## CENTRUE FINANCIAL CORP

## Form 10-Q

## August 08, 2008



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UNITED STATES SECURITIES AND EXCHANGE COMMISSION Washington, D.C. 20549
FORM 10-Q
QUARTERLY REPORT
Pursuant to Section 13 or \(15(d)\) of the Securities Exchange Act of 1934 For the quarterly period ended June 30, 2008
Commission File Number: 0-28846
```

Centrue Financial Corporation
(Exact name of Registrant as specified in its charter)
Delaware

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

7700 Bonhomme Avenue, St. Louis, Missouri 63105
(Address of principal executive offices including zip code)
(314) 505-5500
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule $12 \mathrm{~b}-2$ of the Exchange Act.

```
    Large accelerated filer [ ] Accelerated filer [X]
    Non-accelerated filer [ ] Smaller reporting company [ ]
```

Indicate by check mark whether the registrant is a shell company (as defined in
Rule 12b-2 of the Exchange Act). Yes [ ] No [X].
Indicate the number of shares outstanding of each of the issuer's classes of
common stock, as of the latest practicable date.

Class
Shares outstanding at August 8, 2008

Common Stock, Par Value \$1.00
$6,028,491$

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Centrue Financial Corporation<br>Form 10-Q Index June 30, 2008

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ASSETS
    Cash and cash equivalents $ $ $, 238
    Securities available-for-sale
    Restricted securities
    Loans
    Allowance for loan losses
    Net loans
    Cash value of life insurance
    Mortgage servicing rights
    Premises and equipment, net
    Goodwill
    Intangible assets, net
    Other real estate
    Other assets
    Total assets
LIABILITIES AND STOCKHOLDERS' EQUITY
    Liabilities
        Deposits
                Non-interest-bearing $ 116,470
                Interest-bearing
                    Total deposits
        894,253
    1,010,723
        Federal funds purchased and securities sold
                under agreements to repurchase
            64,301
        Federal Home Loan Bank advances 128,300
        Notes payable 21,933
        Series B mandatory redeemable preferred stock
        831
        Subordinated debentures 20,620
        Other liabilities
            Total liabilities
    Commitments and contingent liabilities
    Stockholders' equity
            Series A convertible preferred stock (aggregate liquidation
            preference of 2,762)
                500
            Common stock, $1 par value, 15,000,000 shares authorized;
                7,453,555 and 7,438,110 shares issued at June 30, 2008 and
            at December 31, 2007 7,454
            Surplus
            71,383
            Retained earnings 63,028
            Accumulated other comprehensive income (loss)
            (3,338)
                139,027
            Treasury stock, at cost 1,425,064 shares at June 30, 2008
            and 1,366,564 at December 31, 2007
            (22,420)
                    Total stockholders' equity
                    Total liabilities and stockholders' equity
                $ 1,373,548
```

|  |  |  |  |  |  | Six Mon Ju |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 08 |  | 07 |  | 2008 |
| Interest income |  |  |  |  |  |  |
| Loans | \$ | 15,974 | \$ | 16,917 | \$ | 33,26 |
| Securities |  |  |  |  |  |  |
| Taxable |  | 2,106 |  | 3,182 |  | 4,58 |
| Exempt from federal income taxes |  | 355 |  | 381 |  | 71 |
| Federal funds sold and other |  | 25 |  | 173 |  |  |
| Total interest income |  | 18,460 |  | 20,653 |  | 38,64 |
| Interest expense |  |  |  |  |  |  |
| Deposits |  | 7,026 |  | 9,443 |  | 15,36 |
| Federal funds purchased and securities sold under agreements to repurchase |  | 153 |  | 463 |  | 48 |
| Federal Home Loan Bank advances |  | 776 |  | 628 |  | 1,94 |
| Series B mandatory redeemable preferred |  | 13 |  | 13 |  |  |
| Subordinated debentures |  | 250 |  | 450 |  | 63 |
| Notes payable |  | 238 |  | 165 |  | 47 |
| Total interest expense |  | 8,456 |  | 11,162 |  | 18,93 |
| Net interest income |  | 10,004 |  | 9,491 |  | 19,70 |
| Provision for loan losses |  | 866 |  | 226 |  | 1,63 |
| Net interest income after |  |  |  |  |  |  |
| Provision for loan losses |  | 9,138 |  | 9,265 |  | 18,07 |
| Noninterest income |  |  |  |  |  |  |
| Service charges |  | 1,875 |  | 1,969 |  | 3,51 |
| Trust income |  | 232 |  | 232 |  | 48 |
| Mortgage banking income |  | 389 |  | 449 |  | 83 |
| Brokerage commissions and fees |  | 66 |  | 104 |  | 16 |
| Bank owned life insurance |  | 254 |  | 247 |  | 50 |
| Securities gains (losses), net |  | -- |  | (33) |  | 84 |
| Gain on sale of OREO |  | 142 |  | 491 |  | 23 |
| Gain on sale of other assets |  | 629 |  | -- |  | 1,11 |
| Other income |  | 705 |  | 735 |  | 1,52 |
|  |  | 4,292 |  | 4,194 |  | 9,23 |
| Noninterest expenses |  |  |  |  |  |  |
| Salaries and employee benefits |  | 4,493 |  | 5,144 |  | 9,32 |
| Occupancy |  | 919 |  | 1,019 |  | 1,95 |
| Furniture and equipment |  | 624 |  | 627 |  | 1,40 |
| Marketing |  | 315 |  | 221 |  | 55 |


| Supplies and printing | 99 | 156 |  |
| :--- | ---: | ---: | ---: |
| Telephone | 201 | 23 |  |
| Data Processing | 231 | 210 | 44 |
| Amortization of intangible assets | 775 | 276 | 53 |
| Other expenses | 1,564 | 1,602 | 1,68 |
|  | 9,221 | 9,846 | 3,41 |

See Accompanying Notes to Unaudited Financial Statements
2.

```
CENTRUE FINANCIAL CORPORATION
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME THREE AND SIX MONTHS ENDED JUNE 30, 2008 AND 2007
(IN THOUSANDS, EXCEPT PER SHARE DATA)
```



See Accompanying Notes to Unaudited Financial Statements
CENTRUE FINANCIAL CORPORATION
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
SIX MONTHS ENDED JUNE 30, 2008 AND 2007 (IN THOUSANDS)

|  |  |  | Six Mon Jun |
| :---: | :---: | :---: | :---: |
|  |  |  | 2008 |
| Cash flows from operating activities |  |  |  |
|  | Net income | \$ | 5,150 |
|  | Adjustments to reconcile net income to |  |  |
|  | Net cash provided by operating activities |  |  |
|  | Depreciation |  | 1,493 |
|  | Amortization of intangible assets |  | 1,688 |
|  | Amortization of mortgage servicing rights, net |  | 284 |
|  | Amortization of bond premiums, net |  | 244 |
|  | Share based compensation |  | 265 |
|  | Provision for loan losses |  | 1,632 |
|  | Provision for deferred income taxes |  | 1,333 |
|  | Tax benefit related to exercised options |  | - |
|  | Earnings on bank-owned life insurance |  | (506) |
|  | Securities losses/(gains), net |  | (848) |
|  | (Gain) loss on sale of OREO |  | (238) |
|  | (Gain) loss on sale of loans |  | (665) |
|  | (Gain) on sale of branch |  | $(1,111)$ |
|  | Proceeds from sales of loans held for sale |  | 70,488 |
|  | Origination of loans held for sale |  | $(74,786)$ |
|  | Change in assets and liabilities |  |  |
|  | (Increase) decrease in other assets |  | $(3,733)$ |
|  | Increase (decrease) in other liabilities |  | 1,613 |
|  | Net cash provided by (used in) operating activities |  | 2,303 |
| Cash flows from investing activities |  |  |  |
|  | Proceeds from maturities and paydowns of securities available for sale |  | 103,761 |
|  | Purchases of securities available for sale |  | $(75,160)$ |
|  | Net decrease (increase) in loans |  | $(79,033)$ |
|  | Purchase of premises and equipment |  | (402) |
|  | Proceeds from sale of OREO |  | 3,215 |
|  | Purchase of Missouri Bank charter |  | -- |
|  | Sale of Branches, net of premium received |  | $(19,498)$ |
|  | Net cash provided by (used in) investing activities |  | $(67,117)$ |
| Cash flows from financing activities |  |  |  |
|  | Net increase (decrease) in deposits |  | 29,922 |
|  | Net increase (decrease) in federal funds purchased and securities sold under agreements to repurchase |  | 19,364 |
|  | Repayment of advances from the Federal Home Loan Bank |  | $(294,315)$ |
|  | Proceeds from advances from the Federal Home Loan Bank |  | 301,000 |
|  | Payments on notes payable |  | $(2,119)$ |
|  | Proceeds from notes payable |  | 10,250 |
|  | Dividends on common stock |  | $(1,633)$ |
|  | Dividends on preferred stock |  | (104) |
|  | Proceeds from exercise of stock options |  | 233 |
|  | Purchase of treasury stock |  | $(1,174)$ |

```
    Net cash provided by financing activities
        61,424
Net increase (decrease) in cash and cash equivalents
(3,390)
Cash and cash equivalents
    Beginning of period 51,628
    End of period $ 48,238
Supplemental disclosures of cash flow information
        Cash payments for
                Interest $ 20,506
                Income taxes 2,270
                Transfers from loans to other real estate owned 4,497
See Accompanying Notes to Unaudited Financial Statements
```

4. 

CENTRUE FINANCIAL CORPORATION
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

Note 1. Summary of Significant Accounting Policies

Centrue Financial Corporation (the "Company") is a bank holding company organized under the laws of the State of Delaware. The Company provides a full range of banking services to individual and corporate customers located in markets extending from the far western and southern suburbs of the Chicago metropolitan area across Central Illinois down to the metropolitan St. Louis area. These services include demand, time, and savings deposits; lending; mortgage banking; brokerage; asset management; and trust services. The Company is subject to competition from other financial institutions and nonfinancial institutions providing financial services. Additionally, the Company and its subsidiary Centrue Bank (the "Bank") are subject to regulations of certain regulatory agencies and undergo periodic examinations by those regulatory agencies.

Basis of presentation

The consolidated financial statements include the accounts of the Company and Centrue Bank. Intercompany balances and transactions have been eliminated in consolidation.

The accompanying unaudited interim consolidated financial statements of Centrue Financial Corporation have been prepared in accordance with U.S. generally accepted accounting principles and with the rules and regulations of the Securities and Exchange Commission for interim financial reporting. Accordingly, they do not include all of the information and footnotes required for complete financial statements. In the opinion of management, all normal and recurring adjustments which are necessary to fairly present the results for the interim periods presented have been included. The preparation of financial statements requires management to make estimates and assumptions that affect the recorded amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. The allowance for loan losses,

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carrying value of goodwill, value of mortgage servicing rights, deferred taxes, and fair values of financial instruments are particularly subject to change. Actual results could differ from those estimates. Certain 2007 amounts have been reclassified to conform to the 2008 presentation.

Assets held in an agency or fiduciary capacity, other than trust cash on deposit with Centrue Bank, are not assets of the Company and, accordingly, are not included in the accompanying consolidated financial statements.

For further information with respect to significant accounting policies followed by the Company in the preparation of its consolidated financial statements, refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2007. The annualized results of operations during the three and six months ended June 30, 2008 are not necessarily indicative of the results expected for the year ending December 31, 2008. All financial information is in thousands (000s), except shares and per share data.

Note 2. Earnings Per Share
Basic earnings per share for the three and six months ended June 30, 2008 and 2007 were computed by dividing net income by the weighted average number of shares outstanding. Diluted earnings per share for the three and six months ended June 30, 2008 and 2007 were computed by dividing net income by the weighted average number of shares outstanding, adjusted for the dilutive effect of the stock options. Computations for basic and diluted earnings per share are provided below:

CENTRUE FINANCIAL CORPORATION
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

Note 2. Earnings Per Share (continued)


There were approximately 406,300 and 321,200 options outstanding at June 30, 2008 and 2007, respectively that were not included in the computation of diluted earnings per share. These options were antidilutive since the exercise prices were greater than the average market price of the common stock.

Note 3. Securities
All of the Company's securities are classified as available-for-sale and are carried at fair value. The Company does not have any securities classified as trading or held-to-maturity.

The following table describes the fair value, gross unrealized gains and losses of securities available-for-sale at June 30, 2008 and December 31, 2007, respectively:

|  | Fair Value |  | Gross Unrealized Gains |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| U.S. government agencies | \$ | 19,548 | \$ | 396 | \$ |
| States and political subdivisions |  | 40,419 |  | 603 |  |
| U. S. government mortgage-backed securities |  | 96,116 |  | 211 |  |
| Collateralized mortgage obligations |  | 21,796 |  | 10 |  |
| Equity securities |  | 1,621 |  | 101 |  |
| Investment in Trust Preferred instruments |  | 22,391 |  | -- |  |
| Corporate |  | 1,973 |  | 6 |  |
|  | \$ | 203,864 | \$ | 1,327 |  |
|  |  |  |  | cember | , |
|  |  |  |  |  |  |
| U.S. government agencies | \$ | 103,624 | \$ | 1,415 | \$ |
| States and political subdivisions |  | 41,561 |  | 501 |  |
| U. S. government mortgage-backed securities |  | 47,784 |  | 287 |  |
| Collateralized mortgage obligations |  | 24,077 |  | 68 |  |
| Equity securities |  | 1,601 |  | 105 |  |
| Investment in Trust Preferred instruments |  | 17,273 |  | -- |  |
| Corporate |  | 2,741 |  | 9 |  |
|  | \$ | 238,661 | \$ | 2,385 | \$ |

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CENTRUE FINANCIAL CORPORATION
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

Note 3. Securities (continued)
Management does not believe any individual unrealized losses as of June 30 , 2008, identified in the preceding tables represent other-than-temporary impairment based on our analysis. These unrealized losses are primarily attributable to changes in interest rates, general market risk repricing, and illiquidity in the capital markets. The Company has both the intent and ability to hold each of the securities shown in the table for the time necessary to recover its amortized cost. The unrealized loss on the available for sale securities is included, net of tax, in other comprehensive income.

The amounts below include the activity related to security sales and calls. The activity related to securities available-for-sale were as follows:


Note 4. Loans
The following table describes the composition of loans by major categories outstanding as of June 30,2008 and December 31,2007 , respectively:

|  | June 30, 2008 |  |  | December 31, 2007 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | \$ | \% |  | \$ | \% |  |
| Commercial | \$ | 188,039 | 18.7\% | \$ | 181,210 |  | 18 |
| Agricultural |  | 12,834 | 1.3 |  | 21,861 |  | 2 |
| Real estate: |  |  |  |  |  |  |  |
| Commercial mortgages |  | 408,775 | 40.7 |  | 362,920 |  | 37 |
| Construction |  | 180,589 | 18.0 |  | 159,274 |  | 16 |
| Agricultural |  | 17,819 | 1.8 |  | 23,560 |  | 2 |
| 1-4 family mortgages |  | 188,648 | 18.8 |  | 198,208 |  | 20 |
| Installment |  | 6,354 | 0.6 |  | 8,611 |  | 0 |
| Other |  | 631 | 0.1 |  | 1,641 |  | 0 |
| Total loans |  | 1,003,689 | 100.0\% |  | 957,285 |  | 100 |
| Allowance for loan losses |  | (11,542) |  |  | $(10,755)$ |  |  |
| Loans, net | \$ | 992,147 |  | \$ | 946,530 |  |  |
|  |  | $========$ |  |  | ======= |  |  |

The following table presents data on impaired loans:

|  | $\begin{gathered} \text { June } 30, \\ 2008 \end{gathered}$ |  | $\begin{gathered} \text { December } 3 \\ 2007 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: | :---: |
| Impaired loans for which an allowance has been provided | \$ | 23,410 | \$ | 5,5 |
| Impaired loans for which no allowance has been provided |  | 1,752 |  | 5,9 |
| Total loans determined to be impaired | \$ | 25,162 | \$ | 11, 4 |
| Allowance for loan loss for impaired loans included in the allowance for loan losses | \$ | 2,640 | \$ | 2,3 |

In originating loans, the Company recognizes that credit losses will be experienced and the risk of loss will vary with, among other things, current economic conditions; the type of loan being made; the creditworthiness of the borrower over the term of the loan; and in the case of a collateralized loan, the quality of the collateral for such loan. The allowance for loan losses represents the Company's estimate of the allowance necessary to provide

## 7.

CENTRUE FINANCIAL CORPORATION
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

Note 4. Loans (continued)
for probable incurred losses in the loan portfolio. In making this determination, the Company analyzes the ultimate collectibility of the loans in its portfolio; incorporating feedback provided by internal loan staff; the independent loan review function; and information provided by regulatory agencies.

The Company reported loans held for sale of $\$ 3,769$ and $\$ 1,598$ at June 30,2008 and December 31, 2007 respectively.

The Company conducts a quarterly evaluation as to the adequacy of the allowance for loan losses. Transactions in the allowance for loan losses for the three and six months ended June 30,2008 and 2007 are summarized below:

|  | Three Months Ended June 30, |  |  |  |  | Six Mo <br> Ju |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2008 |  | 2007 |  | 2008 |  |
| Beginning balance | \$ | 11,221 | \$ | 10,607 | \$ | 10,755 |
| Charge-offs |  | (622) |  | (191) |  | $(1,020$ |
| Recoveries |  | 77 |  | 186 |  | 175 |
| Provision for loan losses |  | 866 |  | 226 |  | 1,632 |

Ending balance

\author{
Period end total loans <br> Average loans <br> ```
Ratio of net charge-offs to average loans <br> Ratio of provision for loan losses to average loans <br> Ratio of allowance for loan losses <br> to period end total loans <br> Ratio of allowance for loan losses <br> to total nonperforming loans <br> Ratio of allowance for loan losses <br> to average loans

```
}
\begin{tabular}{|c|c|c|c|}
\hline \$ & 11,542 & \$ & 10,828 \\
\hline \$ & 1,003,689 & \$ & 912,168 \\
\hline & 1,012,878 & \$ & 883,151 \\
\hline & 0.05\% & & \(0.00 \%\) \\
\hline & 0.09 & & 0.03 \\
\hline & 1.15 & & 1.19 \\
\hline & 58.27 & & 241.05 \\
\hline
\end{tabular}

Note 5. Share Based Compensation
In 1999, the Company adopted the 1999 Option Plan. Under the 1999 Option Plan, nonqualified options may be granted to employees and eligible directors of the Company and its subsidiaries to purchase the Company's common stock at \(100 \%\) of the fair market value on the date the option is granted. The Company has authorized 50,000 shares for issuance under the 1999 Option Plan. During 1999, 40,750 of these shares were granted and are \(100 \%\) fully vested. The options have an exercise period of ten years from the date of grant. There are 9,250 shares available for grant under this plan.

In April 2003, the Company adopted the 2003 Option Plan. Under the 2003 Option Plan, as amended on April 24, 2007, nonqualified options, incentive stock options, and/or stock appreciation rights may be granted to employees and outside directors of the Company and its subsidiaries to purchase the Company's common stock at an exercise price to be determined by the Executive and Compensation committee. Pursuant to the 2003 Option Plan, 570,000 shares of the Company's unissued common stock have been reserved and are available for issuance upon the exercise of options and rights granted under the 2003 Option Plan. The options have an exercise period of ten years from the date of grant. There are 209,000 shares available for grant under this plan.

\section*{8.}

CENTRUE FINANCIAL CORPORATION
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

Note 5. Share Based Compensation (continued)
The Company's compensation committee awarded 5,000 restricted common stock awards on November 14, 2006 which were available under the restricted stock portion of the plan. The restricted shares were issued out of treasury shares with an aggregate grant date fair value of \(\$ 90\). The awards were granted using the fair value as the last sale price as quoted on the NASDAQ Stock Market on the date of grant of \(\$ 18.03\). The awarded shares vest at a rate of \(20 \%\) of the initially awarded amount per year, beginning on the first anniversary date of the award, and are contingent upon continuous service by the recipient through the vesting date. Currently, there are 1,000 shares of the restricted stock that have vested.

A summary of the status of the option plans as of June 30, 2008, and changes during the period ended on those dates is presented below:

June 30, 2008


Options outstanding at June 30, 2008 and December 31, 2007 were as follows:


NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

Note 5. Share Based Compensation (continued)

Information related to the stock option plan during the quarter ended June 30 , 2008 and 2007 is as follows:
\begin{tabular}{|c|c|c|c|c|}
\hline & & \[
\begin{gathered}
\text { June } 30, \\
2008
\end{gathered}
\] & & \[
\begin{gathered}
\text { June } 30, \\
2007
\end{gathered}
\] \\
\hline Intrinsic value of options exercised & \$ & 6 & \$ & 75 \\
\hline Cash received from option exercises & & 233 & & 316 \\
\hline Tax benefit realized from option exercises & & -- & & 122 \\
\hline Weighted average of fair value of options granted & & 3.69 & & 4.62 \\
\hline
\end{tabular}

The compensation cost that has been charged against income for the stock options portion of the Equity Incentive Plan was \(\$ 256\) and \(\$ 63\) for the six months ended June 30,2008 and 2007. The compensation cost that has been charged against income for the restricted stock portion of the Equity Incentive Plan was \(\$ 9\) and \(\$ 0\) for the six months ended June 30, 2008 and 2007.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company's common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior. (Employee and management options are tracked separately.) The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. The fair value of options granted was determined using the following weighted-average assumptions as of grant date:


Unrecognized stock option compensation expense related to unvested awards (net of estimated forfeitures) for the remainder of 2008 and beyond is estimated as follows:


\begin{abstract}
10.

CENTRUE FINANCIAL CORPORATION
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

Note 6. Contingent Liabilities and Other Matters

Neither the Company nor its subsidiary is involved in any pending legal proceedings other than routine legal proceedings occurring in the normal course of business, which, in the opinion of management, in the aggregate, are not material to the Company's consolidated financial condition.

Note 7. Segment Information

The Company utilizes a line of business ("LOB") reporting structure which was implemented as of January 1, 2005. The reportable segments are determined by the products and services offered, primarily distinguished between retail, commercial, treasury, wealth management, and other operations. Loans, and deposits generate the revenues in the commercial segments; deposits, loans, secondary mortgage sales and servicing generates the revenue in the retail segment; investment income generates the revenue in the treasury segment; brokerage, and trust services generate the revenue in the wealth management segment and holding company services generate revenue in the other operations segment. The "net allocations" line represents the allocation of the costs that are overhead being spread to the specific segments.

The accounting policies used with respect to segment reporting are the same as those described in the summary of significant accounting policies as forth in Note 1. Segment performance is evaluated using net income.

Information reported internally for performance assessment follows.
\end{abstract}


Three Months Ended
June 30, 2007

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\begin{tabular}{|c|c|c|c|c|c|c|c|c|c|c|}
\hline & \multicolumn{2}{|r|}{\begin{tabular}{l}
Retail \\
Segment
\end{tabular}} & \multicolumn{2}{|l|}{Commercial Segment} & \multicolumn{2}{|r|}{\begin{tabular}{l}
Treasury \\
Segment
\end{tabular}} & \multicolumn{2}{|r|}{\begin{tabular}{l}
Wealth \\
Management
\end{tabular}} & & \\
\hline Net interest income (loss) & \$ & 3,440 & \$ & 6,089 & \$ & 1,182 & \$ & 64 & & \\
\hline Other revenue & & 2,822 & & 686 & & (27) & & 366 & & \\
\hline Other expense & & 3,324 & & 478 & & 55 & & 358 & & \\
\hline \multicolumn{11}{|l|}{Noncash items} \\
\hline Depreciation & & 446 & & 4 & & -- & & 4 & & \\
\hline Provision for loan losses & & -- & & 226 & & -- & & -- & & \\
\hline Other intangibles & & 589 & & -- & & -- & & 2 & & \\
\hline Net allocations & & 700 & & 3,204 & & 453 & & 229 & & \\
\hline Income tax expense & & 397 & & 945 & & 213 & & (54) & & \\
\hline Segment profit (loss) & \$ & 806 & \$ & 1,918 & \$ & 434 & \$ & (109) & & \\
\hline Goodwill & \$ & 11,898 & \$ & 12,374 & \$ & -- & \$ & 1,167 & & \\
\hline Segment assets & \$ & 341,965 & \$ & 685,656 & \$ & 281,329 & \$ & 1,396 & & \\
\hline & & 11. & & & & & & & & \\
\hline \multicolumn{11}{|l|}{NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)} \\
\hline \multicolumn{11}{|l|}{Note 7. Segment Information (continued)} \\
\hline & & & & & & Six M June & & & & \\
\hline & & ail ment & & nercial gment & & sury gment & & th ment & & \\
\hline Net interest income (loss) & \$ & 6,849 & \$ & 13,449 & \$ & 965 & \$ & 358 & \$ & \\
\hline Other revenue & & 6,433 & & 634 & & 848 & & 688 & & \\
\hline Other expense & & 6,313 & & 1,755 & & 110 & & 646 & & \\
\hline \multicolumn{11}{|l|}{Noncash items} \\
\hline Depreciation & & 994 & & 3 & & -- & & 6 & & \\
\hline Provision for loan losses & & -- & & 1,632 & & -- & & -- & & \\
\hline Other intangibles & & 988 & & -- & & -- & & 696 & & \\
\hline Net allocations & & 830 & & 6,001 & & 793 & & 402 & & \\
\hline Income tax expense & & 1,372 & & 1,548 & & 300 & & (232) & & \\
\hline Segment profit (loss) & \$ & 2,785 & \$ & 3,144 & \$ & 610 & \$ & (472) & & \\
\hline Goodwill & \$ & 11,927 & \$ & 12,404 & \$ & -- & \$ & 473 & & \\
\hline Segment assets & \$ & 294,634 & \$ & 785,542 & \$ & 216,047 & \$ & 597 & & \\
\hline
\end{tabular}
\begin{tabular}{|c|c|c|c|}
\hline & & \multicolumn{2}{|r|}{Six Months Ended June 30, 2007} \\
\hline Retail & Commercial & Treasury & Wealth \\
\hline Segment & Segment & Segment & Management \\
\hline
\end{tabular}
\begin{tabular}{|c|c|c|c|c|c|c|c|c|c|}
\hline Net interest income (loss) & \$ & 6,777 & \$ & 12,102 & \$ & 1,594 & \$ & 126 & \$ \\
\hline Other revenue & & 5,133 & & 844 & & (27) & & 789 & \\
\hline Other expense & & 6,725 & & 1,133 & & 114 & & 798 & \\
\hline Noncash items & & & & & & & & & \\
\hline Depreciation & & 973 & & 8 & & -- & & 9 & \\
\hline Provision for loan losses & & -- & & 226 & & -- & & -- & \\
\hline Other intangibles & & 1,209 & & -- & & -- & & 3 & \\
\hline Net allocations & & 1,216 & & 6,294 & & 871 & & 441 & \\
\hline Income tax expense & & 590 & & 1,744 & & 192 & & (111) & \\
\hline Segment profit (loss) & \$ & 1,197 & \$ & 3,541 & \$ & 390 & \$ & (225) & \$ \\
\hline Goodwill & \$ & 11,898 & \$ & 12,374 & \$ & -- & \$ & 1,167 & \$ \\
\hline Segment assets & \$ & 341,965 & \$ & 685,656 & \$ & 281,329 & \$ & 1,396 & \$ \\
\hline
\end{tabular}

Note 8. Borrowed Funds and Debt Obligations
On March 31, 2008, the Company entered into a new loan agreement with LaSalle Bank N.A. which provides for up to an aggregate principal amount of \(\$ 35,250\) in borrowings. The loan agreement consists of three credit facilities. The first credit facility consists of a \(\$ 25,000\) secured revolving line of credit which matures in December 2008. The second credit facility consists of a \(\$ 250\) secured term facility, which will mature in March 2015. The third credit facility consists of a \(\$ 10,000\) in subordinated debt, which also matures in March 2015. The interest rate on the term and subordinated debt credit facilities is three month LIBOR plus 295 basis points. The interest rate on the revolving credit facility is three month LIBOR plus 125 basis points. Repayment of each of the three credit facilities is interest only on a quarterly basis, with the principal amount of the loan due at maturity. The revolving and term credit facilities are secured by a pledge of the stock of Centrue Bank. The subordinated debt credit facility is unsecured and is intended to qualify as tier II capital for regulatory purposes. The loan agreement contains customary covenants, including but not limited to, Centrue Bank's maintenance of its status as well-capitalized, minimum return on average assets on an annual basis of \(0.50 \%\), maximum nonperforming assets to primary capital below \(20 \%\) and minimum loan loss reserves to total loans of \(1.00 \%\). The company intends to use the credit facilities for general working capital purposes. The loan agreement contains no penalty for early repayment of either the revolving credit facility or the subordinated debt credit facility.

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Note 9. Business Acquisitions and Divestures

On March 28, 2008 the Company completed the sale of its Hanover and Elizabeth branches to Apple River State Bank headquartered in Apple River, Illinois. Apple River assumed approximately \(\$ 25,300\) in deposits and acquired \(\$ 12,700\) in loans, and \(\$ 401\) in premises and equipment. The net gain on the sale was \(\$ 482\).

On June 6, 2008 the Company completed the sale of its Manlius and Tampico branches to Peoples National Bank headquartered in Kewanee, Illinois. Peoples National assumed approximately \(\$ 29,400\) in deposits and acquired \(\$ 17,400\) in loans, and \(\$ 214\) in premises and equipment. The net gain on the sale was \(\$ 629\).

Note 10. Fair Value

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In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements." This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued staff position (FSP) 157-2, Effective Date of FASB Statement No. 157. This FSP delays the effective date of FAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. The impact of adoption was not material.

Statement 157 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) or identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs to reflect a reporting entity's own assumptions about the assumptions that market participants would use to price and asset or liability.

The fair value of securities available for sale are determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

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Note 10. Fair Value (continued)
Assets and liabilities measured at fair value are summarized below:


\author{
Assets and Liabilities Measured on a Recurring Basis
}

\section*{Assets:}
Available for sale securities \$ 203,864 \$ -- \$

Assets and Liabilities Measured on a Non-Recurring Basis

Assets:
Impaired loans
\$ 20,770 \$

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of \(\$ 23,410\) with a valuation allowance of \(\$ 2,640\), resulting in an additional provision for loan losses of \(\$ 0\) for the period. During the quarter the fair value of impaired loans decreased by \(\$ 440\).

The majority of our impaired loans are collateralized by real estate. The carrying value for these real estate secured impaired loans was based upon information in independent appraisals obtained on the underlying collateral.

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Note 11. Recent Accounting Developments
In February, 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective of SFAS 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting principles. The new standard is effective for the Company on January 1, 2008. The Company did not elect the fair value option for any financial assets or financial liabilities as of January 1, 2008.

In January 2007, the FASB issued Derivatives Implementation Group Issue B40, Application of Paragraph 13 (b) to Securitized Interests in Prepayable Financial Assets (DIG Issue B40). DIG Issue B40 provides an exemption from the embedded derivative test of paragraph 13 (b) of SFAS No. 133 for instruments that would otherwise require bifurcation if the test is met solely because of a prepayment feature included within the securitized interest and prepayment is not controlled by the security holder. SFAS No. 155 and DIG Issue B40 did not have a material impact on the Company's consolidated financial position or results of operations.

In September 2006, the FASB Emerging Issues Task Force finalized Issue No. 06-4, Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. This issue requires that a liability be recorded during the service period when a split-dollar life insurance agreement continues after participants' employment or retirement. The required accrued liability will be based on either the post-employment benefit cost for the continuing life insurance or based on the future death benefit depending on contractual terms of the underlying agreement. This issue is

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effective for fiscal years beginning after December 15, 2007. Due to the adoption of this item, the Company recorded an entry of \(\$ 730\) to the beginning balance for retained earnings as of January 1, 2008.

On November 5, 2007, the SEC issued Staff Accounting Bulletin No. 109, Written Loan Commitments Recorded at Fair Value through Earnings ("SAB 109").
Previously, SAB 105, Application of Accounting Principles to Loan Commitments, stated that in measuring the fair value of a derivative loan commitment, a company should not incorporate the expected net future cash flows related to the associated servicing of the loan. SAB 109 supersedes SAB 105 and indicates that the expected net future cash flows related to the associated servicing of the loan should be included in measuring fair value for all written loan commitments that are accounted for at fair value through earnings. SAB 105 also indicated that internally-developed intangible assets should not be recorded as part of the fair value of a derivative loan commitment, and SAB 109 retains that view. SAB 109 is effective for derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The impact of this standard was not material.

On March 19, 2008, the FASB issued FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS 161), which is intended to improve financial reporting for derivative instruments and hedging activities. Additional disclosures will be required that require disclosure of the fair values of derivative instruments and their gains and losses in tabular format. It also requires disclosure of derivatives features that are credit risk-related. These changes will enable investors to better understand their effects on an entity's financial position, financial performance and cash flows. It is effective for financial statements for fiscal years and interim periods beginning after November 15, 2008. The impact of this statement will not have a material effect on the Company's consolidated financial statements.

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Centrue Financial Corporation (the "Company") is a bank holding company organized under the laws of the State of Delaware. Operating results of former Centrue are included in the consolidated financial statements since the date of the acquisition. The Company provides a full range of products and services to individual and corporate customers located in the north central, east central, south central, suburban west area of Chicago, suburban metro east area of St. Louis areas. These products and services include demand, time, and savings deposits; lending; mortgage banking, brokerage, asset management, and trust services. The Company is subject to competition from other financial institutions, including banks, thrifts and credit unions, as well as nonfinancial institutions providing financial services. Additionally, the Company and its subsidiary Centrue Bank (the "Bank") are subject to regulations of certain regulatory agencies and undergo periodic examinations by those regulatory agencies.

The following discussion provides an analysis of the Company's results of operations and financial condition for the three and six months ended June 30 , 2008 as compared to the same period in 2007 . In the opinion of management, all normal and recurring adjustments which are necessary to fairly present the results for the interim periods presented have been included. The preparation of financial statements requires management to make estimates and assumptions that affect the recorded amounts of assets and liabilities and disclosure of

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contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

For further information with respect to significant accounting policies followed by the Company in the preparation of its consolidated financial statements, refer to the Company's Annual Report on Form \(10-\mathrm{K}\) for the year ended December 31, 2007. The annualized results of operations during the three and six months ended June 30, 2008 are not necessarily indicative of the results expected for the year ending December 31, 2008. All financial information is in thousands (000s), except shares and per share data.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. By their nature, changes in these assumptions and estimates could significantly affect the Company's financial position or results of operations. Actual results could differ from those estimates. Those critical accounting policies that are of particular significance to the Company are discussed in Note 1 of the Company's 2007 Annual Report on Form 10-K.

Securities: Available-for-sale securities are those that the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Any decision to sell a security classified as available-for-sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Securities available-for-sale are carried at fair value with unrealized gains or losses, net of the related deferred income tax effect, reported in other comprehensive income. Declines in the fair value of securities below their cost that are other than temporary are reflected as realized losses. In estimating other-than-temporary losses, management considers: The length of time and extent that fair value has been less than cost, the financial condition and near term prospects of the issuer, and the Company's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value. Securities are written down to fair value when a decline in fair value is not temporary.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Management estimates the allowance balance required based on past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, current economic conditions and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Loan losses are charged against the allowance when management believes that the uncollectibility of a loan balance is confirmed.

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Goodwill and other intangible assets: Goodwill results from business acquisitions and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed at least annually for impairment and any such impairment will be recognized in the period identified. Other intangible assets consist of core deposit and acquired customer relationship intangible assets arising from whole bank, and branch company acquisitions. They are initially measured at fair value and then are amortized over their estimated useful lives, which is ten years.

Income taxes: Deferred tax assets and liabilities are recognized for temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. Deferred taxes are recognized for the estimated taxes ultimately payable or recoverable based on enacted tax laws. Changes in enacted tax rates and laws are reflected in the financial statements in the periods they occur.

General
o Second quarter 2008 results included the following nonrecurring activity:
- Net gain on sale of branches of \(\$ 629\).
o Write-down of \(\$ 297\) in goodwill related to the anticipated sale of a Wealth Management business line.
- Approximately \(\$ 266\) in costs associated with branch sales/closings and employee separation costs.
- Excluding \(\$ 563\) in nonrecurring 2008 operating expense items mentioned above and \(\$ 716\) in restructuring items taken in the second quarter 2007, noninterest expense levels decreased \$457 or \(5.0 \%\) in the second quarter of 2008 compared to 2007 .
o Total core deposits (checking, NOW, savings and money market) increased \(\$ 11,500\) or \(2.5 \%\) from year-end 2007. Excluding \(\$ 24,300\) in core deposits related to branch sales recorded in the first and second quarters of 2008, core deposits grew \(\$ 37,100\) or \(8.0 \%\) since year-end 2007 .
o The efficiency ratio improved to \(64.76 \%\) during the quarter from \(73.06 \%\) in the first quarter 2008 and \(70.80 \%\) recorded in the first quarter 2007.
o The net interest margin increased 4 basis points to \(3.34 \%\) as compared to \(3.30 \%\) recorded in the second quarter of 2007 and increased 9 basis points from the first quarter of 2008 level of \(3.25 \%\).
- The level of nonperforming assets increased to \(\$ 24,100\) versus the \(\$ 5,200\) recorded at March 31,2008 and \(\$ 7,100\) at December 31, 2007 .
o As part of an ongoing effort to redeploy capital to higher growth markets, the Company closed its Ashkum branch and completed the sale of its Manlius and Tampico branches. The transaction resulted in selling \(\$ 17,400\) in loans and \(\$ 29,400\) in deposits and generated a net gain on sale of \(\$ 629\).

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Results of Operations
Net Income
Net Income for the second quarter ended June 30,2008 equaled \(\$ 2,705\) or \(\$ 0.44\) per diluted share as compared to \(\$ 2,506\) or \(\$ 0.38\) per diluted share in the same period of 2007 . This represents increases of \(7.9 \%\) in net income and \(15.8 \%\) in diluted per share earnings. For the six months ended June 30, 2008, net income equaled \(\$ 5,150\) or \(\$ 0.83\) per diluted share as compared to \(\$ 4,405\) or \(\$ 0.66\) per diluted share in the same period during 2007. This represents increases of \(16.9 \%\) in net income and \(25.8 \%\) in diluted per share earnings.

Return on average equity was 9.26\% for the second quarter 2008 as compared to 8.51\% for the same period in 2007. Return on average assets was \(0.80 \%\) for the second quarter 2008 compared to \(0.76 \%\) for the same period in 2007.

Return on average equity was \(8.74 \%\) for the six month period ended June 30, 2008 compared to \(7.51 \%\) for the same period in 2007. Return on average assets was \(0.76 \%\) for the six month period ended June 30, 2008 compared to \(0.68 \%\) for the same period in 2007.

\section*{Net Interest Income/ Margin}

The Company's net interest income is affected by changes in the amount and mix of interest-earning assets and interest-bearing liabilities, referred to as "volume change." It is also affected by changes in yields earned on interest-earning assets and rates paid on interest-bearing deposits and other borrowed funds referred to as "rate change." The following table details each category of average amounts outstanding for interest-earning assets and interest-bearing liabilities, average rate earned on all interest-earning assets, average rate paid on all interest-bearing liabilities and the net yield on average interest-earning assets. In addition, the table reflects the changes in net interest income stemming from changes in interest rates and from asset and liability volume, including mix. The change in interest attributable to both rate and volume has been allocated to the changes in the rate and the volume on a pro rata basis.

Fully tax equivalent net interest income for the second quarter 2008 increased \(5.3 \%\) to \(\$ 10,251\) as compared \(\$ 9,740\) for the same period in 2007 . The improvement in net interest income was due to strong growth in average earning assets, an improving net interest margin from a year ago and decreases in rates paid on interest-bearing funding, which dropped in response to the rate environment changes that occurred during the first quarter 2008.

The net interest margin increased 4 basis points to \(3.34 \%\) as compared to \(3.30 \%\) recorded in the second quarter of 2007 and increased 9 basis points from the first quarter of 2008 level of \(3.25 \%\). The improvement in the net interest margin was due to several factors, including growth in higher spread assets, an increase in yield-related loan fees and decreases in time deposit and other wholesale funding rates due to current market conditions. It is likely that the net interest margin will remain under pressure throughout 2008 due to ongoing competitive and market pressures in pricing loans and deposits.

Fully tax equivalent net interest income for the six months ended June 30, 2008
totaled \(\$ 20,219\), representing an increase of \(\$ 906\) or \(4.7 \%\) compared to the \(\$ 19,313\) earned during the same period in 2007. Net interest income increased largely due to the factors described above impacting the second quarter results.

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\(\qquad\)

AVERAGE BALANCE SHEET AND ANALYSIS OF NET INTEREST INCOME

For the Three Months Ended June 30,
\begin{tabular}{|c|c|c|c|c|c|}
\hline \multicolumn{3}{|c|}{2008} & \multicolumn{3}{|c|}{2007} \\
\hline & Interest & & & Interest & \\
\hline Average & Income/ & Average & Average & Income/ & Average \\
\hline Balance & Expense & Rate & Balance & Expense & Rate \\
\hline
\end{tabular}

ASSETS
\begin{tabular}{|c|c|c|c|c|c|c|c|c|c|c|}
\hline \multicolumn{11}{|l|}{Interest-earning assets} \\
\hline ```
Interest-earning
```

    deposits & \$ & 2,855 & \$ & 2 & 0.29\% & \$ & 5,898 & \$ & 8 & 0.56\% \\
    \hline \multicolumn{11}{|l|}{Securities} <br>
\hline Taxable \& \& 177,521 \& \& 2,100 \& 4.76 \& \& 243,905 \& \& 3,196 \& 5.26 <br>
\hline Non-taxable \& \& 39,142 \& \& 554 \& 5.69 \& \& 40,956 \& \& 563 \& 5.51 <br>
\hline \multicolumn{11}{|l|}{Total securities (tax} <br>
\hline equivalent) \& \& 216,663 \& \& 2,654 \& 4.93 \& \& 284,861 \& \& 3,759 \& 5.29 <br>
\hline Federal funds sold \& \& 2,679 \& \& 13 \& 1.96 \& \& 12,878 \& \& 165 \& 5.15 <br>
\hline \multicolumn{11}{|l|}{Loans} <br>
\hline Commercial \& \& 203,604 \& \& 3,121 \& 6.17 \& \& 175,253 \& \& 3,538 \& 8.10 <br>
\hline Real estate \& \& 798,308 \& \& 12,755 \& 6.43 \& \& 691,119 \& \& 13,184 \& 7.65 <br>
\hline Installment and other \& \& 10,966 \& \& 162 \& 5.94 \& \& 16,779 \& \& 248 \& 5.92 <br>

\hline \multicolumn{11}{|l|}{$$
\begin{aligned}
& \text { Gross loans } \\
& \text { (tax }
\end{aligned}
$$} <br>

\hline equivalent) \& \& 012,878 \& \& 16,038 \& 6.37 \& \& 883,151 \& \& 16,970 \& 7.71 <br>
\hline \multicolumn{11}{|l|}{Total} <br>
\hline interestearnings \& \& \& \& \& \& \& \& \& \& <br>
\hline assets \& \& 235,075 \& \& 18,707 \& 6.09 \& \& 186,788 \& \& 20,902 \& 7.06 <br>

\hline | Noninterest-earning assets |
| :--- |
| Cash and cash | \& \& \& \& \& \& \& \& \& \& <br>

\hline
\end{tabular}


(1) Average balance and average rate on securities classified as
available-for-sale is based on historical amortized cost balances.
(2) Interest income and average rate on non-taxable securities are reflected on a tax equivalent basis based upon a statutory federal income tax rate of $34 \%$.
(3) Nonaccrual loans are included in the average balances; overdraft loans are excluded in the balances.
(4) Loan fees are included in the specific loan category.

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available-for-sale is based on historical amortized cost balances.
(2) Interest income and average rate on non-taxable securities are reflected on a tax equivalent basis based upon a statutory federal income tax rate of $34 \%$.
(3) Nonaccrual loans are included in the average balances; overdraft loans are excluded in the balances.
(4) Loan fees are included in the specific loan category.

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Provision for Loan Losses

The amount of the provision for loan losses is based on management's evaluations of the loan portfolio, with particular attention directed toward nonperforming, impaired and other potential problem loans. During these evaluations, consideration is also given to such factors as management's evaluation of specific loans, the level and composition of impaired loans, other nonperforming loans, other identified potential problem loans, historical loss experience, results of examinations by regulatory agencies, results of the independent asset quality review process, the market value of collateral, the estimate of discounted cash flows, the strength and availability of guarantees, concentrations of credits and various other factors, including concentration of credit risk in various industries and current economic conditions.

Due largely to the deterioration of two loan relationships during the second quarter 2008 (see "Nonperforming Asset" section for further discussion), the Company recorded an $\$ 866$ provision for loan losses versus $\$ 226$ in the same quarter of 2007 . For the six months ended June 30,2008 , the Company recorded a $\$ 1,632$ provision for loan losses as compared to recognizing a provision of $\$ 226$ in the 2007 period.

The following factors have impacted 2008 provision levels:
o growth in loan portfolio;

- increase in action list loans since year-end;
o identifying and addressing problem credits based on the recent deteriorating economic conditions.

Net charge-offs for the second quarter 2008 were $\$ 545$ or $0.05 \%$ of average loans as compared to $\$ 300$ or $0.03 \%$ reported in the first quarter 2008 and $\$ 5$ in net charge-offs reported in the second quarter 2007. Net charge-offs for the six months ended June 30,2008 were $\$ 845$ or $0.08 \%$ of average loans as compared to $\$ 233$ or $0.03 \%$ of average loans for the comparable period in 2007.

Management remains watchful of credit quality issues. Should the economic climate deteriorate from current levels, borrowers may experience difficulty, and the level of nonperforming loans, charge-offs and delinquencies could rise and require further increases in the provision. See "Nonperforming Assets" and "Other Potential Problem Loans" for further information.

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Noninterest Income
Noninterest income consists of a wide variety of fee-based revenues from bank-related service charges on deposits and mortgage revenues. Also included in this category are revenues generated by the Company's brokerage, trust and asset management services as well as increases in cash surrender value on bank-owned life insurance. The following table summarizes the Company's noninterest income:

|  | Three Months Ended June 30, |  |  |  | Six Months Ended June 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2008 |  | 2007 |  | 2008 |  | 2007 |  |
| Service charges |  | 1,875 |  | 1,969 |  | 3,511 |  | 3,5 |
| Trust income |  | 232 |  | 232 |  | 485 |  |  |
| Mortgage banking income |  | 389 |  | 449 |  | 835 |  |  |
| Brokerage commissions and fees |  | 66 |  | 104 |  | 168 |  |  |
| Bank owned life insurance |  | 254 |  | 247 |  | 506 |  |  |
| Securities gains, net |  | -- |  | (33) |  | 848 |  |  |
| Gain on sale of OREO |  | 142 |  | 491 |  | 238 |  |  |
| Gain on sale of Other Assets |  | 629 |  | -- |  | 1,111 |  |  |
| Other income |  | 705 |  | 735 |  | 1,528 |  | 1,2 |
| Total noninterest income | \$ | 4,292 | \$ | 4,194 | \$ | 9,230 | \$ | 7, 4 |

Noninterest income increased $\$ 98$ during the second quarter 2008 to $\$ 4,292$ as compared to $\$ 4,194$ for the same period in 2007. Excluding $\$ 771$ in gains on sale of branches and OREO properties from the second quarter 2008 and $\$ 491$ in OREO gains from the second quarter 2007, noninterest income decreased $\$ 182$ or $4.9 \%$. The decrease was primarily the result of a reduction in service charges on deposit accounts, fees received on items drawn on customer accounts with insufficient funds and revenue generated from the mortgage banking and wealth management business units.

Noninterest income totaled $\$ 9,230$ for the six months ended June 30, 2008, compared to $\$ 7,448$ for the same period in 2007. Excluding all net gains on sale of assets, OREO, and net securities gains for both periods, noninterest income increased $\$ 140$ or $2.0 \%$. This improvement was largely due to increases in fees collected for electronic banking services for debit cards and ATM machines.

## Noninterest Expense

Noninterest expense is comprised primarily of compensation and employee benefits, occupancy and other operating expense. The following table summarizes the Company's noninterest expense:

Three Months Ended
June 30,

Six Months Ended June 30,

|  | 2008 |  | 2007 |  | 2008 |  | 2007 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Salaries and employee benefits | \$ | 4,493 | \$ | 5,144 | \$ | 9,322 | \$ | 10, 2 |
| Occupancy expense, net |  | 919 |  | 1,019 |  | 1,957 |  | 1,9 |
| Furniture and equipment expense |  | 624 |  | 627 |  | 1,406 |  | 1,3 |
| Marketing |  | 315 |  | 221 |  | 551 |  |  |
| Supplies and printing |  | 99 |  | 156 |  | 230 |  |  |
| Telephone |  | 201 |  | 210 |  | 442 |  |  |
| Data processing |  | 231 |  | 276 |  | 534 |  |  |
| Amortization of intangible assets |  | 775 |  | 591 |  | 1,684 |  | 1,2 |
| Other expenses |  | 1,564 |  | 1,602 |  | 3,411 |  | 3,0 |
| Total noninterest expense | \$ | 9,221 | \$ | 9,846 | \$ | 19,537 | \$ | 19,7 |

Noninterest expense decreased $\$ 625$ to $\$ 9,221$ for the three months ended June 30 , 2008 as compared to $\$ 9,846$ for the same period in 2007 . Excluding nonrecurring charges of $\$ 563$ in 2008 and $\$ 716$ in 2007 , noninterest expense levels decreased $\$ 472$ or $5.2 \%$. The decrease was reported across most categories and was predominantly due to a reduction in the number of full-time equivalent employees which yielded lower salary and benefits costs.

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Noninterest expense totaled $\$ 19,537$ for the six months ended June 30, 2008, decreasing by $\$ 257$ or $1.3 \%$ from the same period in 2007 . Excluding nonrecurring charges of $\$ 1,307$ for 2008 and $\$ 716$ for 2007 , noninterest expense levels decreased $\$ 848$ or $4.4 \%$ for the first six months of 2008 as compared to 2007 . The change was largely reflective of the same items discussed regarding the second quarter.

## Applicable Income Taxes

Income tax expense for the periods included benefits for tax-exempt income, tax-advantaged investments and general business tax credits offset by the effect of nondeductible expenses. The following table shows the Company's income before income taxes, as well as applicable income taxes and the effective tax rate for the three and six months ended June 30, 2008 and 2007.

|  | Three Months Ended June 30, |  |  |  | Six Months Ended June 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2008 |  | 2007 |  | 2008 |  | 2007 |  |
| Income before income taxes | \$ | 4,209 | \$ | 3,613 | \$ | 7,768 | \$ | 6,242 |
| Applicable income taxes |  | 1,504 |  | 1,107 |  | 2,618 |  | 1,837 |
| Effective tax rates |  | 35.7\% |  | 30.6\% |  | 33.7\% |  | $29.4 \%$ |

The Company recorded an income tax expense of $\$ 1,504$ and $\$ 1,107$ for the three months ended June 30, 2008 and 2007, respectively. Effective tax rates equaled $35.7 \%$ and $30.6 \%$ respectively, for such periods. The Company recorded income tax expense of $\$ 2,618$ and $\$ 1,837$ for the six months ended June 30,2008 and 2007, respectively. Effective tax rates equaled $33.7 \%$ and $29.4 \%$ respectively, for such

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periods.
The Company's effective tax rate was lower than statutory rates due to several factors. First, the Company derives interest income from municipal securities and loans, which are exempt from federal tax and certain U. S. government agency securities, which are exempt from state tax. Also, the Company derives income from bank owned life insurance policies, which is exempt from federal and state tax. The increase in the effective tax rates over the prior year is driven by the higher pretax income and a decline in tax-exempt interest leading to higher federal taxes. In regard to the increased state tax expense, the growth in the Missouri branch and the changes in the Illinois tax code regarding apportionment rules resulted in higher state taxes for the applicable states.

## Earnings Review by Business Segment

The Company's internal reporting and planning process focuses on four primary lines of business: Retail, Commercial, Treasury and Wealth Management. See Note 7 of the Notes to Unaudited Consolidated Financial Statements for the presentation of the condensed income statement and total assets for each Segment.

The financial information presented was derived from the Company's internal profitability reporting system that is used by management to monitor and manage the financial performance of the Company. This information is based on internal management accounting policies which have been developed to reflect the underlying economics of the Segments and, to the extent practicable, to portray the Segment as if it operated on a stand alone basis. Thus, each Segment, in addition to its direct revenues and expenses, assets and liabilities, includes an allocation of shared support function expenses. The Retail, Commercial, Treasury, and Wealth Management Segments also include funds transfer adjustments to appropriately reflect the cost of funds on loans made and funding credits on deposits generated. Apart from these adjustments, the accounting policies used are similar to those described in Note 1 of the Notes to Consolidated Financial Statements.

Since there are no comprehensive authorities for management accounting equivalent to U.S. generally accepted accounting principles, the information presented is not necessarily comparable with similar information from other financial institutions. In addition, methodologies used to measure, assign and allocate certain items may change from time-to-time to reflect, among other things, accounting estimate refinements, changes in risk profiles, changes in customers or product lines and changes in management structure.

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Retail Segment. The Retail Segment ("Retail") provides retail banking services to individual customers through the Company's branch locations in Illinois and Missouri. The services provided by this Segment include direct lending, checking, savings, money market, CD accounts, safe deposit rental, ATM's and other traditional and electronic banking services.

Retail generated $\$ 1,901$ of net income in the second quarter of 2008 as compared to $\$ 806$ during same period in 2007. Year to date Retail Segment net income was $\$ 2,785$ as compared to $\$ 1,197$ for the same period in 2007. Retail assets were $\$ 294,634$ at June 30, 2008, $\$ 306,156$ at December 31, 2007 and

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$\$ 341,965$ as of June 30, 2007.

For the second quarter of 2008, net income increased due to the gain on sale of branches and stronger revenues on electronic banking products. Additionally, FTE's are lower which decreased the payroll and benefit costs for retail and core deposit amortization was lower. These positive variances were slightly offset by higher IT costs, debit card expenses, miscellaneous deposit expenses and miscellaneous expenses.

The change in net income for the six months ended June 30, 2008 was reflective of the same reasons discussed for the second quarter.

Commercial Segment. The Commercial Segment ("Commercial") provides commercial banking services to business customers served through the Company's full service branch channels located in Illinois and Missouri. The services provided by this Segment include lending, business checking and deposits, cash management, and other traditional as well as electronic commercial banking services.

Commercial had $\$ 2,542$ of net income in the second quarter of 2008 as compared to $\$ 1,918$ during same period in 2007. Year to date Commercial Segment net income was $\$ 3,144$ as compared to $\$ 3,541$ for the same period in 2007 . Commercial assets were $\$ 785,542$ at June 30, 2008, $\$ 741,861$ at December 31, 2007 and $\$ 685,656$ as of June $30,2007$.

Net income for the second quarter of 2008 increased as compared to the same period in 2007 due to the growth in the commercial loan portfolio which led to $30.3 \%$ increase in margin. Lower funding costs also helped increase the margin during the period. This increase was slightly offset by an increased provision due to the growth in the loan portfolio, identifying and addressing problem credits, and the recent deteriorating economic conditions. Additionally, noninterest income was lower as compared to 2007 due to the gain on sale of OREO recorded in 2007 as well as, payroll costs are higher than in 2007 due to an increase in the FTE's in this line of business.

For the six months ended June 30, 2008, the change in net income was largely due to the higher provision taken during the second quarter as discussed in "Provision for Loan Losses" section.

Treasury Segment. The Treasury Segment ("Treasury") is responsible for managing the investment portfolio and acquiring funding for loan activity. Treasury had a net loss of (\$11) in the second quarter of 2008 and generated net income of $\$ 434$ during same period in 2007. Year to date Treasury Segment net income was $\$ 610$ as compared to $\$ 390$ for the same period in 2007. Treasury assets were $\$ 216,047$ at June 30, 2008, $\$ 268,484$ at December 31, 2007 and $\$ 281,329$ as of June 30, 2007.

Treasury's net income for second quarter declined in comparison to 2007 results due to the approximately $\$ 83,000$ in discounted agency securities called during first quarter which resulted in fewer earning assets to generate revenue during the period. Additionally, since assets were lower than in 2007, net allocated expenses were lower due to the decreased asset base. These positive variances were augmented by a tax benefit for the period.

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Net income for the first six months of 2008 decreased in comparison to 2007 due to the discounted agency securities called during first quarter as mentioned previously which led to lower net interest income that was offset partially by the net gain on sale of $\$ 848$. Offsetting this negative variance was lower net allocated expenses attributed to the decreased asset base and lower income taxes.

Wealth Management Segment. The Wealth Management Segment ("Wealth") provides trust services, estate administration, financial planning, employee benefit plan administration, asset management, and brokerage transaction services.

Wealth had a loss of $\$(347)$ during the second quarter 2008 as compared to $\$(109)$ in same period in 2007. Year to date Wealth generated a loss of $\$(472)$ as compared to $\$(225)$ for the same period in 2007 . Wealth assets were $\$ 597$ at June 30, 2008, \$1,289 at December 31, 2007 and $\$ 1,396$ as of June 30, 2007.

Assets and earnings decreased due to the $\$ 297$ write-down of goodwill for its business lines in the second quarter.

The results for the first six months of 2008 decreased over the same period in 2007 due to the write-down of $\$ 694$ of goodwill during the first and second quarters of 2008. This negative variance was slightly offset by increased earnings and other costs being lower during the period.

Financial Condition

General

As of June 30, 2008, the following are the highlights of the balance sheet when compared to December 31, 2007:

- Outstanding loans totaled $\$ 1,003,689$ at June 30, 2008 compared to $\$ 957,285$ at December 31, 2007, representing an increase of $\$ 46,404$ or $4.8 \%$. The loan growth was largely generated in the St. Louis market and was concentrated in commercial real estate. Excluding $\$ 30,100$ in loans related to branch sales recorded in the first and second quarters of 2008 , loans grew $\$ 76,500$ or $8.0 \%$ since year-end 2007 . The Company has no direct exposure to subprime mortgages.
- Deposits totaled $\$ 1,011,723$ at June 30,2008 compared to $\$ 1,033,022$ at December 31, 2007, representing a decrease of $\$ 21,299$ or $2.1 \%$. The decrease was experienced across most types with a significant portion coming from higher costing time deposits. Excluding $\$ 54,700$ in deposits related to branch sales recorded in the first and second quarters of 2008, deposits increased $\$ 32,400$ or $3.1 \%$ since year-end 2007 . This increase was due to an overall increase in core deposits which grew 8.0\%.
o The Company's consolidated securities portfolio is managed to minimize interest rate risk, maintain sufficient liquidity and maximize return. Total securities fair market value declined $\$ 5,400$ from March 31, 2008 and $\$ 6,979$ from December 31, 2007.
o Management believes that the decline in fair market value was attributable to interest rate factors, general market risk repricing, and lack of liquidity in the capital markets verses an underlying collateral or credit quality issues of $a$ particular investment. As such, we do not believe any
individual unrealized losses as of June 30, 2008 represent other-than-temporary impairment based on the following factors:


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o No holdings have been downgraded below investment grade by any of the rating agencies.
o We have no knowledge that any of our direct investments consists of sub prime loans.
o We've obtained updated cash flow projections on all of our Trust Preferred issuances. Based on this analysis and our review, these instruments have cash flows sufficient to cover any scheduled principle and interest payments.
o The Company has both the intent and ability to hold each of the securities shown in the table for the time necessary to recover its amortized cost.

## Nonperforming Assets

If a loan is placed on nonaccrual status, the loan does not generate current period income for the Company. Loans are placed on nonaccrual status when there are serious doubts regarding the collectibility of all principal and interest due under the terms of the loans. Amounts received on nonaccrual loans generally are applied first to principal and then to interest after all principal has been collected. A loan is generally transferred to nonaccrual status if it is not in the process of collection and is delinquent in payment of either principal or interest beyond 90 days. Other nonperforming assets consist of real estate acquired through loan foreclosures or other workout situations and other assets acquired through repossessions.

The classification of a loan as nonaccrual does not necessarily indicate that the principal is uncollectible, in whole or in part. The Bank makes a determination as to collectibility on a case-by-case basis. The Bank considers both the adequacy of the collateral and the other resources of the borrower in determining the steps to be taken to collect nonaccrual loans. The final determination as to the steps taken is made based upon the specific facts of each situation. Alternatives that are typically considered to collect nonaccrual loans are foreclosure, collection under guarantees, loan restructuring or judicial collection actions.

Each of the Company's loans is assigned a rating based upon an internally developed grading system. A separate credit administration department also reviews grade assignments on an ongoing basis. Management continuously monitors nonperforming, impaired and past due loans to prevent further deterioration of these loans. The Company has an independent loan review function which is separate from the lending function and is responsible for the review of new and existing loans.

The following table summarizes nonperforming assets and loans past due 90 days or more for the previous five quarters.

|  | 2008 |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Jun 30, |  | Mar 31, |  | Dec 31, |  |  |
| Nonaccrual loans | \$ | 19,808 | \$ | 4,057 | \$ | 4,090 | \$ |
| Loans 90 days past due and still accruing interest |  | -- |  | -- |  | -- |  |
| Total nonperforming loans |  | 19,808 |  | 4,057 |  | 4,090 |  |
| Other real estate owned |  | 4,317 |  | 1,153 |  | 2,937 |  |
| Total nonperforming assets | \$ | 24,125 | \$ | 5,210 | \$ | 7,027 | \$ |
| Nonperforming loans to total end of period loans |  | 1.97\% |  | $0.44 \%$ |  | $0.43 \%$ |  |
| Nonperforming assets to total end of period loans |  | $2.40 \%$ |  | $0.57 \%$ |  | $0.73 \%$ |  |
| Nonperforming assets to total end of period assets |  | 1.76\% |  | $0.38 \%$ |  | $0.51 \%$ |  |

The level of nonperforming loans at June 30,2008 increased to $\$ 19,808$ versus $\$ 4,058$ that existed at March 31, 2008 and $\$ 4,090$ that existed as of December 31, 2007. As previously disclosed in its quarterly report on Form 10-Q for the first quarter 2008 filed on May 9, 2008, the Company is engaging in an ongoing review of its commercial real estate loan portfolio. This review prompted the identification of two large problem relationships aggregating $\$ 28,000$ in late March and early-April. Upon further analysis and deterioration of these two relationships, action plans were implemented to address these loans which resulted in $\$ 20,000$ related to these loans being classified as nonperforming loans during the second quarter 2008.

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One relationship, totaling $\$ 16,300$, is currently in foreclosure which is expected to be completed in the third quarter. The Company's exposure was reduced by extinguishing an unfunded commitment of $\$ 100$ and a $\$ 500$ write down during the second quarter. Marketing efforts are under way and, management has entered into a contract for $\$ 6,800$ to sell one parcel of the collateral and anticipates selling all of the underlying collateral prior to year-end.

The second relationship, totaling $\$ 11,100$, included a $\$ 7,300$ loan which is currently being restructured and is expected to continue as a performing relationship. Of the remaining balance, the Company successfully foreclosed on the property securing a $\$ 3,800$ loan. This foreclosed property is now under contract and management anticipates closing on the sale of this property prior to year-end.

The level of nonperforming loans to total end of period loans was $1.97 \%$ at June 30, 2008, as compared to 0.43\% at December 31, 2007 and $0.40 \%$ at March 31, 2008. The reserve coverage ratio (allowance to nonperforming loans) was reported at $58.27 \%$ as of June 30,2008 as compared to $262.96 \%$ as of December 31, 2007 and $276.52 \%$ as of March 31, 2008. In light of current market conditions, the Company is continuing to review its commercial real estate loan portfolio.

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## Other Potential Problem Loans

The Company has other potential problem loans that are currently performing, but where some concerns exist as to the ability of the borrower to comply with present loan repayment terms. Excluding nonperforming loans and loans that management has classified as impaired, these other potential problem loans totaled $\$ 1,039$ at June 30, 2008 as compared to $\$ 2,044$ at June 30,2007 and $\$ 1,485$ at December 31, 2007. The classification of these loans, however, does not imply that management expects losses on each of these loans, but believes that a higher level of scrutiny and close monitoring is prudent under the circumstances. Such classifications relate to specific concerns for each individual borrower and do not relate to any concentration risk common to all loans in this group.

## Allowance for Loan Losses

At June 30, 2008, the allowance for loan losses was $\$ 11,542$ or $1.15 \%$ of total loans as compared to $\$ 10,755$ or $1.12 \%$ at December 31, 2007. The allowance was $1.15 \%$ of total loans outstanding at June 30, 2008, compared to $1.10 \%$ reported at March 31, 2008 and 1.12\% as of December 31, 2007. In originating loans, the Company recognizes that credit losses will be experienced and the risk of loss will vary with, among other things, the following:

- general economic conditions;
the type of loan being made;
the creditworthiness of the borrower over the term of the
loan;
in the case of a collateralized loan, the quality of the
collateral for such a loan.

The allowance for loan losses represents the Company's estimate of the allowance necessary to provide for probable incurred losses in the loan portfolio by analyzing the following:

> - ultimate collectibility of the loans in its portfolio;
> - incorporating feedback provided by internal loan staff;
> - the independent loan review function;
> - results of examinations performed by regulatory agencies.

The Company regularly evaluates the adequacy of the allowance for loan losses. Commercial credits are graded using a system that is in compliance with regulatory classifications by the loan officers and the loan review function validates the officers' grades. In the event that the loan review function downgrades the loan, it is included in the allowance analysis at the lower

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grade. To establish the appropriate level of the allowance, a sample of loans

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(including impaired and nonperforming loans) are reviewed and classified as to potential loss exposure.

Based on an estimation computed pursuant to the requirements of Financial Accounting Standards Board ("FASB") Statement No. 5, "Accounting for Contingencies," and FASB Statements Nos. 114 and 118, "Accounting by Creditors for Impairment of a Loan," the analysis of the allowance for loan losses consists of three components:
o specific credit allocation established for expected losses resulting from analysis developed through specific credit allocations on individual loans for which the recorded investment in the loan exceeds its fair value;
o general portfolio allocation based on historical loan loss experience for each loan category;
o subjective reserves based on general economic conditions as well as specific economic factors in the markets in which the Company operates.

The specific credit allocation component of the allowance for loan losses is based on a regular analysis of loans over a fixed-dollar amount where the internal credit rating is at or below a predetermined classification. The fair value of the loan is determined based on either the present value of expected future cash flows discounted at the loan's effective interest rate, the market price of the loan, or, if the loan is collateral dependent, the fair value of the underlying collateral less cost of sale.

The general portfolio allocation component of the allowance for loan losses is determined statistically using a loss migration analysis that examines historical loan loss experience. The loss migration analysis is performed quarterly and loss factors are updated regularly based on actual experience. The general portfolio allocation element of the allowance for loan losses also includes consideration of the amounts necessary for concentrations and changes in portfolio mix and volume.

The allowance for loan losses is based on estimates, and ultimate losses will vary from current estimates. These estimates are reviewed monthly, and as adjustments, either positive or negative, become necessary, a corresponding increase or decrease is made in the provision for loan losses. The methodology used to determine the adequacy of the allowance for loan losses is consistent with prior years.

Management remains watchful of credit quality issues. Should the economic climate deteriorate from current levels, borrowers may experience difficulty, and the level of nonperforming loans, charge-offs and delinquencies could rise and require further increases in the provision.

> Liquidity

The Company manages its liquidity position with the objective of maintaining sufficient funds to respond to the needs of depositors and borrowers and to take advantage of earnings enhancement opportunities. In addition to the normal inflow of funds from core-deposit growth together with repayments and maturities of loans and investments, the Company utilizes other short-term funding sources such as brokered time deposits, securities sold under agreements to repurchase, overnight federal funds purchased from correspondent banks and the acceptance of short-term deposits from public entities and Federal Home Loan Bank advances.

The Company monitors and manages its liquidity position on several bases, which vary depending upon the time period. As the time period is expanded, other data

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is factored in, including estimated loan funding requirements, estimated loan payoffs, investment portfolio maturities or calls and anticipated depository buildups or runoffs.

The Company classifies all of its securities as available-for-sale, thereby maintaining significant liquidity. The Company's liquidity position is further enhanced by structuring its loan portfolio interest payments as monthly and by

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the significant representation of retail credit and residential mortgage loans in the Company's loan portfolio, resulting in a steady stream of loan repayments. In managing its investment portfolio, the Company provides for staggered maturities so that cash flows are provided as such investments mature.

The Company's cash flows are comprised of three classifications: cash flows from operating activities, cash flows from investing activities and cash flows from financing activities. Cash flows provided by operating activities and financing activities offset by those used in investing activities, resulted in a net decrease in cash and cash equivalents of $\$ 3,390$ from December 31, 2007 to June 30, 2008.

During the first six months of 2008, the Company experienced net cash outflows of $\$ 67,117$ in investing activities primarily due to an increase in loans and purchases of securities. In contrast, net cash inflows of $\$ 61,423$ were provided by financing activities largely due to the net growth in deposits and issuance of debt and $\$ 2,304$ was provided by operations.

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Contractual Obligations, Commitments, Contingencies, and Off-Balance Sheet
Financial Instruments

The Company has entered into contractual obligations and commitments and off-balance sheet financial instruments. The following tables summarize the Company's contractual cash obligations and other commitments and off balance sheet instruments as of June 30, 2008.

Within 1
Year 1 - 3 Years $4-5$ Years
Short-term debt
Long-term debt
Certificates of deposit
Operating leases
Severance payments
Series B mandatory redeemable
preferred stock
Subordinated debentures
FHLB advances
Total contractual cash obligations

| \$ | 10,893 | \$ | -- | \$ | - |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | 160 |  | 2,345 |  | 2,285 |
|  | 467,456 |  | 58,652 |  | 8,659 |
|  | 348 |  | 594 |  | 613 |
|  | 105 |  | -- |  | -- |
|  | -- |  | 831 |  | -- |
|  | -- |  | -- |  | -- |
|  | 92,037 |  | 31,200 |  | -- |
| \$ | 570,999 | \$ | 93,622 | \$ | 11,557 |

Amount of Commitment Expiration Per

| Within 1 |  |  |
| :---: | :---: | :---: |
| Year | $1-3$ Years | $4-5$ Years |

Off-Balance Sheet Financial Instruments

```
Lines of credit
Standby letters of credit
```

Total contractual cash obligations

| \$ | 170,478 | \$ | 46,002 | \$ | 3,487 |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | 6,464 |  | 6,167 |  | -- |
| \$ | 176,942 | \$ | 52,169 | \$ | 3,487 |

\$
\$
$====$

## Capital Resources

## Stockholders' Equity

The Company is committed to managing capital for maximum shareholder benefit and maintaining strong protection for depositors and creditors. Stockholders' equity at June 30,2008 was $\$ 116,607$, a decrease of $\$ 2,269$ or $1.9 \%$ from December 31 , 2007. The change in stockholders' equity was largely the result of a decrease in accumulated other comprehensive income due to a reduction in the fair market value of available-for-sales securities, postretirement liability adjustment related to the adoption of FASB Issue No. 06-4 and modest repurchase activity transacted in the first quarter 2008. Average quarterly equity as a percentage of average quarterly assets was $8.61 \%$ at June 30,2008 , compared to $8.75 \%$ at December 31, 2007. Book value per common share equaled $\$ 19.26$ at June 30,2008 compared to $\$ 19.50$ at December 31, 2007 .

## Stock Repurchase

The Company did not repurchase shares of stock during the quarter ended June 30 , 2008. The 2006 repurchase program approved on November 13, 2006 authorized the Company to repurchase up to $5 \%$ or 370,000 shares of common stock. This plan was completed in the fourth quarter 2007 . The 2007 repurchase program approved on July 24, 2007 authorized the Company to repurchase an additional 500,000 shares, or approximately $8 \%$ of the Company's currently issued and outstanding shares, in the open market or privately negotiated transactions over an 18 month period commencing immediately following the completion of the 2006 stock repurchase program. The expiration date of this program is January 24, 2009. Unless terminated earlier by resolution of our board of directors, the program will expire on the earlier of such expiration date or when we have repurchased all shares authorized for repurchase under the program.

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## Capital Measurements

As discussed in Note 8, the Company's current debt agreements include a covenant that require the Bank to maintain the status of being well capitalized which is a ratio of $10.0 \%$ for total risk based capital. The Bank is expected to meet a minimum risk-based capital to risk-weighted assets ratio of $8 \%$, of which at least one-half (or $4 \%$ ) must be in the form of Tier 1 (core) capital. The remaining one-half (or $4 \%$ ) may be in the form of Tier 1 (core) or Tier 2 (supplementary) capital. The amount of loan loss allowance that may be included in capital is limited to $1.25 \%$ of risk-weighted assets. The ratio of Tier 1 (core) and the combined amount of Tier 1 (core) and Tier 2 (supplementary) capital to risk-weighted assets for the Company was $9.3 \%$ and $11.2 \%$, respectively, at June 30,2008 . The Company is currently, and expects to continue to be, in compliance with these guidelines.

The following table sets forth an analysis of the Company's capital ratios:

|  | $\begin{gathered} \text { June 30, } \\ 2008 \end{gathered}$ |  | December 31, |  |  |  | Minimum Capital Ratios | Well <br> Capitalize Ratios |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  | 2007 |  | 2006 |  |  |
| Tier 1 risk-based capital | \$ | 105,447 | \$ | 101,831 | \$ | 99,869 |  |  |
| Tier 2 risk-based capital |  | 21,542 |  | 10,755 |  | 10,835 |  |  |
| Total capital |  | 126,989 | \$ | 112,586 | \$ | 110,704 |  |  |
| Risk-weighted assets |  | 137,096 |  | 102,602 | \$ | 926,874 |  |  |
| Capital ratios: |  |  |  |  |  |  |  |  |
| Tier 1 risk-based capital |  | 9.3\% |  | 9.2\% |  | 10.8\% | 4.0\% | 6.0 |
| Total risk-based capital |  | 11.2\% |  | 10.2\% |  | 11.9\% | 8.0\% | 10.0 |
| Leverage ratio |  | 7.9\% |  | 7.7\% |  | 7.9\% | 4.0\% | 5.0 |

Recent Regulatory and Accounting Developments
See Note 11 to the Unaudited Consolidated Financial Statements for information concerning recent regulatory and accounting developments.

Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995
This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Act of 1934 as amended. The Company intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 and is including this statement for purposes of these safe harbor provisions. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies, and expectations of the Company, are generally

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identified by the use of words such as "believe," "expect," "intend," "anticipate," "estimate," "project," "planned" or "potential" or similar expressions.

In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, the Company is hereby identifying important factors that could effect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any forward-looking statements.

Among the factors that could have an impact on the Company's ability to achieve operating results and the growth plan goals are as follows:
o management's ability to reduce and effectively manage interest rate risk and the impact of interest rates in general on the volatility of the Company's net interest income;
o fluctuations in the value of the Company's investment securities;
31.

CENTRUE FINANCIAL CORPORATION
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)
o the Company's ability to ultimately collect on any downgraded long-standing loan relationships;
o the Company's ability to adapt successfully to technological changes to compete effectively in the marketplace;
o credit risks and risks from concentrations (by geographic area and by industry) within the Company's loan portfolio and individual large loans;
o volatility of rate sensitive deposits;
o operational risks, including data processing system failures or fraud;
o asset/liability matching risks and liquidity risks;
o the ability to successfully acquire low cost deposits or funding;
o the ability to successfully execute strategies to increase noninterest income;
o the ability to successfully grow non-commercial real estate loans;
o the ability of the Company to fully realize expected cost savings and revenue generation opportunities in connection with the synergies of merging with the former Centrue Bank;
o the ability to adopt and implement new regulatory requirements as dictated by the SEC, FASB or other rule-making bodies which

govern our industry;

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changes in the general economic or industry conditions, nationally or in the communities in which the company conducts business.

CENTRUE FINANCIAL CORPORATION
ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Sensitivity Management

The Company performs a net interest income analysis as part of its asset/liability management practices. The net interest income analysis measures the change in net interest income in the event of hypothetical changes in interest rates. This analysis assesses the risk of changes in net interest income in the event of a sudden and sustained 100 to 200 basis point increase in market interest rates or a 100 to 200 basis point decrease in market rates. The interest rates scenarios are used for analytical purposes and do not necessarily represent management's view of future market movements. The tables below present the Company's projected changes in net interest income for the various rate shock levels at June 30,2008 and December 31, 2007 , respectively:

|  |  |  |  | $\begin{aligned} & \text { Net } \mathrm{I} \\ & \text { One Ye } \end{aligned}$ |  | Incom izon |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | June |  |  | ecember | 07 |
|  |  |  |  |  |  |  |  |
|  |  |  | \$ | \% |  | \$ | \% |
| $+$ | 200 bp | \$ | 583 | 1. $49 \%$ | \$ | 305 | $0.74 \%$ |
| $+$ | 100 bp |  | 409 | 1.04 |  | 509 | 1.23 |
|  | Base |  | -- | -- |  | -- | -- |
| - | 100 bp |  | (463) | (1.18) |  | $(1,410)$ | (3.41) |
| - | 200 bp |  | $(1,574)$ | (4.01) |  | $(3,109)$ | (7.51) |

As shown above, the Company's model at June 30,2008 , the effect of an immediate 200 basis point increase in interest rates would increase the Company's net interest income by $\$ 583$ or $1.49 \%$. The effect of an immediate 200 basis point decrease in rates would decrease the Company's net interest income by $\$ 1,574$ or 4.01\%.

Management continues to position our balance sheet to maximize the net interest margin as steps were taken to adjust our funding costs to react to the rate reductions that were announced in the first 6 months of 2008 . The mix of our funding portion of the balance sheet has been adjusted to align it with our asset sensitive portion of the balance sheet to create better spreads in various

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sectors. With these changes, we have been able to reposition our funding and align it better with the shorter end of the yield curve which minimizes our exposure to the volatility found at the longer end of the yield curve.

Computations of the prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates, loan prepayments and deposit decay rates and should not be relied upon as indicative of actual results. Actual values may differ from those projections set forth above, should market conditions vary from the assumptions used in preparing the analysis. Further, the computations do not contemplate actions the Company may undertake in response to changes in interest rates.

CENTRUE FINANCIAL CORPORATION
ITEM 4. CONTROLS AND PROCEDURES
(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

Item 4. Controls and Procedures

As of the end of the period covered by this report, the Company carried out an evaluation under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the Company's disclosure controls and procedures (as defined in Rule 13a-15 (e) and 15d-15 (e) under the Securities and Exchange Act of 1934, as amended). Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective in timely alerting them to material information relating to the Company required to be included in the Company's periodic filings with the Securities and Exchange Commission. It should be noted that in designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. The Company has designed its disclosure controls and procedures to reach a level of reasonable assurance of achieving the desired control objectives and, based on the evaluation described above, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective at reaching that level of reasonable assurance.

There was no change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) during the Company's most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## 34.

## PART II - OTHER INFORMATION

Item 1. Legal Proceedings

In the normal course of business the Company may be involved in various legal proceedings from time to time. The Company does not believe it is currently involved in any claim or action the ultimate disposition of which would have a material adverse effect on the Company's financial statements.

Item 1A. Risk Factors

The Company did not experience any material changes in the Risk Factors during the Company's most recently completed fiscal quarter. For specific information about the risks facing the Company refer to the Company's Annual Report on Form $10-\mathrm{K}$ for the year ended December 31, 2007.

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

The following table provides information about purchases of the Company's common stock by the Company during the quarter ended June 30, 2008.

(1) The Company repurchased no shares of stock during the quarter ended June 30, 2008. The 2006 repurchase program approved on November 13, 2006 authorized the Company to repurchase up to $5 \%$ or 370,000 shares of common stock. This plan was completed in the fourth quarter 2007. The 2007 repurchase program approved on July 24,2007 authorized the Company to repurchase an additional 500,000 shares, or approximately $8 \%$ of the Company's currently issued and outstanding shares, in the open market or privately negotiated transactions over an 18 month period commencing immediately following the completion of the 2006 stock repurchase program. The expiration date of this program is January 24, 2009. Unless terminated earlier by resolution of our board of directors, the program will expire on the earlier of such expiration date or when we have repurchased all shares authorized for repurchase under the program.

Item 3. Defaults Upon Senior Securities

None.
35.

Item 4. Submission of Matters to a Vote of Security Holders

At the April 23, 2008 annual meeting of stockholders, Richard J. Berry, Walter E. Breipohl and Randall E. Ganim were elected to serve as Class I directors until 2011. Continuing as Class II directors until 2009 are Michael A.

Griffith, Michael J. Hejna and John A. Shinkle. Continuing as Class III directors until 2010 are Thomas A. Daiber, Dennis J. McDonnell, Mark L. Smith and Scott C. Sullivan.

There were $6,470,840$ issued and outstanding shares of common stock entitled to vote at the annual meeting. The voting on each item presented at the annual meetings was as follows:

|  | For | Withheld |
| :---: | ---: | ---: |
| Election of Directors | ------- |  |
| Richard J. Berry | $5,438,442$ | 109,915 |
| Walter E. Breipohl | $5,462,248$ | 86,109 |
| Randall E. Ganim | $5,462,395$ | 85,962 |

Item 5. Other Information

None

Item 6. Exhibits

Exhibits:
31.1 Certification of Thomas A. Daiber, President and Principal Executive Officer, required by Rule 13a - 14(a).
31.2 Certification of Kurt R. Stevenson, Senior Executive Vice President and Principal Financial and Accounting Officer required by Rule 13a - 14 (a).
32.1(1) Certification Pursuant to 18 U.S.C. Section 1350 , as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, from the Company's President and Principal Executive Officer.
32.2(1) Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, from the Company's Senior Executive Vice President and Principal Financial and Accounting Officer.
(1) This certification is not "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.
36.

## SIGNATURES

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

CENTRUE FINANCIAL CORPORATION

Date: August 8, 2008
By: /s/ Thomas A. Daiber
Thomas A. Daiber President and Principal Executive

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Date: August 8, 2008

By: /s/ Kurt R. Stevenson<br>Kurt R. Stevenson<br>Senior Executive Vice President and Principal Financial and Accounting Officer

37. 

[^0]:    (1) Average balance and average rate on securities classified as

