed by the end of the 2001 fiscal year. The source of funds for capital improvements of this type is from the normal operations of the Company.

On September 20, 1993, the Bank converted from a federally chartered mutual savings and loan association to a federally chartered stock savings bank. At that time, a liquidation account was established for the

benefit of eligible account holders who continue to maintain their account with the Bank after the conversion. The liquidation account is reduced annually to the extent that eligible account holders have reduced their qualifying deposits. At September 30, 2000, the liquidation account approximated \$2.5 million.

First Federal and Security are in full compliance with their capital requirements. See Note 13 of Notes to Consolidated Financial Statements for additional information.

#### **IMPACT OF INFLATION AND CHANGING PRICES**

The Consolidated Financial Statements and Notes thereto presented herein have been prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time due to inflation. The primary impact of inflation is reflected in the increased cost of the Company's operations. Unlike most industrial companies, virtually all the assets and liabilities of the Company are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction, or to the same extent, as the prices of goods and services.

#### **IMPACT OF NEW ACCOUNTING STANDARDS**

SFAS No. 133 on derivatives will, beginning with the quarter ended December 31, 2000, require all derivatives to be recorded at fair value in the balance sheet, with changes in fair value run through income. If derivatives are documented and effective as hedges, the change in the derivative fair value will be offset by an equal change in the fair value of the hedged item. The adoption of SFAS No. 133 is not expected to have a material impact on the results of operations or financial condition of the Company.

SFAS No. 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" was issued in September 2000, and replaces SFAS No. 125 of the same title. SFAS 140 revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, but it carries over most of SFAS No. 125's provisions without reconsideration. The adoption of SFAS No. 140 is not expected to have a material impact on the results of operations or financial condition of the Company.

## **Forward-Looking Statements**

The Company, and its wholly-owned subsidiaries First Federal and Security, may from time to time make written or oral "forward-looking statements," including statements contained in its filings with the Securities and Exchange Commission, in its reports to shareholders, and in other communications by the Company, which are made in good faith by the Company pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements include statements with respect to the Company's beliefs, expectations, estimates, and intentions, that are subject to significant risks and uncertainties, and are subject to change based on various factors, some of which are beyond the Company's control. Such statements address the following subjects: future operating results; customer growth and retention; loan and other product demand; earnings growth and expectations; new products and services; credit quality and adequacy of reserves; technology; and our employees. The following factors, among others, could cause the Company's financial performance to differ materially from the expectations, estimates, and intentions expressed in such forward-looking statements: the strength of the United States economy in general and the strength of the local economies in which the Company conducts operations; the effects of, and changes in, trade, monetary, and fiscal policies and laws, including interest rate policies of the Federal Reserve Board; inflation, interest rate, market, and monetary fluctuations; the timely development of and acceptance of new products and services of the Company and the perceived overall value of these products and services by users; the impact of changes in financial services' laws and regulations; technological changes; acquisitions; changes in consumer spending and saving habits; and the success of the Company at managing the risks involved in the foregoing.

The foregoing list of factors is not exclusive. Additional discussion of factors affecting the Company's business and prospects is contained in the Company's periodic filings with the SEC. The Company does not undertake, and expressly disclaims any intent or obligation, to update any forward-looking statement, whether written or oral, that may be made from time to time by or on behalf of the Company.

*First Midwest Financial, Inc. and Subsidiaries*

**Consolidated Balance Sheets**

September 30, 2000 and 1999

	2000	1999
<b>ASSETS</b>		
Cash and due from banks	\$ 984,937	\$ 1,165,895
Interest-bearing deposits in other financial institutions	5,937,594	4,208,016
Total cash and cash equivalents	6,922,531	5,373,911
Securities available for sale	147,478,931	178,489,030
Loans receivable, net of allowance for loan losses of \$3,589,873 in 2000 and \$3,092,628 in 1999	324,702,629	303,078,500
Federal Home Loan Bank (FHLB) stock, at cost	8,327,600	8,125,800
Accrued interest receivable	5,216,929	5,046,234
Premises and equipment, net	6,091,741	4,770,056
Foreclosed real estate	445,133	142,901
Other assets	6,404,936	6,186,320
Total assets	<u>\$ 505,590,430</u>	<u>\$ 511,212,752</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Noninterest-bearing demand deposits	\$ 6,040,991	\$ 5,680,923
Savings, NOW and money market demand deposits	72,508,530	75,003,028
Time certificates of deposit	240,104,200	224,095,970
Total deposits	318,653,721	304,779,921
Advances from FHLB	139,738,451	161,348,071
Securities sold under agreements to repurchase	4,254,965	3,020,951
Advances from borrowers for taxes and insurance	461,514	422,593
Accrued interest payable	1,006,341	875,365
Accrued expenses and other liabilities	1,440,353	995,103
Total liabilities	<u>465,555,345</u>	<u>471,442,004</u>
<b>SHAREHOLDERS' EQUITY</b>		
Preferred stock, 800,000 shares authorized; none issued	-	-
Common stock, \$.01 par value; 5,200,000 shares authorized; 2,957,999 shares issued and 2,431,574 shares outstanding at September 30, 2000; 2,957,999 shares issued and 2,507,073 shares outstanding at September 30, 1999	29,580	29,580
Additional paid-in capital	20,976,107	21,305,937
Retained earnings - substantially restricted	30,404,386	29,352,943
Accumulated other comprehensive income (loss)	(2,553,891)	(2,520,633)
Unearned Employee Stock Ownership Plan shares	-	(167,200)
Treasury stock, 526,425 and 450,926 common shares, at cost, at September 30, 2000 and 1999, respectively	(8,821,097)	(8,229,879)
Total shareholders' equity	<u>40,035,085</u>	<u>39,770,748</u>
Total liabilities and shareholders' equity	<u>\$ 505,590,430</u>	<u>\$ 511,212,752</u>

See Notes to Consolidated Financial Statements.



*First Midwest Financial, Inc. and Subsidiaries*

**Consolidated Statements of Income**

Years ended September 30, 2000, 1999 and 1998

	2000	1999	1998
Interest and dividend income:			
Loans receivable, including fees	\$ 26,267,638	\$ 23,795,796	\$ 23,054,813
Securities available for sale	11,589,221	11,108,170	8,629,761
Dividends on FHLB stock	553,165	468,765	374,220
	<u>38,410,024</u>	<u>35,372,731</u>	<u>32,058,794</u>
Interest expense:			
Deposits	15,636,793	14,506,472	13,432,454
FHLB advances and other borrowings	8,941,569	7,669,408	5,797,499
	<u>24,578,362</u>	<u>22,175,880</u>	<u>19,229,953</u>
Net interest income	13,831,662	13,196,851	12,828,841
Provision for loan losses	<u>1,640,000</u>	<u>1,992,000</u>	<u>1,662,472</u>
Net interest income after provision for loan losses	<u>12,191,662</u>	<u>11,204,851</u>	<u>11,166,369</u>
Noninterest income:			
Loan fees and deposit service charges	1,310,642	1,346,117	1,263,367
Gain (loss) on sales of securities available for sale, net	(1,020,885)	331,611	398,903
Gain (loss) on sales of foreclosed real estate, net	(12,033)	16,513	(33,034)
Brokerage commissions	131,801	79,159	52,479
Other income	156,707	144,625	193,158
	<u>566,232</u>	<u>1,918,025</u>	<u>1,874,873</u>
Noninterest expense:			
Employee compensation and benefits	5,830,791	5,135,672	4,644,809
Occupancy and equipment expense	1,301,495	1,158,946	1,133,187
SAIF deposit insurance premium	89,990	155,901	143,199
Data processing expense	410,645	378,709	339,385
Provision for losses on foreclosed real estate	-	-	299,532
Other expense	1,775,122	1,815,730	1,692,728
	<u>9,408,043</u>	<u>8,644,958</u>	<u>8,252,840</u>
Income before income taxes	3,349,851	4,477,918	4,788,402
Income tax expense	<u>1,374,220</u>	<u>1,836,786</u>	<u>2,003,520</u>
Income before extraordinary item	1,975,631	2,641,132	2,784,882
Extraordinary item, gain on extinguishment of debt, less income tax effect of \$208,600	<u>351,995</u>	-	-
Net income	<u>\$ 2,327,626</u>	<u>\$ 2,641,132</u>	<u>\$ 2,784,882</u>
Earnings per common and common equivalent share:			
Basic earnings per common share:			
Income before extraordinary item	\$ 0.81	\$ 1.07	\$ 1.08
Extraordinary item, net of income taxes	0.14	-	-
Net income	<u>\$ 0.95</u>	<u>\$ 1.07</u>	<u>\$ 1.08</u>
Diluted earnings per common share:			
Income before extraordinary item	\$ 0.79	\$ 1.04	\$ 1.03
Extraordinary item, net of income taxes	0.14	-	-
Net income	<u>\$ 0.93</u>	<u>\$ 1.04</u>	<u>\$ 1.03</u>

See Notes to Consolidated Financial Statements.

First Midwest Financial, Inc. and Subsidiaries

Consolidated Statements of Changes in Shareholders' Equity

Years ended September 30, 2000, 1999 and 1998

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net of Tax	Unearned Employee Stock Ownership Plan Shares	Treasury Stock	Total Shareholders' Equity
Balance at September 30, 1997	\$ 29,580	\$ 20,984,754	\$ 26,427,657	\$ 960,371	\$ (567,200)	\$ (4,358,158)	\$ 43,477,004
Comprehensive income:							
Net income for the year ended September 30, 1998	-	-	2,784,882	-	-	-	2,784,882
Net change in net unrealized gains and losses on securities available for sale, net of reclassification adjustments and tax effects	-	-	-	(161,551)	-	-	(161,551)
Total comprehensive income							2,623,331
Purchase of 152,226 common shares of treasury stock	-	-	-	-	-	(3,271,203)	(3,271,203)
30,000 common shares committed to be released under the ESOP	-	454,460	-	-	200,000	-	654,460
Cash dividends declared on common stock (\$.48 per share)	-	-	(1,226,725)	-	-	-	(1,226,725)
Purchase of 1,033 common shares upon exercise of stock options	-	-	-	-	-	(21,972)	(21,972)
Issuance of 7,600 common shares from treasury stock due to exercise of stock options	-	(109,139)	-	-	-	159,807	50,668
Balance, September 30, 1998	<u>\$ 29,580</u>	<u>\$ 21,330,075</u>	<u>\$ 27,985,814</u>	<u>\$ 798,820</u>	<u>\$ (367,200)</u>	<u>\$ (7,491,526)</u>	<u>\$ 42,285,563</u>
Balance, September 30, 1998	\$ 29,580	\$ 21,330,075	\$ 27,985,814	\$ 798,820	\$ (367,200)	\$ (7,491,526)	\$ 42,285,563
Comprehensive income:							
Net income for the year ended September 30, 1999	-	-	2,641,132	-	-	-	2,641,132
Net change in net unrealized gains and losses on securities available for sale, net of reclassification adjustments and tax effects	-	-	-	(3,319,453)	-	-	(3,319,453)
Total comprehensive income (loss)							(678,321)
Purchase of 79,647 common shares of treasury stock	-	-	-	-	-	(1,289,186)	(1,289,186)
30,000 common shares committed to be released under the ESOP	-	255,220	-	-	200,000	-	455,220
Amortization of management recognition and retention plan common shares and tax benefits of restricted stock under the plans	-	101,634	-	-	-	-	101,634
Cash dividends declared on common stock (\$.52 per share)	-	-	(1,274,003)	-	-	-	(1,274,003)
Issuance of 23,051 common shares from treasury stock due to exercise of stock options	-	(222,026)	-	-	-	391,867	169,841
Issuance of 10,424 common shares from treasury stock for award of stock under management recognition and retention plans	-	(158,966)	-	-	-	158,966	-
Balance, September 30, 1999	<u>\$ 29,580</u>	<u>\$ 21,305,937</u>	<u>\$ 29,352,943</u>	<u>\$ (2,520,633)</u>	<u>\$ (167,200)</u>	<u>\$ (8,229,879)</u>	<u>\$ 39,770,748</u>

*First Midwest Financial, Inc. and Subsidiaries*

**Consolidated Statements of Changes in Shareholders' Equity (cont.)**

Years ended September 30, 2000, 1999 and 1998

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net of Tax	Unearned Employee Stock Ownership Plan Shares	Treasury Stock	Total Shareholders' Equity
Balance, September 30, 1999	\$ 29,580	\$ 21,305,937	\$ 29,352,943	\$ (2,520,633)	\$ (167,200)	\$ (8,229,879)	\$ 39,770,748
Comprehensive income:							
Net income for the year ended September 30, 2000	-	-	2,327,626	-	-	-	2,327,626
Net change in net unrealized gains and losses on securities available for sale, net of reclassification adjustments and tax effects	-	-	-	(33,258)	-	-	(33,258)
Total comprehensive income							2,294,368
Purchase of 129,999 common shares of treasury stock	-	-	-	-	-	(1,478,508)	(1,478,508)
ESOP stock released for allocation	-	103,664	-	-	167,200	-	270,864
Issuance of 54,500 common shares from treasury stock due to exercise of stock options	-	(467,372)	-	-	-	887,290	419,918
Cash dividends declared on common stock (\$.52 per share)	-	-	(1,276,183)	-	-	-	(1,276,183)
Amortization of management recognition and retention plan common shares and tax benefits of restricted stock under the plans	-	33,878	-	-	-	-	33,878
Balance, September 30, 2000	<u>\$ 29,580</u>	<u>\$ 20,976,107</u>	<u>\$ 30,404,386</u>	<u>\$ (2,553,891)</u>	<u>\$ -</u>	<u>\$ (8,821,097)</u>	<u>\$ 40,035,085</u>

See Notes to Consolidated Financial Statements.

*First Midwest Financial, Inc. and Subsidiaries*

**Consolidated Statements of Cash Flows**

Years Ended September 30, 2000, 1999 and 1998

	2000	1999	1998
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$ 2,327,626	\$ 2,641,132	\$ 2,784,882
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation, amortization and accretion, net	1,522,239	1,757,207	973,454
Provision for loan losses	1,640,000	1,992,000	1,662,472
Provision for losses on foreclosed real estate	-	-	299,532
Gain on transfer of FHLB advances	(560,595)	-	-
(Gain) loss on sales of securities available for sale, net	1,020,885	(331,611)	(398,903)
Proceeds from the sales of loans held for sale	1,435,581	7,403,780	5,613,115
Originations of loans held for sale	(1,435,581)	(7,403,780)	(5,613,115)
(Gain) loss on sales of foreclosed real estate, net	12,033	(16,513)	33,034
Net change in:			
Accrued interest receivable	(170,695)	(77,627)	397,502
Other assets	(505,918)	113,315	46,622
Accrued interest payable	130,976	40,624	(231,005)
Accrued expenses and other liabilities	445,250	360,857	(152,159)
Net cash provided by operating activities	<u>5,861,801</u>	<u>6,479,384</u>	<u>5,415,431</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Net change in interest-bearing deposits in other financial institutions	-	-	200,000
Purchase of securities available for sale	(515,000)	(125,354,705)	(89,877,636)
Proceeds from sales of securities available for sale	20,275,060	24,791,295	18,280,412
Proceeds from maturities and principal repayment of securities available for sale	9,822,708	37,255,192	67,062,074
Loans purchased	(55,565,541)	(77,329,717)	(36,947,582)
Net change in loans	31,437,629	42,151,758	18,415,456
Proceeds from sales of foreclosed real estate	498,316	1,357,430	440,401
Purchase of FHLB stock	(201,800)	(2,620,000)	(447,700)
Proceeds from redemption of FHLB stock	-	-	571,200
Purchase of premises and equipment	(1,770,906)	(1,110,859)	(227,895)
Net cash provided by (used in) investing activities	<u>3,980,466</u>	<u>(100,859,606)</u>	<u>(22,531,270)</u>

*First Midwest Financial, Inc. and Subsidiaries*

**Consolidated Statements of Cash Flows (cont.)**

Years Ended September 30, 2000, 1999 and 1998

	2000	1999	1998
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Net change in noninterest-bearing demand, savings, NOW and money market demand deposits	\$ (2,134,430)	\$ 17,956,774	\$ 7,316,146
Net change in time deposits	16,008,230	2,964,995	30,426,308
Proceeds from advances from FHLB	789,920,595	278,950,000	198,850,000
Repayments of advances from FHLB	(810,969,620)	(202,865,491)	(221,012,663)
Net change in securities sold under agreements to repurchase	1,234,014	(1,053,616)	2,274,567
Net change in other borrowings	-	(550,000)	(2,350,000)
Net change in advances from borrowers for taxes and insurance	38,921	17,375	(44,269)
Cash dividends paid	(1,276,183)	(1,274,003)	(1,226,725)
Proceeds from exercise of stock options	363,335	169,841	28,696
Purchase of treasury stock	(1,478,509)	(1,289,186)	(3,271,203)
Net cash provided by (used in) financing activities	<u>(8,293,647)</u>	<u>93,026,689</u>	<u>10,990,857</u>
Net change in cash and cash equivalents	1,548,620	(1,353,533)	(6,124,982)
<b>CASH AND CASH EQUIVALENTS</b>			
Beginning of year	5,373,911	6,727,444	12,852,426
End of year	<u>\$ 6,922,531</u>	<u>\$ 5,373,911</u>	<u>\$ 6,727,444</u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>			
Cash paid during the year for:			
Interest	\$ 24,447,386	\$ 22,135,256	\$ 19,460,958
Income taxes	2,038,500	1,919,389	1,795,805
<b>SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING ACTIVITIES</b>			
Loans transferred to foreclosed real estate	\$ 812,581	\$ 420,501	\$ 1,679,984

See Notes to Consolidated Financial Statements.

## Notes to Consolidated Financial Statements

Note 1. **Summary of Significant Accounting Policies**

**PRINCIPLES OF CONSOLIDATION:** The consolidated financial statements include the accounts of First Midwest Financial, Inc., a bank holding company located in Storm Lake, Iowa, (the “Company”) and its wholly-owned subsidiaries which include First Federal Savings Bank of the Midwest, a federally chartered savings bank whose primary regulator is the Office of Thrift Supervision, (the “Bank” or “First Federal”), Security State Bank, a state chartered commercial bank whose primary regulator is the Federal Reserve, (“Security”), First Services Financial Limited, which offers brokerage services and non-insured investment products and Brookings Service Corporation. All significant intercompany balances and transactions have been eliminated.

**NATURE OF BUSINESS, CONCENTRATION OF CREDIT RISK AND INDUSTRY SEGMENT INFORMATION:** The primary source of income for the Company is the purchase or origination of consumer, commercial, agricultural commercial real estate, and residential real estate loans. See Note 4 for a discussion of concentrations of credit risk. The Company accepts deposits from customers in the normal course of business primarily in northwest and central Iowa and eastern South Dakota. The Company operates primarily in the banking industry which accounts for more than 90% of its revenues, operating income and assets. While the Company’s management monitors the revenue streams of the various Company products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Accordingly, all of the Company’s banking operations are considered by management to be aggregated in one reportable operating segment.

Assets held in trust or fiduciary capacity are not assets of the Company and, accordingly, are not included in the accompanying consolidated financial statements. At September 30, 2000 and 1999, trust assets totaled approximately \$14,473,000 and \$14,405,000, respectively.

**USE OF ESTIMATES IN PREPARING FINANCIAL STATEMENTS:** 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, liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the report-

ed amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**CERTAIN SIGNIFICANT ESTIMATES:** The allowance for loan losses, fair values of securities and other financial instruments, and stock-based compensation expense, involve certain significant estimates made by management. These estimates are reviewed by management routinely and it is reasonably possible that circumstances that exist at September 30, 2000 may change in the near-term future and that the effect could be material to the consolidated financial statements.

**CASH AND CASH EQUIVALENTS:** For purposes of reporting cash flows, cash and cash equivalents is defined to include the Company’s cash on hand and due from financial institutions and short-term interest-bearing deposits in other financial institutions. The Company reports net cash flows for customer loan transactions, deposit transactions, longer term interest-bearing deposits in other financial institutions, and short-term borrowings with maturities of 90 days or less.

**SECURITIES:** The Company classifies all securities as available for sale. Available for sale securities are those the Company may decide to sell if needed for liquidity, asset-liability management or other reasons. Available for sale securities are reported at fair value, with net unrealized gains and losses reported as other comprehensive income or loss and as a separate component of shareholders’ equity, net of tax.

Gains and losses on the sale of securities are determined using the specific identification method based on amortized cost and are reflected in results of operations at the time of sale. Interest and dividend income, adjusted by amortization of purchase premium or discount over the estimated life of the security using the level yield method, is included in earnings.

**LOANS HELD FOR SALE:** Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. Net unrealized losses are recognized in a valuation allowance by charges to income.

**LOANS RECEIVABLE:** Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal balances reduced by the

allowance for loan losses, and any deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.

Premiums or discounts on purchased loans are amortized to income using the level yield method over the remaining period to contractual maturity, adjusted for anticipated prepayments.

Interest income on loans is accrued over the term of the loans based upon the amount of principal outstanding except when serious doubt exists as to the collectibility of a loan, in which case the accrual of interest is discontinued. Interest income is subsequently recognized only to the extent that cash payments are received until, in management's judgment, the borrower has the ability to make contractual interest and principal payments, in which case the loan is returned to accrual status.

**LOAN ORIGATION FEES, COMMITMENT FEES, AND RELATED COSTS:** Loan fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income using the interest method.

**ALLOWANCE FOR LOAN LOSSES:** Because some loans may not be repaid in full, an allowance for loan losses is recorded. The allowance for loan losses is increased by a provision for loan losses charged to expense and decreased by charge-offs (net of recoveries). Estimating the risk of loss and the amount of loss on any loan is necessarily subjective. Management's periodic evaluation of the adequacy of the allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and current economic conditions. While management may periodically allocate portions of the allowance for specific problem loan situations, the whole allowance is available for any loan charge-offs that occur.

Loans are considered impaired if full principal or interest payments are not anticipated in accordance with the contractual loan terms. Impaired loans are carried at the present value of expected future cash flows discounted at the loan's effective interest rate or at the fair value of the collateral if the loan is collateral dependent. A portion of the allowance for loan losses is allocated to impaired loans if the value of such loans is deemed to be less than the unpaid balance. If these allocations cause the allowance for loan losses to require an increase, such increase is reported as a component of the provision for loan losses.

Smaller-balance homogeneous loans are evaluated for impairment in total. Such loans include residential first mortgage loans secured by one-to-four family residences, residential construction loans, and automobile, manufactured homes, home equity and second mortgage loans. Commercial and agricultural loans and mortgage loans secured by other properties are evaluated individually for impairment. When analysis of borrower operating results and financial condition indicates that underlying cash flows of the borrower's business are not adequate to meet its debt service requirements, the loan is evaluated for impairment. Often this is associated with a delay or shortfall in payments of 90 days or more. Nonaccrual loans are often also considered impaired. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

**FORECLOSED REAL ESTATE:** Real estate properties acquired through, or in lieu of, loan foreclosure are initially recorded at fair value at the date of acquisition, establishing a new cost basis. Any reduction to fair value from the carrying value of the related loan at the time of acquisition is accounted for as a loan loss and charged against the allowance for loan losses. Valuations are periodically performed by management and valuation allowances are adjusted through a charge to income for changes in fair value or estimated selling costs.

**INCOME TAXES:** The Company records income tax expense based on the amount of taxes due on its tax return plus deferred taxes computed based on the expected future tax consequences of temporary differences between the carrying amounts and tax bases of assets and liabilities, using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

**PREMISES AND EQUIPMENT:** Land is carried at cost. Buildings, furniture, fixtures and equipment are carried at cost, less accumulated depreciation and amortization computed principally by using the straight-line method over the estimated useful lives of the assets ranging from 3 to 40 years. These assets are reviewed for impairment under Statement of Financial Accounting Standards (SFAS) No. 121 when events indicate the carrying amount may not be recoverable.

**EMPLOYEE STOCK OWNERSHIP PLAN:** The Company accounts for its employee stock ownership plan (ESOP) in accordance with AICPA Statement of Position (SOP) 93-6. Under SOP 93-6, the cost of

## *First Midwest Financial, Inc. and Subsidiaries*

shares issued to the ESOP, but not yet allocated to participants, are presented in the consolidated balance sheets as a reduction of shareholders' equity. Compensation expense is recorded based on the market price of the shares as they are committed to be released for allocation to participant accounts. The difference between the market price and the cost of shares committed to be released is recorded as an adjustment to additional paid-in capital. Dividends on allocated ESOP shares are recorded as a reduction of retained earnings. Dividends on unearned shares are used to reduce the accrued interest and principal amount of the ESOP's loan payable to the Company.

**FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK:** The Company, in the normal course of business, makes commitments to make loans which are not reflected in the consolidated financial statements. A summary of these commitments is disclosed in Note 15.

**INTANGIBLE ASSETS:** Goodwill arising from the acquisition of subsidiary banks is amortized over 15 years using the straight-line method. As of September 30, 2000 and 1999, unamortized goodwill totaled \$3,767,951 and \$4,132,883, respectively. Amortization expense was \$364,932, \$364,932 and \$364,932 for each of the years ended September 30, 2000, 1999 and 1998, respectively.

**SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE:** The Company enters into sales of securities under agreements to repurchase with primary dealers only, which provide for the repurchase of the same security. Securities sold under agreements to purchase identical securities are collateralized by assets which are held in safekeeping in the name of the Bank or Security by the dealers who arranged the transaction. Securities sold under agreements to repurchase are treated as financings and the obligations to repurchase such securities are reflected as a liability. The securities underlying the agreements remain in the asset accounts of the Company.

**EARNINGS PER COMMON SHARE:** Basic earnings per common share is based on the net income divided by the weighted average number of common shares outstanding during the period. ESOP shares are considered outstanding for earnings per common share calculations as they are committed to be released;

unearned ESOP shares are not considered outstanding. Management recognition and retention plan (MRRP) shares are considered outstanding for basic earnings per common share calculations as they become vested. Diluted earnings per common share shows the dilutive effect of additional potential common shares issuable under stock options and nonvested shares issued under management recognition and retention plans.

**COMPREHENSIVE INCOME:** Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes the net change in net unrealized gains and losses on securities available for sale, net of reclassification adjustments and tax effects, and is also recognized as a separate component of shareholders' equity.

**STOCK COMPENSATION:** Expense for employee compensation under stock option plans is based on Accounting Principles Board (APB) Opinion 25, with expense reported only if options are granted below market price at grant date. Disclosures of net income and earnings per share are provided as if the fair value method of SFAS No. 123 were used for stock-based compensation.

**NEW ACCOUNTING PRONOUNCEMENTS:** SFAS No. 133 on derivatives will, beginning with the quarter ended December 31, 2000, require all derivatives to be recorded at fair value in the balance sheet, with changes in fair value run through income. If derivatives are documented and effective as hedges, the change in the derivative fair value will be offset by an equal change in the fair value of the hedged item. The adoption of SFAS No. 133 is not expected to have a material impact on the results of operations or financial condition of the Company.

SFAS No. 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" was issued in September 2000, and replaces SFAS No. 125 of the same title. SFAS No. 140 revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, but it carries over most of SFAS No. 125's provisions without reconsideration. The adoption of SFAS No. 140 is not expected to have a material impact on the results of operations or financial condition of the Company.



## Earnings Per Common Share

Note 2.

A reconciliation of the numerators and denominators used in the computation of basic earnings per common share and diluted earnings per common share is presented below.

	2000	1999	1998
Basic earnings per common share:			
Numerator:			
Net income before extraordinary item	\$ 1,975,631	\$ 2,641,132	\$ 2,784,882
Extraordinary item, gain on extinguishment of debt, less income tax effect of \$208,600	351,995	-	-
Net Income	<u>\$ 2,327,626</u>	<u>\$ 2,641,132</u>	<u>\$ 2,784,882</u>
Denominator, weighted average common shares outstanding	2,464,829	2,510,494	2,646,105
Less weighted average unallocated ESOP shares	<u>(11,535)</u>	<u>(41,327)</u>	<u>(71,327)</u>
Weighted average common shares outstanding for basic earnings per common share	<u>2,453,294</u>	<u>2,469,167</u>	<u>2,574,778</u>
Basic earnings per common share:			
Earnings per common share before extraordinary item	\$ 0.81	\$ 1.07	\$ 1.08
Extraordinary item per common share	0.14	-	-
Earnings per common share	<u>\$ 0.95</u>	<u>\$ 1.07</u>	<u>\$ 1.08</u>

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**Earnings Per Common Share (cont.)**

	2000	1999	1998
Diluted earnings per common share:			
Numerator:			
Net income before extraordinary item	\$ 1,975,631	\$ 2,641,132	\$ 2,784,882
Extraordinary item, gain on extinguishment of debt, less income tax effect of \$208,600	351,995	-	-
Net income	<u>\$ 2,327,626</u>	<u>\$ 2,641,132</u>	<u>\$ 2,784,882</u>
Denominator, weighted average common shares outstanding for basic earnings per common share	2,453,294	2,469,167	2,574,778
Add dilutive effects of assumed exercises of stock options and average nonvested MRRP shares, net of tax benefits	<u>40,661</u>	<u>79,681</u>	<u>127,862</u>
Weighted average common and dilutive potential common shares outstanding	<u>2,493,955</u>	<u>2,548,848</u>	<u>2,702,640</u>
Diluted earnings per common share:			
Diluted earnings per common share before extraordinary item	\$ 0.79	\$ 1.04	\$ 1.03
Diluted extraordinary item per common share	<u>0.14</u>	<u>-</u>	<u>-</u>
Diluted earnings per common share	<u>\$ 0.93</u>	<u>\$ 1.04</u>	<u>\$ 1.03</u>

Stock options totaling 171,096 shares were not considered in computing diluted earnings per common share for the year ended September 30, 2000, because they were not dilutive.

During the year ended September 30, 2000, the Company acquired approximately 5.1% (129,999

shares) of its beginning of year outstanding common shares under its common stock repurchase program. This repurchase will affect the Company's future earnings per common share computations by reducing amounts available for investment and weighted average shares outstanding.

## Securities

Note 3.

Year end securities available for sale were as follows:

2000	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities:				
Trust preferred	\$ 27,159,373	\$ 6,410	\$ (1,244,923)	\$ 25,920,860
Obligations of states and political subdivisions	1,199,591	24,016	(8,850)	1,214,757
U.S. Government and federal agencies	16,959,412	-	(579,462)	16,379,950
Mortgage-backed securities	104,795,500	408,115	(2,666,055)	102,537,560
	150,113,876	438,541	(4,499,290)	146,053,127
Marketable equity securities	1,434,043	280,511	(288,750)	1,425,804
	<u>\$151,547,919</u>	<u>\$ 719,052</u>	<u>\$ (4,788,040)</u>	<u>\$147,478,931</u>

1999	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities:				
Trust preferred	\$ 27,148,725	\$ 34,696	\$ (476,743)	\$ 26,706,678
Obligations of states and political subdivisions	1,360,307	37,368	(10,830)	1,386,845
U.S. Government and federal agencies	15,922,716	-	(430,409)	15,492,307
Mortgage-backed securities	136,600,215	425,464	(3,596,526)	133,429,153
	181,031,963	497,528	(4,514,508)	177,014,983
Marketable equity securities	1,471,705	302,168	(299,826)	1,474,047
	<u>\$182,503,668</u>	<u>\$ 799,696</u>	<u>\$ (4,814,334)</u>	<u>\$178,489,030</u>

The amortized cost and fair value of debt securities by contractual maturity are shown below. Certain securities have call features which allow the issuer to call the security prior to maturity. Expected maturities may differ from contractual maturities in mortgage-backed

securities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Therefore these securities are not included in the maturity categories in the following maturity summary.

September 30, 2000	Amortized Cost	Fair Value
Due in one year or less	\$ 210,000	\$ 211,010
Due after one year through five years	664,591	685,359
Due after five years through ten years	16,284,412	15,719,747
Due after ten years	28,159,373	26,899,451
	45,318,376	43,515,567
Mortgage-backed securities	104,795,500	102,537,560
	<u>\$150,113,876</u>	<u>\$146,053,127</u>

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Activities related to the sale of securities available for sale are summarized below. Included in gross gains (losses) on sales in 2000 is an impairment loss of approximately \$142,000.

	2000	1999	1998
Proceeds from sales	\$ 20,275,060	\$ 24,791,295	\$ 18,280,412
Gross gains on sales	-	331,611	398,903
Gross (losses) on sales	(878,679)	-	-

Note 4. **Loans Receivable, Net**

Year end loans receivable were as follows:

	2000	1999
One to four family residential mortgage loans:		
Insured by FHA or guaranteed by VA	\$ 127,377	\$ 107,610
Conventional	105,574,680	110,209,779
Construction	31,301,308	28,379,330
Commercial and multi-family real estate loans	103,595,098	85,793,177
Agricultural real estate loans	10,894,866	9,873,850
Commercial business loans	29,331,875	29,941,661
Agricultural business loans	26,810,047	29,284,440
Consumer loans	26,483,135	23,425,672
	<u>334,118,386</u>	<u>317,015,519</u>
Less:		
Allowance for loan losses	(3,589,873)	(3,092,628)
Undistributed portion of loans in process	(5,424,794)	(10,494,446)
Net deferred loan origination fees	(401,090)	(349,945)
	<u>\$324,702,629</u>	<u>\$303,078,500</u>

Activity in the allowance for loan losses for the years ended September 30 was as follows:

	2000	1999	1998
Beginning balance	\$ 3,092,628	\$ 2,908,902	\$ 2,379,091
Provision for loan losses	1,640,000	1,992,000	1,662,472
Recoveries	126,887	58,240	33,635
Charge-offs	(1,269,642)	(1,866,514)	(1,166,296)
Ending balance	<u>\$ 3,589,873</u>	<u>\$ 3,092,628</u>	<u>\$ 2,908,902</u>

Virtually all of the Company's originated loans are to Iowa and South Dakota-based individuals and organizations. The Company's purchased loans totaled approximately \$136,798,000 at September 30, 2000 and were secured by properties located, as a percentage of total loans, as follows: 13% in Washington, 5% in North Carolina, 4% in Minnesota, 4% in Iowa, 3% in

Wisconsin, 2% in South Dakota, 2% in New Mexico, 2% in Arizona and the remaining 6% in 17 other states. The Company's purchased loans totaled approximately \$125,475,000 at September 30, 1999 and were secured by properties located, as a percentage of total loans, as follows: 12% in Washington, 6% in North Carolina, 5% in Minnesota, 3% in Iowa, 2% in

Wisconsin, 2% in New Mexico, 2% in South Dakota, 2% in Nebraska and the remaining 6% in 20 other states.

The Company originates and purchases commercial real estate loans. These loans are considered by management to be of somewhat greater risk of uncollectibility due to the dependency on income production. The Company's commercial real estate loans include approximately \$18,333,000 and \$9,848,000 of loans secured by hotel properties and \$17,216,000 and \$13,022,000 of loans secured by assisted living

facilities at September 30, 2000 and 1999, respectively. The remainder of the commercial real estate portfolio is diversified by industry. The Company's policy for requiring collateral and guarantees varies with the creditworthiness of each borrower.

The amount of restructured and related party loans as of September 30, 2000 and 1999 were not significant. The amount of nonaccruing loans as of September 30, 2000 and 1999 were approximately \$311,000 and \$2,239,000, respectively.

Impaired loans were as follows:

	2000	1999
Year-end loans with no allowance for loan losses allocated	\$ -	\$ 109,461
Year-end loans with allowance for loan losses allocated	5,693,460	4,019,156
Amount of the allowance allocated	734,237	438,452
Average of impaired loans during the year	3,954,277	3,188,310
Interest income recognized during impairment	374,205	206,778
Cash basis interest income recognized	-	-

### Foreclosed Real Estate

Note 5.

Year end foreclosed real estate was as follows:

	2000	1999
Foreclosed real estate	\$ 445,133	\$ 142,901
Less allowance for foreclosed real estate losses	-	-
	<u>\$ 445,133</u>	<u>\$ 142,901</u>

Activity in the allowance for foreclosed real estate losses for the years ended September 30 was as follows:

	2000	1999	1998
Balance, beginning of period	\$ -	\$ 299,532	\$ -
Provision for losses on foreclosed real estate	-	-	299,532
Less losses charged against allowance	-	(299,532)	-
Balance, end of period	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 299,532</u>

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**Note 6. Loan Servicing**

Mortgage loans serviced for others are not reported as assets. The unpaid principal balances of these loans at year end were as follows:

	2000	1999
Mortgage loan portfolios serviced for FNMA	\$ 5,695,000	\$ 4,941,000
Other	<u>16,096,000</u>	<u>11,040,000</u>
	<u>\$ 21,791,000</u>	<u>\$ 15,981,000</u>

Custodial escrow balances maintained in connection with the foregoing loan servicing were approximately \$12,000 and \$97,000 at September 30, 2000 and 1999, respectively.

**Note 7. Premises and Equipment, Net**

Year end premises and equipment were as follows:

	2000	1999
Land	\$ 1,782,970	\$ 935,289
Buildings	5,214,003	4,858,210
Furniture, fixtures and equipment	3,430,664	2,969,748
	<u>10,427,637</u>	<u>8,763,247</u>
Less accumulated depreciation	(4,335,896)	(3,993,191)
	<u>\$ 6,091,741</u>	<u>\$ 4,770,056</u>

Depreciation of premises and equipment included in occupancy and equipment expense was approximately \$449,000, \$390,000 and \$355,000 for the years ended September 30, 2000, 1999 and 1998, respectively.

**Note 8. Deposits**

Jumbo certificates of deposit in denominations of \$100,000 or more were approximately \$31,214,000 and \$20,533,000 at year end 2000 and 1999.

At September 30, 2000, the scheduled maturities of certificates of deposit were as follows for the years ended September 30:

2001	\$132,313,120
2002	74,182,987
2003	23,190,190
2004	4,635,354
2005	5,410,227
Thereafter	<u>372,322</u>
	<u>\$240,104,200</u>

### Advances from Federal Home Loan Bank

Note 9.

At September 30, 2000, advances from the FHLB of Des Moines with fixed and variable rates ranging from 4.26% to 7.82% (weighted-average rate of 5.78%) are required to be repaid in the year ending September 30 as presented below. Certain advances contain call features that allow the FHLB to call for the prepayment of the borrowing prior to maturity.

2001	\$ 46,706,421
2002	11,921,408
2003	2,009,298
2004	115,509
2005	8,917,073
Thereafter	70,068,742
	<u>\$139,738,451</u>

The Bank and Security have executed blanket pledge agreements whereby the Bank and Security assign, transfer and pledge to the FHLB and grant to the FHLB a security interest in all property now or hereafter owned. However, the Bank and Security have the right to use, commingle and dispose of the collateral they have assigned to the FHLB. Under the agreements, the Bank and Security must maintain "eligible collateral" that has a "lending value" at least equal to the "required collateral amount," all as defined by the agreements.

At year end 2000 and 1999, the Bank and Security collectively pledged securities with amortized costs of

\$87,376,000 and \$88,067,000 and fair values of approximately \$85,104,000 and \$86,741,000 against specific FHLB advances. In addition, qualifying mortgage loans of approximately \$103,338,000 and \$107,712,000 were pledged as collateral at year end 2000 and 1999.

During fiscal 2000, the Company recognized a gain totaling \$351,995, net of related income taxes, on the transfer of \$15,000,000 of FHLB advances. The transfer of FHLB advances was in conjunction with a restructuring of the balance sheet wherein lower yielding securities were sold with the proceeds reinvested in higher yielding assets and used to repay borrowings.

### Securities Sold Under Agreements to Repurchase

Note 10.

Year end securities sold under agreements to repurchase totaled \$4,254,965 and \$3,020,951 for 2000 and 1999.

An analysis of securities sold under agreements to repurchase is as follows:

	2000	1999
Highest month-end balance	\$4,920,423	\$4,321,674
Average balance	3,460,390	3,299,584
Weighted average interest rate during the period	5.95%	5.38%
Weighted average interest rate at end of period	6.43%	5.28%

At year end 2000, securities sold under agreements to repurchase had maturities ranging from 1 to 18 months with a weighted average maturity of 15 months.

The Company pledged securities with amortized costs of approximately \$4,323,000 and \$6,105,000

and fair values of approximately \$4,221,000 and \$6,079,000, respectively, at year end 2000 and 1999 as collateral for securities sold under agreements to repurchase.

Note 11. **Employee Benefits**

**EMPLOYEE STOCK OWNERSHIP PLAN (ESOP):**

The Company maintains an ESOP for eligible employees who have 1,000 hours of employment with the Bank and who have attained age 21. In 1993, the ESOP borrowed \$1,534,100 from the Company to purchase 230,115 shares of the Company's common stock. Final payment of this loan was received during the year ended September 30, 2000. Shares purchased by the ESOP are held in suspense for allocation among participants as the loan is repaid. ESOP expense of \$270,864, \$455,220 and \$654,460 was recorded for the years ended September 30, 2000, 1999 and 1998, respectively. Contributions of \$167,200, \$200,000 and \$200,000 were made to the ESOP during the years ended September 30, 2000, 1999 and 1998, respectively.

Contributions to the ESOP and shares released from suspense in an amount proportional to the repayment of the ESOP loan are allocated among ESOP participants on the basis of compensation in the year of allocation. Benefits generally become 100% vested after seven years of credited service. Prior to the

completion of seven years of credited service, a participant who terminates employment for reasons other than death or disability receives a reduced benefit based on the ESOP's vesting schedule. Forfeitures are reallocated among remaining participating employees, in the same proportion as contributions. Benefits are payable in the form of stock upon termination of employment. The Company's contributions to the ESOP are not fixed, so benefits payable under the ESOP cannot be estimated.

For the years ended September 30, 2000, 1999 and 1998, 25,080, 30,000 and 30,000 shares with an average fair value of \$10.80, \$15.17 and \$21.82 per share, respectively, were committed to be released. Also for the years ended September 30, 2000, 1999 and 1998, allocated shares and total ESOP shares reflect 1,287, 23,275 and 11,359 shares, respectively, withdrawn from the ESOP by participants who are no longer with the Company and 7,434, 4,735 and 2,742 shares, respectively, purchased for dividend reinvestment.

Year-end ESOP shares are as follows:

	2000	1999	1998
Allocated shares	\$ 199,815	\$ 168,588	\$ 157,128
Unearned shares	-	25,080	55,080
Total ESOP shares	199,815	193,668	212,208
Fair value of unearned shares	\$ -	\$ 319,770	\$ 950,130

**STOCK OPTIONS AND INCENTIVE PLANS:** Certain officers and directors of the Company have been granted options to purchase common stock of the Company pursuant to stock option plans.

SFAS No. 123, which became effective for stock-based compensation during fiscal years beginning after December 15, 1995, requires proforma disclosures for companies that do not adopt its fair value accounting method for stock-based employee compensation for awards granted in the first fiscal year beginning after December 15, 1994. Accordingly, the following proforma information presents net income and earnings per share had the fair value method been used to

measure compensation cost for stock option plans.

The exercise price of options granted is equivalent to the market value of underlying stock at the grant date. Accordingly, no compensation cost was actually recognized for stock options during 2000, 1999 or 1998.

The fair value of options granted during 2000, 1999, and 1998 is estimated using the following weighted-average information: risk-free interest rate of 5.99%, 6.17% and 4.49%, expected life of 7.0 years, expected dividends of 5.30%, 4.00% and 2.69% per year and expected stock price volatility of 22%, 22% and 20% per year.



	2000	1999	1998
Net income as reported	\$ 2,327,626	\$ 2,641,132	\$ 2,784,882
Proforma net income	2,287,501	2,569,635	2,689,596
<hr/>			
Reported earnings per common and common equivalent share:			
Basic	\$ 0.95	\$ 1.07	\$ 1.08
Diluted	0.93	1.04	1.03
<hr/>			
Proforma earnings per common and common equivalent share:			
Basic	\$ 0.93	\$ 1.04	\$ 1.04
Diluted	0.92	1.01	1.00

In future years, the proforma effect of not applying this standard is expected to increase as additional options are granted.

Stock option plans are used to reward directors, officers and employees and provide them with an addi-

tional equity interest. Options are issued for 10 year periods, with 100% vesting generally occurring either at grant date or 48 months after grant date. At September 30, 2000, 95,364 shares were authorized for future grants. Information about option grants follows:

	Number of Options	Weighted-Average Exercise Price
Outstanding, September 30, 1997	325,298	\$ 10.23
Granted	13,418	17.88
Exercised	(7,600)	6.67
Forfeited	-	-
Outstanding, September 30, 1998	331,116	10.62
Granted	26,335	13.00
Exercised	(23,051)	7.37
Forfeited	(9,000)	17.59
Outstanding, September 30, 1999	325,400	10.85
Granted	29,418	9.88
Exercised	(54,500)	6.67
Forfeited	-	-
Outstanding, September 30, 2000	<u>300,318</u>	\$ 11.51

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The weighted-average fair value per option for options granted in 2000, 1999 and 1998 was \$.66, \$1.54 and \$2.01. At September 30, 2000, options outstanding were as follows:

Exercise Price	Weighted-Average Exercise Price	Weighted-Average Remaining Life (Years)	Number of Options
\$6.67 - \$9.99	\$ 7.19	4.17	156,640
\$10.00 - \$14.99	13.04	8.68	30,855
\$15.00 - \$19.99	16.80	6.43	102,383
\$20.00 - \$20.13	20.13	7.00	10,440
	\$ 11.51	5.50	300,318

Options exercisable at year end are as follows:

	Number of Options	Weighted-Average Exercise Price
1998	285,491	\$ 9.54
1999	286,650	10.09
2000	270,443	11.17

**MANAGEMENT RECOGNITION AND RETENTION PLANS:** The Company granted 10,424, 7,191 and 106,428 (8,986 of which have been forfeited under terms of the Plan due to termination of service) shares of the Company's common stock on September 30, 1999, May 23, 1994 and September 20, 1993, respectively, to certain officers of the Bank pursuant to a management recognition and retention plan (the "Plan"). The holders of the restricted stock have all of the rights of a shareholder, except that they cannot sell, assign, pledge or transfer any of the restricted stock during the restricted period. The stock granted in 1999 under the Plan vests as follows: 5,212 shares vested at the date of grant on September 30, 1999 and

5,212 shares vests on September 30, 2000. Previously granted restricted stock vests at a rate of 25% on each anniversary of the grant date. Expense of \$33,878, \$101,634 and \$0 was recorded for these plans for the years ended 2000, 1999 and 1998. The remaining unamortized unearned compensation value of the plans at September 30, 2000 and 1999 was \$0 and \$57,332, respectively.

**PROFIT SHARING PLAN:** The Company has a profit sharing plan covering substantially all full-time employees. Contribution expense for the years ended September 2000, 1999 and 1998, was \$329,108, \$0 and \$0, respectively.

### Note 12. Income Taxes

The Company, the Bank and its subsidiaries and Security file a consolidated federal income tax return on a fiscal year basis. Prior to fiscal year 1997, if certain conditions were met in determining taxable "income" on the consolidated federal income tax return, the Bank was allowed a special bad debt deduction based on a percentage of taxable income (8% for 1996) or on specified experience formulas. Tax legislation passed in August 1996 now requires the

Bank to deduct a provision for bad debts for tax purposes based on actual loss experience and recapture the excess bad debt reserve accumulated in tax years beginning after September 30, 1987. The related amount of deferred tax liability which must be recaptured is approximately \$554,000 and is payable over a six-year period beginning with the tax year ended September 30, 1999.

The provision for income taxes consists of:

	2000	1999	1998
Federal:			
Current	\$ 1,644,698	\$ 1,690,170	\$ 2,012,841
Deferred	(258,085)	(90,137)	(230,887)
	<u>1,386,613</u>	<u>1,600,033</u>	<u>1,781,954</u>
State:			
Current	236,122	250,616	304,679
Deferred	(39,915)	(13,863)	(83,113)
	<u>196,207</u>	<u>236,753</u>	<u>221,566</u>
Total income tax expense	<u>\$ 1,582,820</u>	<u>\$ 1,836,786</u>	<u>\$ 2,003,520</u>

Income tax expense includes \$208,600 related to a gain on an extraordinary item.

Total income tax expense differs from the statutory federal income tax rate as follows:

	2000	1999	1998
Income taxes at 34% federal tax rate	\$ 1,139,000	\$ 1,522,000	\$ 1,628,000
Increase (decrease) resulting from:			
State income taxes - net of federal benefit	111,000	156,000	146,000
Excess of cost over net assets acquired	124,000	124,000	124,000
Excess of fair value of ESOP shares released over cost	35,000	87,000	155,000
Other, net	(34,780)	(52,214)	(49,480)
Total income tax expense	<u>\$ 1,374,220</u>	<u>\$ 1,836,786</u>	<u>\$ 2,003,520</u>

Year end deferred tax assets and liabilities consist of:

	2000	1999
Deferred tax assets:		
Bad debts	\$ 861,000	\$ 570,000
Deferred loan fees	44,000	65,000
Net unrealized losses on securities available for sale	1,514,054	1,494,005
Other items	84,000	72,000
	<u>2,503,054</u>	<u>2,201,005</u>
Deferred tax liabilities:		
Federal Home Loan Bank stock dividend	(452,000)	(452,000)
Accrual to cash basis	(89,000)	(133,000)
Premises and equipment	(72,000)	(51,000)
Other	(30,000)	(74,000)
	<u>(643,000)</u>	<u>(659,000)</u>
Valuation allowance	-	-
Net deferred tax assets	<u>\$ 1,860,054</u>	<u>\$ 1,542,005</u>

## *First Midwest Financial, Inc. and Subsidiaries*

Federal income tax laws provided savings banks with additional bad debt deductions through September 30, 1987, totaling \$6,744,000 for the Bank. Accounting standards do not require a deferred tax liability to be recorded on this amount, which liability otherwise

would total \$2,300,000 at September 30, 2000 and 1999. If the Bank were liquidated or otherwise ceases to be a bank or if tax laws were to change, the \$2,300,000 would be recorded as expense.

### Note 13. **Capital Requirements and Restrictions on Retained Earnings**

The Company has two primary subsidiaries, First Federal and Security. First Federal and Security are subject to various regulatory capital requirements. Failure to meet minimum capital requirements can initiate certain mandatory or discretionary actions by regulators that, if undertaken, could have a direct material effect on the financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, First Federal and Security must meet specific quantitative capital guidelines using their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The requirements are also subject to qualitative judgments by the regulators

about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require First Federal and Security to maintain minimum amounts and ratios (set forth in the table below) of total risk-based capital and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and a leverage ratio consisting of Tier I capital (as defined) to average assets (as defined). Management believes, as of September 30, 2000, that First Federal and Security meet the capital adequacy requirements.

First Federal's and Security's actual capital and required capital amounts and ratios are presented below.

	Actual		Minimum Requirement For Capital Adequacy Purposes		Minimum Requirement To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<i>As of September 30, 2000:</i>						
Total capital (to risk-weighted assets):						
First Federal	\$ 35,898	11.8%	\$ 24,291	8.0%	\$ 30,364	10.0%
Security	4,144	13.3	2,490	8.0	3,113	10.0
Tier I (Core) capital (to risk-weighted assets):						
First Federal	32,541	10.7	12,146	4.0	18,218	6.0
Security	3,848	12.4	1,245	4.0	1,868	6.0
Tier I (Core) capital (to average total assets):						
First Federal	32,541	7.1	18,423	4.0	23,028	5.0
Security	3,848	8.2	1,876	4.0	2,345	5.0
Tier I (Core) capital (to total assets),						
First Federal	32,541	7.1	18,227	4.0	22,784	5.0

	Actual		Minimum Requirement For Capital Adequacy Purposes		Minimum Requirement To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
As of September 30, 1999:						
Total capital (to risk-weighted assets):						
First Federal	\$ 35,111	12.0%	\$ 23,470	8.0%	\$ 29,338	10.0%
Security	3,890	14.8	2,107	8.0	2,634	10.0
Tier 1 (Core) capital (to risk-weighted assets):						
First Federal	32,172	11.0	11,735	4.0	17,603	6.0
Security	3,670	13.9	1,053	4.0	1,580	6.0
Tier 1 (Core) capital (to average total assets):						
First Federal	32,172	7.3	17,602	4.0	22,002	5.0
Security	3,670	9.4	1,563	4.0	1,954	5.0
Tier 1 (Core) capital (to total assets),						
First Federal	32,172	7.0	1,857	4.0	23,134	5.0

Regulations limit the amount of dividends and other capital distributions that may be paid by a financial institution without prior approval of its primary regulator. The regulatory restriction is based on a three-tiered system with the greatest flexibility being afforded to well-capitalized (Tier 1) institutions. First Federal and Security are currently Tier 1 institutions. Accordingly, First Federal and Security can make, without prior regulatory approval, distributions during a calendar year up to 100% of their retained net

income for the calendar year-to-date plus retained net income for the previous two calendar years (less any dividends previously paid) as long as they remain well-capitalized, as defined in prompt corrective action regulations, following the proposed distribution. Accordingly, at September 30, 2000, approximately \$317,000 of First Federal's retained earnings and none of Security's retained earnings were potentially available for distribution to the Company.

### Commitments and Contingencies

In the normal course of business, the Company's subsidiary banks make various commitments to extend credit which are not reflected in the accompanying consolidated financial statements.

At September 30, 2000 and 1999, loan commitments approximated \$14,810,000 and \$33,212,000, respectively, excluding undisbursed portions of loans in process. Loan commitments at September 30, 2000 included commitments to originate fixed-rate loans with interest rates ranging from 8% to 8.875% totaling \$530,000 and adjustable-rate loan commitments with interest rates ranging from 6.25% to 19% totaling \$13,280,000. The Company also had commitments to purchase adjustable rate loans of \$1,000,000 with interest rates of 11.25%. Loan commitments at

September 30, 1999 included commitments to originate fixed-rate loans with interest rates ranging from 6.875% to 8.75% totaling \$865,000 and adjustable-rate loan commitments with interest rates ranging from 7.75% to 10.25% totaling \$18,391,000. The Company also had commitments to purchase adjustable rate loans of \$7,056,000 with interest rates ranging from 7.50% to 9.25%, and commitments to purchase \$6,900,000 in fixed rate loans with interest rates ranging from 7.375% to 7.50% as of year end 1999. Commitments, which are disbursed subject to certain limitations, extend over various periods of time. Generally, unused commitments are canceled upon expiration of the commitment term as outlined in each individual contract.

Note 14.

## *First Midwest Financial, Inc. and Subsidiaries*

The exposure to credit loss in the event of nonperformance by other parties to financial instruments for commitments to extend credit is represented by the contractual amount of those instruments. The same credit policies and collateral requirements are used in making commitments and conditional obligations as are used for on-balance-sheet instruments.

Since certain commitments to make loans and to fund lines of credit and loans in process expire without being used, the amount does not necessarily represent future cash commitments. In addition, commitments used to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract.

Securities with amortized costs of approximately \$11,190,000 and \$11,958,000 and fair values of approximately \$10,831,000 and \$11,767,000 at September 30, 2000 and 1999, respectively, were

pledged as collateral for public funds on deposit.

Securities with amortized costs of approximately \$6,135,000 and \$5,813,000 and fair values of approximately \$6,096,000 and \$5,865,000 at September 30, 2000 and 1999, respectively, were pledged as collateral for individual, trust and estate deposits.

Under employment agreements with certain executive officers, certain events leading to separation from the Company could result in cash payments totaling approximately \$2,519,000 as of September 30, 2000.

The Company and its subsidiaries are subject to certain claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material adverse effect on the consolidated financial position or results of operations of the Company.

### Note 15. **Other Comprehensive Income (Loss)**

Other comprehensive income (loss) components and related taxes were as follows:

	2000	1999	1998
Net change in net unrealized gains and losses on securities available for sale:			
Unrealized gains (losses) arising during the year	\$ (1,075,235)	\$ (4,956,193)	\$ 143,685
Reclassification adjustment for (gains) losses included in net income	1,020,885	(331,611)	(398,903)
Net change in unrealized gains and losses on securities available for sale	(54,350)	(5,287,804)	(255,218)
Tax effects	21,092	1,968,351	93,667
Other comprehensive income (loss)	<u>\$ (33,258)</u>	<u>\$ (3,319,453)</u>	<u>\$ (161,551)</u>

### Note 16. **Lease Commitment**

The Company has leased property under various non-cancelable operating lease agreements which expire at various times through December 2009, and require annual rentals of \$52,600 plus the payment of the property taxes,

normal maintenance and insurance on the property.

The total minimum rental commitment at September 30, 2000, under the leases is as follows:

2001	\$ 52,600
2002	52,600
2003	52,600
2004	46,600
2005	46,600
Thereafter	172,550
	<u>\$ 423,550</u>

## Parent Company Financial Statements

Note 17.

Presented below are condensed financial statements for the parent company, First Midwest Financial, Inc.

### Condensed Balance Sheets

September 30, 2000 and 1999

	2000	1999
<b>ASSETS</b>		
Cash and cash equivalents	\$ 72,236	\$ 435,866
Securities available for sale	3,380,496	3,546,100
Investment in subsidiary banks	38,702,338	38,373,373
Loan receivable from ESOP	-	167,200
Loan receivable	325,179	-
Other assets	211,071	272,713
Total assets	<u>\$ 42,691,320</u>	<u>\$ 42,795,252</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Loan payable to subsidiary banks	\$ 2,550,000	\$ 2,750,000
Accrued expenses and other liabilities	106,235	274,504
Total liabilities	<u>2,656,235</u>	<u>3,024,504</u>
<b>SHAREHOLDERS' EQUITY</b>		
Common stock	29,580	29,580
Additional paid-in capital	20,976,108	21,305,937
Retained earnings, substantially restricted	30,404,386	29,352,943
Accumulated other comprehensive income	(2,553,891)	(2,520,633)
Unearned employee stock ownership plan shares	-	(167,200)
Treasury stock, at cost	(8,821,098)	(8,229,879)
Total shareholders' equity	<u>40,035,085</u>	<u>39,770,748</u>
Total liabilities and shareholders' equity	<u>\$ 42,691,320</u>	<u>\$ 42,795,252</u>

*First Midwest Financial, Inc. and Subsidiaries*

**Condensed Statements of Income**

Years Ended September 30, 2000, 1999 and 1998

	2000	1999	1998
Dividend income from subsidiary banks	\$ 2,525,000	\$ 2,350,000	\$ 2,000,000
Interest income	280,351	297,447	272,260
Gain (loss) on sales of securities available for sale, net	(37,206)	62,466	317,960
	<u>2,768,145</u>	<u>2,709,913</u>	<u>2,590,220</u>
Interest expense	205,863	210,444	72,581
Operation expenses	388,023	405,076	354,945
	<u>593,886</u>	<u>615,520</u>	<u>427,526</u>
Income before income taxes and equity in undistributed net income of subsidiaries	2,174,259	2,094,393	2,162,694
Income tax expense (benefit)	(142,000)	(106,000)	50,000
Income before equity in undistributed net income of subsidiaries	2,316,259	2,200,393	2,112,694
Equity in undistributed net income of subsidiary banks	11,367	440,739	672,188
Net income	<u>\$ 2,327,626</u>	<u>\$ 2,641,132</u>	<u>\$ 2,784,882</u>



## Condensed Statements of Cash Flows

Years Ended September 30, 2000, 1999 and 1998

	2000	1999	1998
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$ 2,327,626	\$ 2,641,132	\$ 2,784,882
Adjustments to reconcile net income to net cash from operating activities:			
Equity in undistributed net income of subsidiary banks	(11,367)	(440,739)	(672,188)
Amortization of recognition and retention plan	33,878	101,634	-
Gain on sales of securities available for sale, net	37,206	(62,466)	(317,960)
Change in other assets	(9,817)	(38,470)	174,711
Change in accrued expenses and other liabilities	7,771	94,617	142,705
Net cash provided by operating activities	<u>2,385,297</u>	<u>2,295,708</u>	<u>2,112,150</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Repayment of securities	5,409	-	-
Purchase of securities available for sale	(500,000)	(1,626,721)	(5,150,000)
Proceeds from sales of securities available for sale	495,000	2,155,709	2,195,509
Loans purchased	(325,179)	-	-
Repayments on loan receivable from ESOP	167,200	200,000	200,000
Net cash provided by (used in) investment activities	<u>(157,570)</u>	<u>728,988</u>	<u>(2,754,491)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from loan payable to subsidiary banks	-	1,150,000	4,550,000
Repayments on loan payable to subsidiary banks	(200,000)	(1,450,000)	(1,500,000)
Cash dividends paid	(1,276,183)	(1,274,003)	(1,226,725)
Proceeds from exercise of stock options	363,335	169,841	28,696
Purchase of treasury stock	(1,478,509)	(1,289,186)	(3,271,203)
Net cash (used in) financing activities	<u>(2,591,357)</u>	<u>(2,693,348)</u>	<u>(1,419,232)</u>
Net change in cash and cash equivalents	(363,630)	331,348	(2,061,573)
<b>CASH AND CASH EQUIVALENTS</b>			
Beginning of year	435,866	104,518	2,166,091
End of year	<u>\$ 72,236</u>	<u>\$ 435,866</u>	<u>\$ 104,518</u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>			
Cash paid during the year for interest	\$ 209,447	\$ 210,444	\$ 72,581

The extent to which the Company may pay cash dividends to shareholders will depend on the cash currently available at the Company, as well as the ability of the subsidiary banks to pay dividends to the Company (see Note 13).

*First Midwest Financial, Inc. and Subsidiaries*

Note 18. **Selected Quarterly Financial Data (Unaudited)**

	Quarter Ended			
	December 31	March 31	June 30	September 30
<b>Fiscal year 2000:</b>				
Total interest income	\$ 9,404,770	\$ 9,545,028	\$ 9,672,083	\$ 9,788,143
Total interest expense	5,911,477	5,991,817	6,264,173	6,410,895
Net interest income	3,493,293	3,553,211	3,407,910	3,377,248
Provision for loan losses	325,000	270,000	400,000	645,000
Net income before extraordinary item	764,680	760,747	2,055	448,149
Extraordinary item	-	-	351,995	-
Net income	764,680	760,747	354,050	448,149
Earnings per common and common equivalent share:				
Basic:				
Net income before extraordinary item	\$ 0.31	\$ 0.31	\$ -	\$ 0.18
Extraordinary item	-	-	0.15	-
Net income	0.31	0.31	0.15	0.18
Diluted:				
Net income before extraordinary item	0.30	0.30	-	0.18
Extraordinary item	-	-	0.14	-
Net income	0.30	0.30	0.14	0.18
<b>Fiscal year 1999:</b>				
Total interest income	\$ 8,761,124	\$ 8,585,259	\$ 8,842,903	\$ 9,183,445
Total interest expense	5,342,257	5,472,837	5,577,855	5,782,931
Net interest income	3,418,867	3,112,422	3,265,048	3,400,514
Provision for loan losses	243,000	358,000	299,000	1,092,000
Net income	908,517	759,500	756,673	216,442
Earnings per common and common equivalent share:				
Basic	\$ 0.37	\$ 0.31	\$ 0.31	\$ 0.09
Diluted	0.36	0.30	0.30	0.09
<b>Fiscal year 1998:</b>				
Total interest income	\$ 7,894,734	\$ 7,839,781	\$ 7,996,291	\$ 8,327,988
Total interest expense	4,712,639	4,622,771	4,815,319	5,079,224
Net interest income	3,182,095	3,217,010	3,180,972	3,248,764
Provision for loan losses	35,000	1,345,000	55,000	227,472
Net income	989,055	46,316	893,056	856,455
Earnings per common and common equivalent share:				
Basic	\$ 0.38	\$ 0.02	\$ 0.35	\$ 0.34
Diluted	0.36	0.02	0.33	0.32

## Fair Values of Financial Instruments

SFAS No. 107, "Disclosures About Fair Value of Financial Instruments," requires that the Company disclose estimated fair value amounts of its financial instruments. It is management's belief that the fair values presented below are reasonable based on the valuation techniques and data available to the Company as of September 30, 2000 and 1999, as more fully described below. It should be noted that the operations of the Company are managed from a going concern basis and not a liquidation basis. As a result, the ultimate value realized for the financial instruments presented could be substantially different when actually

recognized over time through the normal course of operations. Additionally, a substantial portion of the Company's inherent value is the subsidiary banks' capitalization and franchise value. Neither of these components have been given consideration in the presentation of fair values below.

The following presents the carrying amount and estimated fair value of the financial instruments held by the Company at September 30, 2000 and 1999. This information is presented solely for compliance with SFAS No. 107 and is subject to change over time based on a variety of factors.

Note 19.

	2000		1999	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Selected assets:				
Cash and cash equivalents	\$ 6,922,531	\$ 6,923,000	\$ 5,373,911	\$ 5,374,000
Securities available for sale	147,478,931	147,479,000	178,489,030	178,489,000
Loans receivable, net	324,702,629	321,192,000	303,078,500	302,980,000
FHLB stock	8,327,600	8,328,000	8,125,800	8,126,000
Accrued interest receivable	5,216,929	5,217,000	5,046,234	5,046,000
Selected liabilities:				
Noninterest bearing demand deposits	(6,040,991)	(6,041,000)	(5,680,923)	(5,681,000)
Savings, NOW and money market demand deposits	(72,508,530)	(72,509,000)	(75,003,028)	(75,003,000)
Other time certificates of deposit	(240,104,200)	(239,698,000)	(224,095,970)	(224,027,000)
Total deposits	(318,653,721)	(318,248,000)	(304,779,921)	(304,711,000)
Advances from FHLB	(139,738,451)	(137,078,000)	(161,348,071)	(159,253,000)
Securities sold under agreements to repurchase	(4,254,965)	(4,250,000)	(3,020,951)	(3,026,000)
Advances from borrowers for taxes and insurance	(461,514)	(462,000)	(422,593)	(423,000)
Accrued interest payable	(1,006,341)	(1,006,000)	(875,365)	(875,000)
Off-balance-sheet instruments, loan commitments	(14,810,000)	-	(33,212,000)	-

## *First Midwest Financial, Inc. and Subsidiaries*

The following sets forth the methods and assumptions used in determining the fair value estimates for the Company's financial instruments at September 30, 2000 and 1999.

**CASH AND CASH EQUIVALENTS:** The carrying amount of cash and short-term investments is assumed to approximate the fair value.

**SECURITIES AVAILABLE FOR SALE:** Quoted market prices or dealer quotes were used to determine the fair value of securities available for sale.

**LOANS RECEIVABLE, NET:** The fair value of loans receivable, net was estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for similar remaining maturities. When using the discounting method to determine fair value, loans were gathered by homogeneous groups with similar terms and conditions and discounted at a target rate at which similar loans would be made to borrowers as of September 30, 2000 and 1999. In addition, when computing the estimated fair value for all loans, allowances for loan losses have been subtracted from the calculated fair value for consideration of credit issues.

**FHLB STOCK:** The fair value of such stock approximates book value since the Company is able to redeem this stock with the Federal Home Loan Bank at par value.

**ACCRUED INTEREST RECEIVABLE:** The carrying amount of accrued interest receivable is assumed to approximate the fair value.

**DEPOSITS:** The fair value of deposits were determined as follows: (i) for noninterest bearing demand deposits, savings, NOW and money market demand deposits, since such deposits are immediately withdrawable, fair value is determined to approximate the

carrying value (the amount payable on demand); (ii) for other time certificates of deposit, the fair value has been estimated by discounting expected future cash flows by the current rates offered as of September 30, 2000 and 1999 on certificates of deposit with similar remaining maturities. In accordance with SFAS No. 107 no value has been assigned to the Company's long-term relationships with its deposit customers (core value of deposits intangible) since such intangible is not a financial instrument as defined under SFAS No. 107.

**ADVANCES FROM FHLB:** The fair value of such advances was estimated by discounting the expected future cash flows using current interest rates as of September 30, 2000 and 1999, for advances with similar terms and remaining maturities.

**SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE:** The fair value of securities sold under agreements to repurchase and other borrowings was estimated by discounting the expected future cash flows using derived interest rates approximating market as of September 30, 2000 and 1999 over the contractual maturity of such borrowings.

**ADVANCES FROM BORROWERS FOR TAXES AND INSURANCE:** The carrying amount of advances from borrowers for taxes and insurance is assumed to approximate the fair value.

**ACCRUED INTEREST PAYABLE:** The carrying amount of accrued interest payable is assumed to approximate the fair value.

**LOAN COMMITMENTS:** The commitments to originate and purchase loans have terms that are consistent with current market terms. Accordingly, the Company estimates that the fair values of these commitments are not significant.

**LIMITATIONS:** It must be noted that fair value estimates are made at a specific point in time, based on relevant market information about the financial instrument. Additionally, fair value estimates are based on existing on and off-balance-sheet financial instruments without attempting to estimate the value of anticipated future business, customer relationships and the value of assets and liabilities that are not considered financial instruments. These estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time. Furthermore, since no market exists for certain of the Company's financial instruments, fair value estimates may be based on

judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with a high level of precision. Changes in assumptions as well as tax considerations could significantly affect the estimates. Accordingly, based on the limitations described above, the aggregate fair value estimates are not intended to represent the underlying value of the Company, on either a going concern or a liquidation basis.

## *Independent Auditor's Report*

### **To the Board of Directors First Midwest Financial, Inc. and Subsidiaries**

**STORM LAKE, IOWA**

We have audited the accompanying consolidated balance sheet of First Midwest Financial, Inc. and Subsidiaries, as of September 30, 2000, and the related consolidated statements of income, changes in shareholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of First Midwest Financial, Inc. and Subsidiaries as of September 30, 1999 and for each of the years ended September 30, 1999 and 1998, were audited by other auditors whose report, dated October 15, 1999, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of First Midwest Financial, Inc. as of September 30, 2000, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

*McGladrey & Pullen, LLP*

**MCGLADREY & PULLEN, LLP**

*Des Moines, Iowa*

*October 27, 2000*

## Board of Directors

**JAMES S. HAAHR** – Chairman of the Board, President and Chief Executive Officer for First Midwest Financial, Inc. and First Federal Savings Bank of the Midwest; Chairman of the Board for Security State Bank. Mr. Haahr has served in various capacities since beginning his career with First Federal in 1961. He is a member of the Board of Trustees and Chairman of the Investment Committee of Buena Vista University. He is a member of the Savings Association Insurance Fund Industry Advisory Committee and a member of the Legislative Committee of Iowa Bankers Association. Mr. Haahr is former Vice Chairman of the Board of Directors of the Federal Home Loan Bank of Des Moines, former Chairman of the Iowa League of Savings Institutions a former director of the U.S. League of Savings Institutions and a former member of the Board of Directors of America's Community Bankers. Board committee: First Federal Trust Committee. James S. Haahr is the father of J. Tyler Haahr.

**J. TYLER HAAHR** – Senior Vice President, Secretary and Chief Operating Officer for First Midwest Financial, Inc.; Executive Vice President, Secretary and Chief Operating Officer for First Federal Savings Bank of the Midwest; Chief Executive Officer of Security State Bank; and Vice President and Secretary of First Services Financial Limited. First Midwest and its affiliates have employed Mr. Haahr since March 1997. Previously Mr. Haahr was a partner with the law firm of Lewis and Roca LLP, Phoenix, Arizona. Board committee: First Federal Trust Committee. J. Tyler Haahr is the son of James S. Haahr.

**E. WAYNE COOLEY** – Member of the Board of Directors for First Midwest Financial, Inc., First Federal Savings Bank of the Midwest, and Security State Bank. Dr. Cooley has served as Executive Secretary of the Iowa Girls' High School Athletic Union in Des Moines, Iowa, since 1954. He is Executive Vice President of the Iowa High School Speech Association, a member of the Buena Vista University Board of Trustees, a member of the Drake Relays Executive Committee, and on the Board of Directors of the Women's College Basketball Association Hall of Fame. Dr. Cooley has served as Chairman of the Iowa Heart Association and as Vice Chairman of the Iowa Games. Board committees: Chairman of the Audit-Compensation/Personnel Committee and member of the Stock Option Committee.

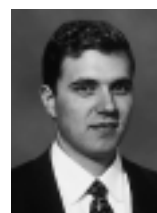
**E. THURMAN GASKILL** – Member of the Board of Directors for First Midwest Financial, Inc., First Federal Savings Bank of the Midwest, and Security State Bank.

Mr. Gaskill has owned and operated a grain farming operation located near Corwith, Iowa, since 1958. He has served as a commissioner with the Iowa Department of Economic Development and also as a commissioner with the Iowa Department of Natural Resources. Mr. Gaskill is the past president of Iowa Corn Growers Association, past chairman of the United States Feed Grains Council, and has served in numerous other agriculture positions. He was re-elected to the Iowa State Senate in 2000 and represents District 8. He serves as Chairman of the Senate Agricultural Committee. Board committees: Chairman of the First Federal Trust Committee and member of the Audit-Compensation/Personnel Committee.

**G. MARK MICKELSON** – Member of the Board of Directors for First Midwest Financial, Inc., First Federal Savings Bank of the Midwest, and Security State Bank. Mr. Mickelson is a Principal with Northwestern Growth Corporation in Sioux Falls, South Dakota. Northwestern Growth Corporation is the corporate development and investment function of Northwestern Corporation. Mr. Mickelson graduated with high honors from Harvard Law School and is an inactive member of the South Dakota Bar Association and a Certified Public Accountant. Board committees: First Federal Audit-Compensation/Personnel Committee and Stock Option Committee.

**RODNEY G. MUILENBURG** – Member of the Board of Directors for First Midwest Financial, Inc., First Federal Savings Bank of the Midwest, and Security State Bank. Mr. Muilenburg is employed as a dairy specialist with Purina Mills, Inc. and supervises the sale of agricultural products in a region that encompasses northwest Iowa, southeast South Dakota, and southwest Minnesota. Board committees: Chairman of the Stock Option Committee and member of the Audit-Compensation/Personnel Committee.

**JEANNE PARTLOW** – Member of the Board of Directors for First Midwest Financial, Inc. Mrs. Partlow retired in June 1998 as President of the Iowa Savings Bank Division of First Federal, located in Des Moines, Iowa. She was President, Chief Executive Officer and Chairperson of the Board of Iowa Savings Bank, F.S.B., from 1987 until the end of December 1995, when Iowa Savings Bank was acquired by and became a division of First Federal Savings Bank of the Midwest. Mrs. Partlow is a past member of the Board of Directors of the Federal Home Loan Bank of Des Moines. Board committee: Stock Option Committee.



## *Executive Officers*



**JAMES S. HAAHR**  
Chairman of the Board, President and Chief Executive Officer for First Midwest Financial, Inc. and First Federal Savings Bank of the Midwest; and Chairman of the Board for Security State Bank



**J. TYLER HAAHR**  
Senior Vice President, Secretary and Chief Operating Officer for First Midwest Financial, Inc.; Executive Vice President, Secretary and Chief Operating Officer for First Federal Savings Bank of the Midwest; and Chief Executive Officer for Security State Bank



**DONALD J. WINCHELL, CPA**  
Senior Vice President, Treasurer and Chief Financial Officer for First Midwest Financial, Inc. and First Federal Savings Bank of the Midwest; and Secretary for Security State Bank



**ELLEN E. MOORE**  
Vice President, Marketing and Sales for First Midwest Financial, Inc.; and Senior Vice President, Marketing and Sales for First Federal Savings Bank of the Midwest



**TIM D. HARVEY**  
President for Brookings Federal Bank Division



**TROY MOORE**  
President for Iowa Savings Bank Division



**TONY TRUSSELL**  
President for First Federal Sioux Falls Division



**I. EUGENE RICHARDSON, JR.**  
President for Security State Bank



**SUSAN C. JESSE**  
Senior Vice President for First Federal Savings Bank of the Midwest

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## *Bank Directors*

**DIRECTORS OF FIRST FEDERAL SAVINGS BANK OF THE MIDWEST**  
JAMES S. HAAHR, CHAIRMAN  
E. WAYNE COOLEY  
E. THURMAN GASKILL  
J. TYLER HAAHR  
G. MARK MICKELSON  
RODNEY G. MUILENBURG

**DIRECTORS OF SECURITY STATE BANK**  
JAMES S. HAAHR, CHAIRMAN  
JEFFREY N. BUMP  
E. WAYNE COOLEY  
E. THURMAN GASKILL  
J. TYLER HAAHR  
G. MARK MICKELSON  
RODNEY G. MUILENBURG  
I. EUGENE RICHARDSON, JR.

**BROOKINGS FEDERAL BANK ADVISORY BOARD**  
FRED J. RITTERSHAUS, CHAIRMAN  
VIRGIL G. ELLERBRUCH  
J. TYLER HAAHR  
TIM D. HARVEY  
O. DALE LARSON  
EARL R. RUE



## Office Locations

### FIRST FEDERAL SAVINGS BANK OF THE MIDWEST



First Federal Storm Lake, Main Office

#### First Federal Storm Lake Division

##### Main Office

Fifth at Erie  
P.O. Box 1307  
Storm Lake, Iowa 50588  
712.732.4117  
800.792.6815  
712.732.7105 fax

##### Storm Lake Plaza

1415 North Lake Avenue  
Storm Lake, Iowa 50588  
712.732.6655  
712.732.7924 fax

##### Lake View

Fifth at Main  
Lake View, Iowa 51450  
712.657.2721  
712.657.2896 fax

##### Laurens

104 North Third Street  
Laurens, Iowa 50554  
712.841.2588  
712.841.2029 fax

##### Manson

Eleventh at Main  
Manson, Iowa 50563  
712.469.3319  
712.469.2458 fax

##### Odebolt

219 South Main Street  
Odebolt, Iowa 51458  
712.668.4881  
712.668.4882 fax

##### Sac City

518 Audubon Street  
Sac City, Iowa 50583  
712.662.7195  
712.662.7196 fax



Brookings Federal Bank, Main Office

#### Brookings Federal Bank Division

##### Main Office

600 Main Avenue  
P.O. Box 98  
Brookings, South Dakota 57006  
605.692.2314  
800.842.7452  
605.692.7059 fax

##### Eastbrook

425 22nd Avenue South  
Brookings, South Dakota 57006  
605.692.2314



Iowa Savings Bank, Main Office

#### Iowa Savings Bank Division

##### Main Office

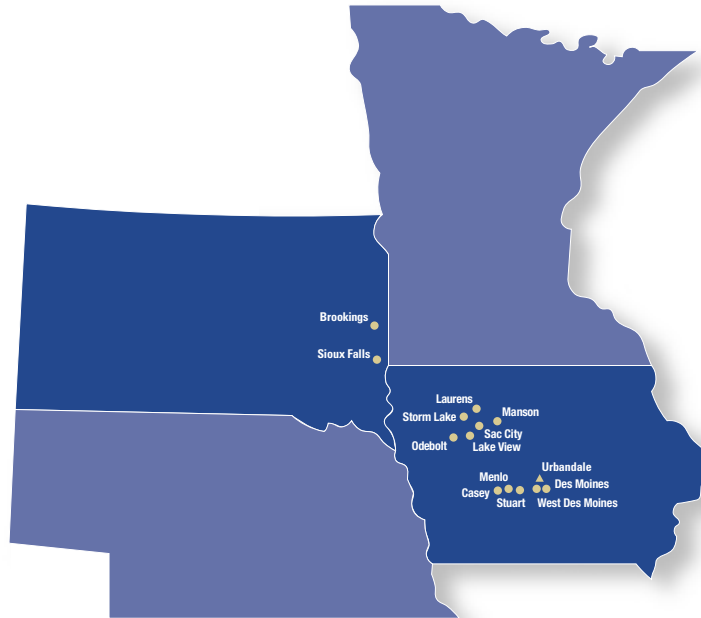
3448 Westown Parkway  
West Des Moines, Iowa 50266  
515.226.8474  
515.226.8475 fax

##### Highland Park

3624 Sixth Avenue  
Des Moines, Iowa 50313  
515.288.4866  
515.288.3104 fax

##### Urbandale (coming soon)

4848 86th Street  
Urbandale, Iowa 50322



▲ = New building location.



First Federal Sioux Falls, Main Office

#### First Federal Sioux Falls Division

##### Main Office

Minnesota at 33rd  
P.O. Box 520  
Sioux Falls, South Dakota 57101  
605.977.7500  
605.977.7501 fax

### SECURITY STATE BANK



Security State Bank, Main Office

##### Main Office

615 South Division  
P.O. Box 606  
Stuart, Iowa 50250  
515.523.2203  
800.523.8003  
515.523.2460 fax

##### Casey Office

101 East Logan  
P.O. Box 97  
Casey, Iowa 50048  
641.746.3366  
800.746.3367  
641.746.2828 fax

##### Menlo Office

501 Sherman  
P.O. Box 36  
Menlo, Iowa 50164  
641.524.4521

## Investor Information

### CORPORATE HEADQUARTERS

First Midwest Financial, Inc.  
First Federal Building  
Fifth at Erie  
P.O. Box 1307  
Storm Lake, Iowa 50588

### ANNUAL MEETING OF SHAREHOLDERS

The Annual Meeting of Shareholders will convene at 1:00 pm on Monday, January 22, 2001. The meeting will be held in the Board Room of First Federal Savings Bank, Fifth at Erie, Storm Lake, Iowa. Further information with regard to this meeting can be found in the proxy statement.

### GENERAL COUNSEL

Mack, Hansen, Gadd, Armstrong & Brown, P.C.  
316 East Sixth Street  
P.O. Box 278  
Storm Lake, Iowa 50588

### SPECIAL COUNSEL

Silver, Freedman & Taff, LLP  
1100 New York Avenue, NW  
Washington, DC 20005-3934

### INDEPENDENT AUDITORS

McGladrey & Pullen, LLP  
400 Locust Street, Suite 640  
Des Moines, Iowa 50309-2372

### SHAREHOLDER SERVICES AND INVESTOR RELATIONS

Shareholders desiring to change the name, address, or ownership of stock; to report lost certificates; or to consolidate accounts, should contact the corporation's transfer agent:

Registrar & Transfer Company  
10 Commerce Drive  
Cranford, New Jersey 07016  
Telephone: 800.368.5948  
Email: invrelations@rtco.com  
Website: www.rtco.com

### FORM 10-K

Copies of the Company's annual report or Form 10-K for the year ended September 30, 2000 (excluding exhibits thereto) are available without charge, upon request to:

Investor Relations  
First Midwest Financial, Inc.  
First Federal Building  
Fifth at Erie, P.O. Box 1307  
Storm Lake, Iowa 50588

Telephone: 712.732.4117  
Email: invrelations@fmcicash.com  
Website: www.fmcicash.com

## Stock Market Information

First Midwest Financial, Inc.'s common stock trades on the Nasdaq National Market under the symbol "CASH." *The Wall Street Journal* publishes daily trading information for the stock under the abbreviation,

"FstMidwFnl," in the National Market Listing.

Quarterly dividends for 1999 and 2000 were \$0.13.

The price range of the common stock, as reported on the Nasdaq System, was as follows:

	Fiscal Year 2000		Fiscal Year 1999	
	Low	High	Low	High
First Quarter	\$9.00	\$13.63	\$14.13	\$19.63
Second Quarter	\$9.50	\$12.50	\$14.25	\$16.00
Third Quarter	\$8.75	\$11.25	\$14.25	\$15.50
Fourth Quarter	\$9.00	\$10.81	\$12.50	\$14.75

Prices disclose inter-dealer quotations without retail mark-up, mark-down or commissions, and do not necessarily represent actual transactions.

Dividend payment decisions are made with consideration of a variety of factors including earnings, financial condition, market considerations, and regulatory restrictions. Restrictions on dividend payments are described in Note 14 of the Notes to Consolidated Financial Statements included in this Annual Report.

As of September 30, 2000, First Midwest had 2,431,574 shares of common stock outstanding, which were held by 317 shareholders of record, and 300,318 shares subject to outstanding options. The shareholders of record number does not reflect 513 persons or entities who hold their stock in nominee or "street" name.

The following securities firms indicated they were acting as market makers for First Midwest Financial, Inc. stock as of September 30, 2000: First Tennessee Securities Corp.; Herzog, Heine, Geduld, Inc.; Howe Barnes Investments, Inc.; Spear, Leeds & Kellogg; Sandler O'Neill & Partners; and Tucker Anthony Incorporated.

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## *Economic Data*

### **First Federal Storm Lake**

#### **AVERAGE LAND VALUE AS OF SEPTEMBER 2000**

High-quality farmland in northwest  
Iowa: \$2,347 per acre

#### **TAXABLE RETAIL SALES 1999**

Storm Lake — \$129,181,166

#### **UNEMPLOYMENT RATE AS OF AUGUST 2000**

Buena Vista County — 1.8%

### **Brookings Federal Bank**

#### **AVERAGE LAND VALUE AS OF FEBRUARY 2000**

High-productivity, non-irrigated  
cropland in east-central  
South Dakota: \$993 per acre

#### **TAXABLE RETAIL SALES 1999**

Brookings — \$159,975,335

#### **UNEMPLOYMENT RATE AS OF AUGUST 2000**

Brookings — 1.2%

### **Iowa Savings Bank**

#### **AVERAGE LAND VALUE AS OF SEPTEMBER 2000**

High-quality farmland in central  
Iowa: \$2,528 per acre

#### **TAXABLE RETAIL SALES 1999**

Des Moines — \$4,054,937,130

#### **UNEMPLOYMENT RATE AS OF AUGUST 2000**

Polk County — 1.6%

### **First Federal Sioux Falls**

#### **AVERAGE LAND VALUE AS OF FEBRUARY 2000**

High-productivity, non-irrigated  
cropland in east-central  
South Dakota: \$993 per acre

#### **TAXABLE RETAIL SALES 1999**

Sioux Falls — \$1,649,718,363

#### **UNEMPLOYMENT RATE AS OF AUGUST 2000**

Minnehaha County — 1.6%

### **Security State Bank**

#### **AVERAGE LAND VALUE AS OF SEPTEMBER 2000**

High-quality farmland in west-central  
Iowa: \$2,413 per acre

#### **TAXABLE RETAIL SALES 1999**

Stuart — \$7,403,152

#### **UNEMPLOYMENT RATE AS OF AUGUST 2000**

Guthrie County — 1.8%



“Thank you for your support.”

—Julie S. Jensen  
Customer Service  
Representative



**First Midwest  
Financial, Inc.**

**The sign of better banking**

First Midwest Financial, Inc.  
First Federal Building  
Fifth at Erie  
P.O. Box 1307  
Storm Lake, Iowa 50588