

FIRST INTERSTATE BANCSYSTEM INC  
Form 10-Q  
August 07, 2009

**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, 2009**

**OR**

**Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**COMMISSION FILE NUMBER 000-49733**

**First Interstate BancSystem, Inc.**

(Exact name of registrant as specified in its charter)

Montana

81-0331430

(State or other jurisdiction of  
incorporation or organization)

(IRS Employer  
Identification No.)

401 North 31st Street, Billings, MT 59116-0918

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: 406/255-5390

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting

(Do not check if a

company

Smaller Reporting

Company)

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of the Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.)

Yes  No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The Registrant had 7,824,892 shares of common stock outstanding on July 31, 2009.



FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES  
Quarterly Report on Form 10-Q

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**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES****Consolidated Balance Sheets***(In thousands, except share data)*

(Unaudited)

|   | June 30,<br>2009 | December 31,<br>2008 |
|---|------------------|----------------------|
| Assets  |                  |                      |
| Cash and due from banks   | \$ 223,192       | \$ 205,070           |
| Federal funds sold  | 327,019          | 107,502              |
| Interest bearing deposits in banks  | 1,696            | 1,458                |
| Total cash and cash equivalents   | 551,907          | 314,030              |
| Investment securities:  |                  |                      |
| Available-for-sale  | 953,977          | 961,914              |
| Held-to-maturity (estimated fair values of \$101,545 as of June 30, 2009 and \$109,809 as of December 31, 2008) | 101,615          | 110,362              |
| Total investment securities   | 1,055,592        | 1,072,276            |
| Loans   | 4,665,550        | 4,772,813            |
| Less allowance for loan losses  | 98,395           | 87,316               |
| Net loans   | 4,567,155        | 4,685,497            |
| Premises and equipment, net   | 189,349          | 177,799              |
| Goodwill  | 183,673          | 183,673              |
| Core deposit intangible assets, net of accumulated amortization   | 11,611           | 12,682               |
| Company-owned life insurance  | 70,223           | 69,515               |
| Accrued interest receivable   | 38,272           | 38,694               |
| Other real estate owned   | 31,789           | 6,025                |
| Mortgage servicing rights, net of accumulated amortization and impairment reserve                               | 20,565           | 11,002               |
| Net deferred tax asset  | 4,146            | 7,401                |
| Other assets  | 52,636           | 49,753               |
| Total assets  | \$ 6,776,918     | \$ 6,628,347         |
| Liabilities and Stockholders Equity   |                  |                      |
| Deposits:   |                  |                      |
| Non-interest bearing  | \$ 986,830       | \$ 985,155           |
| Interest bearing  | 4,538,485        | 4,189,104            |
| Total deposits  | 5,525,315        | 5,174,259            |
| Federal funds purchased   |                  | 30,625               |
| Securities sold under repurchase agreements   | 368,442          | 525,501              |
| Accrued interest payable  | 22,694           | 20,531               |

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|  |              |              |
|--|--------------|--------------|
| Accounts payable and accrued expenses  | 44,857       | 51,290       |
| Other borrowed funds   | 58,383       | 79,216       |
| Long-term debt   | 79,644       | 84,148       |
| Subordinated debentures held by subsidiary trusts  | 123,715      | 123,715      |
| <br>   |              |              |
| Total liabilities  | 6,223,050    | 6,089,285    |
| <br>   |              |              |
| Stockholders' equity:  |              |              |
| Nonvoting noncumulative preferred stock without par value; authorized 100,000 shares; issued and outstanding 5,000 shares as of June 30, 2009 and December 31, 2008    | 50,000       | 50,000       |
| Common stock without par value; authorized 20,000,000 shares; issued and outstanding 7,824,892 shares as of June 30, 2009 and 7,887,519 shares as of December 31, 2008 | 111,150      | 117,613      |
| Retained earnings  | 382,153      | 362,477      |
| Accumulated other comprehensive income, net  | 10,565       | 8,972        |
| <br>   |              |              |
| Total stockholders' equity   | 553,868      | 539,062      |
| <br>   |              |              |
| Total liabilities and stockholders' equity   | \$ 6,776,918 | \$ 6,628,347 |

*See accompanying notes to unaudited consolidated financial statements.*

**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES****Consolidated Statements of Income***(In thousands, except per share data)*

(Unaudited)

|   | For the three months<br>ended June 30, |           | For the six months<br>ended June 30, |            |
|---|--|-----------|--------------------------------------|------------|
|   | 2009                                   | 2008      | 2009                                 | 2008       |
| Interest income:  |  |           |                                      |            |
| Interest and fees on loans                                    | \$ 69,655                              | \$ 75,197 | \$ 139,773                           | \$ 152,763 |
| Interest and dividends on investment securities:              |  |           |                                      |            |
| Taxable   | 9,952                                  | 11,065    | 20,221                               | 22,458     |
| Exempt from federal taxes                                     | 1,374                                  | 1,508     | 2,781                                | 3,004      |
| Interest on deposits in banks                                 | 4                                      | 37        | 8                                    | 165        |
| Interest on federal funds sold                                | 163                                    | 261       | 248                                  | 787        |
| Total interest income   | 81,148                                 | 88,068    | 163,031                              | 179,177    |
| Interest expense:   |  |           |                                      |            |
| Interest on deposits  | 18,929                                 | 24,003    | 38,433                               | 51,138     |
| Interest on federal funds purchased                           |  | 491       | 10                                   | 772        |
| Interest on securities sold under repurchase agreements       | 175                                    | 1,791     | 418                                  | 5,102      |
| Interest on other borrowed funds                              | 418                                    | 354       | 976                                  | 426        |
| Interest on long-term debt                                    | 798                                    | 1,145     | 1,639                                | 2,352      |
| Interest on subordinated debentures held by subsidiary trusts | 1,638                                  | 1,913     | 3,302                                | 4,213      |
| Total interest expense  | 21,958                                 | 29,697    | 44,778                               | 64,003     |
| Net interest income   | 59,190                                 | 58,371    | 118,253                              | 115,174    |
| Provision for loan losses                                     | 11,700                                 | 5,321     | 21,300                               | 7,684      |
| Net interest income after provision for loan losses           | 47,490                                 | 53,050    | 96,953                               | 107,490    |
| Non-interest income:  |  |           |                                      |            |
| Income from origination and sale of loans                     | 10,359                                 | 3,323     | 20,592                               | 6,702      |
| Other service charges, commissions and fees                   | 6,616                                  | 7,162     | 13,567                               | 14,026     |
| Service charges on deposit accounts                           | 5,071                                  | 4,972     | 9,849                                | 9,845      |
| Wealth management revenues                                    | 2,663                                  | 3,304     | 5,186                                | 6,533      |
| Investment securities gains, net                              | 5                                      | 13        | 52                                   | 74         |
| Technology services revenues                                  |  | 4,363     |                                      | 8,713      |
| Other income  | 1,904                                  | 2,088     | 3,315                                | 5,701      |
| Total non-interest income                                     | 26,618                                 | 25,225    | 52,561                               | 51,594     |
| Non-interest expense:   |  |           |                                      |            |
| Salaries, wages and employee benefits                         | 29,543                                 | 29,720    | 57,554                               | 58,065     |
| FDIC insurance premiums                                       | 5,528                                  | 719       | 7,364                                | 909        |

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|   |           |           |           |           |
|---|-----------|-----------|-----------|-----------|
| Occupancy, net                                | 3,795     | 3,979     | 7,742     | 8,243     |
| Furniture and equipment                       | 3,011     | 4,886     | 6,023     | 9,513     |
| Outsourced technology services                | 3,283     | 841       | 5,954     | 1,853     |
| Mortgage servicing rights amortization        | 2,145     | 1,431     | 5,067     | 2,796     |
| Core deposit intangible amortization          | 536       | 641       | 1,071     | 1,221     |
| Mortgage servicing rights impairment recovery | (4,418)   | (4,297)   | (7,265)   | (745)     |
| Other expenses                                | 10,665    | 11,741    | 20,753    | 20,961    |
| <br>  |           |           |           |           |
| Total non-interest expense                    | 54,088    | 49,661    | 104,263   | 102,816   |
| <br>  |           |           |           |           |
| Income before income taxes                    | 20,020    | 28,614    | 45,251    | 56,268    |
| Income tax expense                            | 6,684     | 9,988     | 15,227    | 19,566    |
| <br>  |           |           |           |           |
| Net income                                    | 13,336    | 18,626    | 30,024    | 36,702    |
| Preferred stock dividends                     | 853       | 853       | 1,697     | 1,622     |
| <br>  |           |           |           |           |
| Net income available to common stockholders   | \$ 12,483 | \$ 17,773 | \$ 28,327 | \$ 35,080 |
| <br>  |           |           |           |           |
| Basic earnings per common share               | \$ 1.59   | \$ 2.27   | \$ 3.61   | \$ 4.45   |
| <br>  |           |           |           |           |
| Diluted earnings per common share             | \$ 1.57   | \$ 2.22   | \$ 3.56   | \$ 4.36   |

*See accompanying notes to unaudited consolidated financial statements.*

**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Changes In Stockholders Equity**  
*(In thousands, except share and per share data)*  
(Unaudited)

|   | For the six months<br>ended June 30, |            |
|---|--------------------------------------|------------|
|   | 2009                                 | 2008       |
| Total stockholders equity at beginning of period  | \$ 539,062                           | \$ 444,443 |
| Cumulative effect of adoption of new accounting principle on January 1, 2008  |                                      | (633)      |
| Comprehensive income:   |                                      |            |
| Net income  | 30,024                               | 36,702     |
| Other comprehensive income (loss):  |                                      |            |
| Post-retirement liability adjustment, net of income tax effect of \$483 in 2009 and \$14 in 2008  | (743)                                | (22)       |
| Unrealized gains (losses) on available-for-sale investment securities, net of income tax effect of \$1,536 in 2009 and \$498 in 2008  | 2,368                                | (768)      |
| Less reclassification adjustments for gains included in net income, net of income tax effect of \$20 in 2009 and \$29 in 2008   | (32)                                 | (45)       |
| Other comprehensive income (loss)   | 1,593                                | (835)      |
| Total comprehensive income  | 31,617                               | 35,867     |
| Preferred stock transactions:   |                                      |            |
| Preferred shares issued, 5,000 in 2008  |                                      | 50,000     |
| Preferred stock issuance costs  |                                      | (38)       |
| Common stock transactions:  |                                      |            |
| Non-vested common shares issued, 15,034 in 2009   |                                      |            |
| Common shares issued, 711 in 2009 and 626 in 2008   | 43                                   | 52         |
| Common shares retired, 99,445 in 2009 and 213,381 in 2008   | (7,341)                              | (18,312)   |
| Stock options exercised of 21,073 in 2009 and 40,920 in 2008, net of shares tendered in payment of option price and income tax withholding amounts of 40,241 in 2009 and 17,668 in 2008 | (265)                                | 1,264      |
| Tax benefits related to stock compensation  | 693                                  | 826        |
| Stock-based compensation expense  | 407                                  | 574        |
| Cash dividends declared:  |                                      |            |
| Common, \$1.10 per share in 2009 and \$1.30 per share in 2008   | (8,651)                              | (10,332)   |
| Preferred (6.75% stated annual rate)  | (1,697)                              | (1,622)    |
| Total stockholders equity at end of period  | \$ 553,868                           | \$ 502,089 |



**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES****Consolidated Statements of Cash Flows***(In thousands)**(Unaudited)*

|  | For the six months<br>ended June 30, |           |
|--|--------------------------------------|-----------|
|  | 2009                                 | 2008      |
| Cash flows from operating activities:  |                                      |           |
| Net income   | \$ 30,024                            | \$ 36,702 |
| Adjustments to reconcile net income to net cash provided by operating activities:  |                                      |           |
| Cumulative effect of change in accounting principle                                |                                      | (633)     |
| Equity in undistributed earnings of unconsolidated subsidiaries and joint ventures | 164                                  | (232)     |
| Provision for loan losses  | 21,300                               | 7,684     |
| Depreciation expense   | 6,063                                | 7,758     |
| Amortization of mortgage servicing rights  | 5,067                                | 2,796     |
| Net premium amortization on investment securities                                  | 318                                  | 441       |
| Net gain on calls of available-for-sale investment securities                      | (52)                                 | (74)      |
| Net loss on sale of other real estate owned, premises and equipment                | 58                                   |           |
| Write-down of other real estate owned and equipment pending disposition            | 932                                  |           |
| Amortization of core deposit intangible assets                                     | 1,071                                | 1,221     |
| Recovery of impairment on mortgage servicing rights                                | (7,265)                              | (745)     |
| Net increase in cash surrender value of company-owned life insurance               | (708)                                | (1,185)   |
| Stock-based compensation expense   | 463                                  | 574       |
| Excess tax benefits from stock-based compensation                                  | (678)                                | (801)     |
| Deferred income taxes  | 1,736                                | (951)     |
| Changes in operating assets and liabilities:                                       |                                      |           |
| Decrease (increase) in loans held for sale   | 706                                  | (2,796)   |
| Decrease (increase) in interest receivable   | 422                                  | (2,035)   |
| Increase in other assets   | (1,717)                              | (8,588)   |
| Increase (decrease) in accrued interest payable                                    | 2,163                                | (1,840)   |
| Decrease in accounts payable and accrued expenses                                  | (6,540)                              | (2,470)   |
| Net cash provided by operating activities  | 53,527                               | 34,826    |
| Cash flows from investing activities:  |                                      |           |
| Purchases of investment securities:  |                                      |           |
| Held-to-maturity   | (3,310)                              | (9,579)   |
| Available-for-sale   | (254,051)                            | (153,426) |
| Proceeds from maturities and paydowns of investment securities:                    |                                      |           |
| Held-to-maturity   | 11,981                               | 11,087    |
| Available-for-sale   | 265,654                              | 341,872   |
| Purchases and originations of mortgage servicing rights                            | (7,365)                              | (3,962)   |
| Extensions of credit to customers, net of repayments                               | 68,282                               | (292,759) |
| Recoveries of loans charged-off  | 1,323                                | 1,072     |
| Proceeds from sales of other real estate   | 314                                  | 211       |
| Net capital expenditures   | (19,343)                             | (13,925)  |
| Capital contributions to deconsolidated subsidiaries                               |                                      | (620)     |

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|   |        |           |
|---|--------|-----------|
| Acquisition of banks & data services company, net of cash and cash equivalents received |        | (135,706) |
| Net cash provided by (used in) investing activities                                     | 63,485 | (255,735) |

**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows (continued)**

*(In thousands)*

(Unaudited)

|   | For the six months<br>ended June 30, |                |
|---|--------------------------------------|----------------|
|   | 2009                                 | 2008           |
| Cash flows from financing activities:                                       |                                      |                |
| Net increase in deposits  | \$ 351,056                           | \$ 72,161      |
| Net increase (decrease) in federal funds purchased                          | (30,625)                             | 108,410        |
| Net decrease in repurchase agreements                                       | (157,059)                            | (137,423)      |
| Net increase (decrease) in other borrowed funds                             | (20,833)                             | 117,319        |
| Borrowings of long-term debt  |                                      | 112,500        |
| Repayments of long-term debt  | (4,504)                              | (28,800)       |
| Proceeds from issuance of subordinated debentures held by subsidiary trusts |                                      | 20,620         |
| Net decrease (increase) in debt issuance costs                              | 63                                   | (471)          |
| Preferred stock issuance costs  |                                      | (38)           |
| Proceeds from issuance of common stock                                      | 43                                   | 1,316          |
| Excess tax benefits from stock-based compensation                           | 678                                  | 801            |
| Purchase and retirement of common stock                                     | (7,606)                              | (18,312)       |
| Dividends paid on common stock  | (8,651)                              | (10,332)       |
| Dividends paid on preferred stock   | (1,697)                              | (1,622)        |
| <br>Net cash provided by financing activities                               | <br>120,865                          | <br>236,129    |
| <br>Net increase in cash and cash equivalents                               | <br>237,877                          | <br>15,220     |
| Cash and cash equivalents at beginning of period                            | 314,030                              | 249,246        |
| <br>Cash and cash equivalents at end of period                              | <br>\$ 551,907                       | <br>\$ 264,466 |

**SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:**

Cash paid during the period for:

|              |           |           |
|--------------|-----------|-----------|
| Interest     | \$ 42,615 | \$ 63,209 |
| Income taxes | 22,000    | 20,894    |

*See accompanying notes to unaudited consolidated financial statements.*

**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements***(In thousands, except share and per share data)***(1) Basis of Presentation**

In the opinion of management, the accompanying unaudited consolidated financial statements of First Interstate BancSystem, Inc. (the Parent Company or FIBS ) and subsidiaries (the Company ) contain all adjustments (all of which are of a normal recurring nature) necessary to present fairly the financial position of the Company at June 30, 2009 and December 31, 2008, the results of operations for each of the three and six month periods ended June 30, 2009 and 2008 and the results of cash flows for each of the six month periods ended June 30, 2009 and 2008, in conformity with U.S. generally accepted accounting principles ( GAAP ). The balance sheet information at December 31, 2008 is derived from audited consolidated financial statements. Certain reclassifications, none of which were material, have been made to conform prior year financial statements to the June 30, 2009 presentation.

These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008. Operating results for the three and six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009.

**(2) Regulatory Capital**

The Company is subject to the regulatory capital requirements administered by federal banking regulators and the Federal Reserve. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company s assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. On December 16, 2008, federal banking regulators approved a final rule permitting banking organizations to reduce the amount of goodwill deducted from tier 1 capital by the amount of any associated deferred tax liability. This rule, which became effective in January 2009, significantly increased the Company s tier 1 and total risk-based capital ratios.

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios of total and tier 1 capital to risk-weighted assets, and of tier 1 capital to average assets, as defined in the regulations. As of June 30, 2009 and December 31, 2008, the Company exceeded all capital adequacy requirements to which it is subject.

The Company s actual capital amounts and ratios and selected minimum regulatory thresholds as of June 30, 2009 and December 31, 2008 are presented in the following table:

|                            | Actual<br>Amount | Ratio  | Adequately Capitalized<br>Amount | Ratio | Well Capitalized<br>Amount | Ratio  |
|----------------------------|------------------|--------|----------------------------------|-------|----------------------------|--------|
| <i>June 30, 2009:</i>      |                  |        |                                  |       |                            |        |
| Total risk-based capital:  |                  |        |                                  |       |                            |        |
| Consolidated               | \$628,983        | 11.93% | \$421,710                        | 8.00% | NA                         | NA     |
| FIB                        | 481,568          | 10.90  | 353,315                          | 8.00  | \$441,644                  | 10.00% |
| Wall                       | 54,283           | 13.71  | 31,675                           | 8.00  | 39,594                     | 10.00  |
| Sturgis                    | 53,602           | 13.83  | 31,001                           | 8.00  | 38,752                     | 10.00  |
| Tier 1 risk-based capital: |                  |        |                                  |       |                            |        |
| Consolidated               | 527,690          | 10.01  | 210,855                          | 4.00  | NA                         | NA     |
| FIB                        | 411,063          | 9.31   | 176,658                          | 4.00  | 264,986                    | 6.00%  |
| Wall                       | 49,258           | 12.44  | 15,838                           | 4.00  | 23,756                     | 6.00   |
| Sturgis                    | 48,721           | 12.57  | 15,501                           | 4.00  | 23,251                     | 6.00   |

Leverage capital ratio:

|              |         |       |         |      |         |       |
|--------------|---------|-------|---------|------|---------|-------|
| Consolidated | 527,690 | 8.06  | 261,859 | 4.00 | NA      | NA    |
| FIB          | 411,063 | 7.39  | 222,570 | 4.00 | 278,212 | 5.00% |
| Wall         | 49,258  | 10.27 | 19,178  | 4.00 | 23,972  | 5.00  |
| Sturgis      | 48,721  | 10.89 | 17,898  | 4.00 | 22,373  | 5.00  |

**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements***(In thousands, except share and per share data)*

|                            | Actual    |        | Adequately Capitalized |       | Well Capitalized |        |
|----------------------------|-----------|--------|------------------------|-------|------------------|--------|
|                            | Amount    | Ratio  | Amount                 | Ratio | Amount           | Ratio  |
| <i>December 31, 2008:</i>  |           |        |                        |       |                  |        |
| Total risk-based capital:  |           |        |                        |       |                  |        |
| Consolidated               | \$554,418 | 10.49% | \$422,952              | 8.00% | NA               | NA     |
| FIB                        | 459,785   | 10.33  | 356,100                | 8.00  | \$445,125        | 10.00% |
| Wall                       | 51,417    | 12.13  | 33,907                 | 8.00  | 42,383           | 10.00  |
| Sturgis                    | 48,432    | 12.42  | 31,184                 | 8.00  | 38,980           | 10.00  |
| Tier 1 risk-based capital: |           |        |                        |       |                  |        |
| Consolidated               | 453,070   | 8.57   | 211,476                | 4.00  | NA               | NA     |
| FIB                        | 388,966   | 8.74   | 178,050                | 4.00  | \$267,075        | 6.00%  |
| Wall                       | 46,062    | 10.87  | 16,953                 | 4.00  | 25,460           | 6.00   |
| Sturgis                    | 43,529    | 11.17  | 15,592                 | 4.00  | 23,388           | 6.00   |
| Leverage capital ratio:    |           |        |                        |       |                  |        |
| Consolidated               | 453,070   | 7.13   | 254,085                | 4.00  | NA               | NA     |
| FIB                        | 388,966   | 7.16   | 217,247                | 4.00  | \$271,559        | 5.00%  |
| Wall                       | 46,062    | 9.65   | 19,093                 | 4.00  | 23,867           | 5.00   |
| Sturgis                    | 43,529    | 9.79   | 17,781                 | 4.00  | 22,226           | 5.00   |

**(3) Investment Securities**

The following tables present the amortized costs, unrealized gains, unrealized losses and approximate fair values of investment securities at June 30, 2009 and December 31, 2008:

|   | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|----------------|------------------------|-------------------------|----------------------|
| <i>Available-for-Sale</i>               |                |                        |                         |                      |
| <i>June 30, 2009</i>                    |                |                        |                         |                      |
| Obligations of U.S. government agencies | \$211,203      | \$ 3,936               | \$ (500)                | \$214,639            |
| Mortgage-backed securities              | 694,481        | 17,070                 | (1,699)                 | 709,852              |
| State, county and municipal securities  | 29,166         | 321                    | (5)                     | 29,482               |
| Other securities                        |                |                        |                         |                      |
| Mutual funds                            | 4              |                        |                         | 4                    |
| Total                                   | \$934,854      | \$21,327               | \$(2,204)               | \$953,977            |
| <br>                                    |                |                        |                         |                      |
| <i>Held-to-Maturity</i>                 |                |                        |                         |                      |
| <i>June 30, 2009</i>                    |                |                        |                         |                      |
| State, county and municipal securities  | \$101,072      | \$854                  | \$(924)                 | \$101,002            |

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|                  |           |       |         |           |
|------------------|-----------|-------|---------|-----------|
| Other securities | 543       |       |         | 543       |
| Total            | \$101,615 | \$854 | \$(924) | \$101,545 |

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**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements***(In thousands, except share and per share data)*

| Available-for-Sale<br><i>December 31, 2008</i> | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|--|-------------------|------------------------------|-------------------------------|----------------------------|
| Obligations of U.S. government agencies        | \$264,008         | \$ 6,371                     | \$                            | \$270,379                  |
| Mortgage-backed securities                     | 646,456           | 9,891                        | (1,088)                       | 655,259                    |
| State, county and municipal securities         | 33,287            | 107                          | (8)                           | 33,386                     |
| Other securities                               | 2,891             | 1                            | (6)                           | 2,886                      |
| Mutual funds                                   | 4                 |                              |                               | 4                          |
| <b>Total</b>                                   | <b>\$946,646</b>  | <b>\$16,370</b>              | <b>\$(1,102)</b>              | <b>\$961,914</b>           |

| Held-to-Maturity<br><i>December 31, 2008</i> | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|--|-------------------|------------------------------|-------------------------------|----------------------------|
| State, county and municipal securities       | \$109,744         | \$856                        | \$(1,409)                     | \$109,191                  |
| Other securities                             | 618               |                              |                               | 618                        |
| <b>Total</b>                                 | <b>\$110,362</b>  | <b>\$856</b>                 | <b>\$(1,409)</b>              | <b>\$109,809</b>           |

There were no sales of investment securities during the six months ended June 30, 2009 or during 2008.

The following table shows the gross unrealized losses and fair values of investment securities, aggregated by investment category, and the length of time individual investment securities have been in a continuous unrealized loss position, as of June 30, 2009 and December 31, 2008.

|   | Less than 12 Months |                               | 12 Months or More |                               | Total            |                               |
|---|---------------------|-------------------------------|-------------------|-------------------------------|------------------|-------------------------------|
|   | Fair<br>Value       | Gross<br>Unrealized<br>Losses | Fair<br>Value     | Gross<br>Unrealized<br>Losses | Fair<br>Value    | Gross<br>Unrealized<br>Losses |
| <i>June 30, 2009</i>                    |                     |                               |                   |                               |                  |                               |
| Available-for-Sale                      |                     |                               |                   |                               |                  |                               |
| Obligations of U.S. government agencies | \$ 44,471           | \$ (500)                      | \$                | \$                            | \$ 44,471        | \$ (500)                      |
| Mortgage-backed securities              | 138,372             | (1,699)                       |                   |                               | 138,372          | (1,699)                       |
| State, county and municipal securities  | 679                 | (5)                           |                   |                               | 679              | (5)                           |
| Other securities                        |                     |                               |                   |                               |                  |                               |
| <b>Total</b>                            | <b>\$183,522</b>    | <b>\$(2,204)</b>              | <b>\$</b>         | <b>\$</b>                     | <b>\$183,522</b> | <b>\$(2,204)</b>              |
| Held-to-Maturity                        |                     |                               |                   |                               |                  |                               |
|   | \$ 17,464           | \$ (290)                      | \$17,689          | \$(634)                       | \$ 35,153        | \$ (924)                      |



State, county and  
municipal securities

|                          | Less than 12 Months |            | 12 Months or More |            | Total      |            |
|--------------------------|---------------------|------------|-------------------|------------|------------|------------|
|                          | Fair                | Gross      | Fair              | Gross      | Fair       | Gross      |
| <i>December 31, 2008</i> | Value               | Unrealized | Value             | Unrealized | Value      | Unrealized |
|                          |                     | Losses     |                   | Losses     |            | Losses     |
| Available-for-Sale       |                     |            |                   |            |            |            |
| Mortgage-backed          |                     |            |                   |            |            |            |
| securities               | \$ 102,193          | \$ (699)   | \$ 61,782         | \$ (389)   | \$ 163,975 | \$ (1,088) |
| State, county and        | 1,862               | (8)        |                   |            | 1,862      | (8)        |
| municipal securities     |                     |            |                   |            |            |            |
| Other securities         | 997                 | (6)        |                   |            | 997        | (6)        |
| Total                    | \$ 105,052          | \$ (713)   | \$ 61,782         | \$ (389)   | \$ 166,834 | \$ (1,102) |
| Held-to-Maturity         |                     |            |                   |            |            |            |
| State, county and        | \$ 28,537           | \$ (1,002) | \$ 11,278         | \$ (407)   | \$ 39,815  | \$ (1,409) |
| municipal securities     |                     |            |                   |            |            |            |

**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES**  
**Notes to Unaudited Consolidated Financial Statements**

*(In thousands, except share and per share data)*

The investment portfolio is evaluated quarterly for other-than-temporary declines in the market value of each individual investment security. Consideration is given to the length of time and the extent to which the fair value has been less than amortized cost; adverse conditions related to the issuer, the issuer's industry or geographic area; the historical and implied volatility of a security's fair value; the payment structure of the security; the financial condition and near term prospects of the issuer including the issuer's ability to make scheduled interest or principal payments; and, the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Unrealized losses as of June 30, 2009 and December 31, 2008 related primarily to fluctuations in market interest rates or the widening of market spreads subsequent to the initial purchase of the securities, and not due to concerns regarding the underlying credit of the issuers or the underlying collateral. As of June 30, 2009, the Company does not have the intent to sell any of the securities classified as available-for-sale in the above table and believes that it is more likely than not that the Company will not have to sell any such securities before a recovery of cost. The fair value is expected to recover as the investments approach their maturity or repricing dates or if market yields for such investments decline. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of June 30, 2009, management believes the impairments summarized in the table above are temporary and no impairment losses have been recorded in the Company's consolidated statements of income.

Maturities of investment securities at June 30, 2009 are shown below. Maturities of mortgage-backed securities have been adjusted to reflect shorter maturities based upon estimated prepayments of principal. All other investment securities maturities are shown at contractual maturity dates.

|                                       | Available-for-Sale |                         | Held-to-Maturity  |                         |
|---------------------------------------|--------------------|-------------------------|-------------------|-------------------------|
|                                       | Amortized<br>Cost  | Estimated<br>Fair Value | Amortized<br>Cost | Estimated<br>Fair Value |
| <i>June 30, 2009</i>                  |                    |                         |                   |                         |
| Within one year                       | \$ 220,536         | \$ 224,933              | \$ 5,766          | \$ 5,849                |
| After one year but within five years  | 519,008            | 529,416                 | 16,671            | 16,869                  |
| After five years but within ten years | 61,348             | 62,704                  | 32,548            | 32,613                  |
| After ten years                       | 133,958            | 136,920                 | 46,087            | 45,671                  |
| <br>                                  |                    |                         |                   |                         |
| Total                                 | 934,850            | 953,973                 | 101,072           | 101,002                 |
| Investments with no stated maturity   | 4                  | 4                       | 543               | 543                     |
| <br>                                  |                    |                         |                   |                         |
| Total                                 | \$ 934,854         | \$ 953,977              | \$ 101,615        | \$ 101,545              |

**(4) Impaired Loans**

Impaired loans include non-consumer loans placed on non-accrual or renegotiated in troubled debt restructurings. The following table sets forth information on impaired loans at the dates indicated:

|  | December         |             |                  |
|--|------------------|-------------|------------------|
|  | June 30,<br>2009 | 31,<br>2008 | June 30,<br>2008 |
| Impaired loans with no allocated allowance | \$ 81,522        | \$ 17,749   | \$ 40,826        |
| Impaired loans with an allocated allowance | 37,838           | 66,667      | 28,794           |

|   |            |           |           |
|---|------------|-----------|-----------|
| Recorded investment in impaired loans                 | \$ 119,360 | \$ 84,416 | \$ 69,620 |
| Allowance for loan losses allocated to impaired loans | \$ 14,555  | \$ 8,015  | \$ 13,507 |

The average recorded investment in impaired loans was \$99,610 and \$92,033 for the three and six months ended June 30, 2009, respectively, and \$32,998 and \$52,349 for the three and six months ended June 30, 2008, respectively. If interest on impaired loans had been accrued, interest income on impaired loans during the three and six months ended June 30, 2009 would have been approximately \$1,488 and \$2,738, respectively. If interest on impaired loans had been accrued, interest income on impaired loans during the three and six months ended June 30, 2008 would have been approximately \$560 and \$1,848, respectively. At June 30, 2009, there were no material commitments to lend additional funds to borrowers whose existing loans have been renegotiated or are classified as non-accrual.

**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements***(In thousands, except share and per share data)***(5) Allowance for Loan Losses**

A summary of changes in the allowance for loan losses follows:

|   | Six months ended June 30, |               |
|---|---------------------------|---------------|
|   | 2009                      | 2008          |
| Balance at beginning of period                      | \$ 87,316                 | \$ 52,355     |
| Allowance of acquired banking offices               |                           | 14,463        |
| Provision charged to operating expense              | 21,300                    | 7,684         |
| Less loans charged-off                              | (11,544)                  | (2,924)       |
| Add back recoveries of loans previously charged-off | 1,323                     | 1,072         |
| <br>Balance at end of period                        | <br>\$ 98,395             | <br>\$ 72,650 |

**(6) Long-Term Debt**

In January 2008, the Company entered into a credit agreement ( Credit Agreement ) with four syndicated banks. The Credit Agreement contains various covenants that, among other things, establish minimum capital and financial performance ratios; and, place certain restrictions on indebtedness, non-performing assets, the allowance for loan losses, the redemption and issuance of common stock and the amounts of dividends payable to shareholders. As of June 30, 2009, the Company was in violation of two financial performance covenants related to non-performing assets. Additionally, as of March 31, 2009, the Company was in violation of one financial performance covenant related to non-performing assets. The Company has requested, and expects to obtain, a waiver and modification of these covenants in the near term. If a waiver and modification are not obtained, the syndicated banks will be entitled to pursue the remedies available under the Credit Agreement including an acceleration of the full amount due thereunder. As of June 30, 2009, the Company had \$39,286 outstanding under the Credit Agreement. If the Credit Agreement is not modified, management expects that similar waivers will be required in future periods.

**(7) Commitments**

In the normal course of business, the Company is involved in various claims and litigation. In the opinion of management, following consultation with legal counsel, the ultimate liability or disposition thereof will not have a material adverse effect on the consolidated financial condition, results of operations or liquidity of the Company.

The Company had commitments under construction contracts of \$13,485 as of June 30, 2009.

**(8) Financial Instruments with Off-Balance Sheet Risk**

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the commitment contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. At June 30, 2009, commitments to extend credit to existing and new borrowers approximated \$1,122,887, which includes \$371,454 on unused credit card lines and \$265,095 with commitment maturities beyond one year.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. At June 30, 2009, the Company had outstanding standby letters of credit of \$94,959. The estimated fair value of the obligation undertaken by the Company in issuing the standby letters of credit is included in other liabilities in the Company's consolidated balance sheet.

**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements***(In thousands, except share and per share data)***(9) Computation of Earnings per Common Share**

Basic earnings per common share is calculated by dividing net income by the weighted average number of common shares outstanding during the period presented. Diluted earnings per common share is calculated by dividing net income by the weighted average number of common shares and potential common shares outstanding during the period.

The following table sets forth the computation of basic and diluted earnings per share for the three and six month periods ended June 30, 2009 and 2008.

|   | Three Months Ended June<br>30, |           | Six Months Ended June 30, |           |
|---|--------------------------------|-----------|---------------------------|-----------|
|   | 2009                           | 2008      | 2009                      | 2008      |
| Net income available to common stockholders | \$ 12,483                      | \$ 17,773 | \$ 28,327                 | \$ 35,080 |
| Average outstanding comon shares-basic      | 7,847,469                      | 7,845,801 | 7,848,338                 | 7,882,820 |
| Add: effect of dilutive stock options       | 88,781                         | 163,227   | 110,160                   | 168,702   |
| Average outstanding common shares-diluted   | 7,936,250                      | 8,009,028 | 7,958,498                 | 8,051,522 |
| Basic earnings per common share             | \$ 1.59                        | \$ 2.27   | \$ 3.61                   | \$ 4.45   |
| Diluted earnings per common share           | \$ 1.57                        | \$ 2.22   | \$ 3.56                   | \$ 4.36   |

The Company had outstanding options to purchase 472,888 and 326,207 shares of common stock for the three and six months ended June 30, 2009, respectively, that were not included in the computation of diluted earnings per common share because their effect would be anti-dilutive. The Company had outstanding options to purchase 299,728 and 261,048 shares of common stock for the three and six months ended June 30, 2008, respectively, that were not included in the computation of diluted earnings per common share because their effect would be anti-dilutive.

**(10) Non-Cash Investing and Financing Activities**

The Company transferred loans of \$26,731 and \$1,835 to other real estate owned during the six months ended June 30, 2009 and 2008, respectively.

In conjunction with the remeasurement of liability classified non-vested stock awards, the Company reduced common stock and accrued liabilities by \$56 during the six months ended June 30, 2009.

The Company transferred equipment pending disposal of \$1,487 to other assets.

On March 27, 2008, the Company transferred \$100,000 from retained earnings to common stock.

On January 8, 2008, the Company issued 5,000 shares of Series A Preferred Stock with an aggregate value of \$50,000. The Series A Preferred stock was issued in partial consideration for an acquisition.

**(11) Fair Value Measurements**

The following table presents information about the Company's assets and liabilities measured at fair value on a recurring basis as of June 30, 2009 and December 31 2008:

| Fair Value Measurements<br>Using |                      |             |
|----------------------------------|----------------------|-------------|
| Quoted<br>Prices<br>in           | Significant<br>Other | Significant |

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|  |            | Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level<br>1) | Observable<br>Inputs<br>(Level 2) | Unobservable<br>Inputs<br>(Level 3) |
|--|------------|---|-----------------------------------|-------------------------------------|
| <i>June 30, 2009</i>                     | Total      |   |                                   |                                     |
| Investment securities available-for-sale | \$ 953,977 | \$  | \$ 953,977                        | \$                                  |
| Mortgage servicing rights                | 19,955     |   | 19,955                            |                                     |

**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements***(In thousands, except share and per share data)*

|  | Total      | Fair Value Measurements Using  |   |  |
|--|------------|--|---|--|
|  |            | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <i>December 31, 2008</i>                 |            |  |   |  |
| Investment securities available-for-sale | \$ 961,914 | \$   | \$ 961,914  | \$   |
| Mortgage servicing rights                | 11,675     |  | 11,675  |  |

The following methods were used to estimate the fair value of each class of financial instrument above:

*Investment Securities Available-for-Sale.* The Company obtains fair value measurements for investment securities available-for-sale from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things.

*Mortgage Servicing Rights.* Mortgage servicing rights are initially recorded at fair value based on comparable market quotes and are amortized in proportion to and over the period of estimated net servicing income. Mortgage servicing rights are evaluated quarterly for impairment using an independent valuation service. The valuation service utilizes discounted cash flow modeling techniques, which consider observable data that includes consensus prepayment speeds and the predominant risk characteristics of the underlying loans including loan type, note rate and loan term. Management believes the significant inputs utilized in the valuation model are observable in the market.

Additionally, from time to time, certain assets are measured at fair value on a non-recurring basis. These adjustments to fair value generally result from the application of lower-of-cost-or-market accounting or write-downs of individual assets due to impairment.

The following table presents information about the Company's assets and liabilities measured at fair value of a non-recurring basis during the six months ended June 30, 2009 and 2008:

|  | Total     | Fair Value Measurements Using   |  |  | Total<br>Gains<br>(Losses) |
|--|-----------|---|--|--|----------------------------|
|  |           | Quoted<br>Prices<br>in Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level<br>2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |                            |
| <i>Six Months Ended June 30, 2009</i>      |           |   |  |  |                            |
|  |           |   |  |  |                            |
| Impaired loans                             | \$ 23,283 | \$  | \$   | \$ 23,283  | \$ (14,555)                |
| Other real estate owned                    | 4,120     |   |  | 4,120  |                            |
| Long-lived asset to be disposed of by sale | 1,237     |   |  | 1,237  |                            |

|                                       | Total     | Fair Value Measurements Using   |  |  | Total<br>Gains<br>(Losses) |
|---------------------------------------|-----------|---|--|--|----------------------------|
|                                       |           | Quoted<br>Prices<br>in Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level<br>2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |                            |
| <i>Six Months Ended June 30, 2008</i> |           |   |  |  |                            |
| Impaired loans                        | \$ 15,287 | \$  | \$   | \$ 15,287  | \$ (13,507)                |
| Other real estate owned               | 375       |   |  | 375  | (18)                       |



**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements**

*(In thousands, except share and per share data)*

**Impaired Loans.** Impaired loans include collateral dependent loans reported at the fair value of the underlying collateral. Collateral values are estimated using inputs based upon observable market data and customized discounting criteria. When it is determined that the fair value of an impaired loan is less than the recorded investment in the loan, the carrying value of the loan is adjusted to fair value through a charge to the allowance for loan losses. During the six months ended June 30, 2009, impaired loans with a carrying value of \$37,838 were reduced by specific valuation allowance allocations of \$14,555 resulting in a reported fair value of \$23,283. During the six months ended June 30, 2008, impaired loans with a carrying value of \$28,794 were reduced by specific valuation allowance allocations of \$13,507 resulting in a reported fair value of \$15,287.

**Other Real Estate Owned.** Other real estate owned ( OREO ) represents real estate acquired in full or partial satisfaction of a loan. OREO is carried at the lower of the Company's recorded investment in the property at the date of foreclosure or the property's current fair value less estimated selling costs. The fair values of foreclosed asset are determined by independent appraisals or are estimated using observable market data and customized discounting criteria. Upon initial recognition, write-downs based on the foreclosed asset's fair value at foreclosure are reported through charges to the allowance for loan losses. Periodically, the fair value of foreclosed assets is remeasured with any subsequent write-downs charged to earnings in the period in which they are identified. During the six months ended June 30, 2009, OREO with a carrying amount of \$4,802 was written down to its fair value of \$4,120, resulting in an impairment charge of \$682. During the six months ended June 30, 2008, OREO with a carrying amount of \$393 was written down to its fair value of \$375, resulting in an impairment charge of \$18.

**Long-lived Assets to be Disposed of by Sale.** Long-lived assets to be disposed of by sale are carried at the lower of carrying value or fair value less estimated costs to sell. The fair values of long-lived assets to be disposed of by sale are based upon observable market data and customized discounting criteria. During the six months ended June 30, 2009, a long-lived asset to be disposed of by sale with a carrying amount of \$1,487 was written down to its fair value of \$1,237, resulting in an impairment charge of \$250, which was included in other non-interest expense.

**Mortgage Loans Held for Sale.** Mortgage loans held for sale are required to be measured at the lower of cost or fair value. The fair value of mortgage loans held for sale is based upon binding contracts or quotes or bids from third party investors. As of June 30, 2009 and December 31, 2008, all mortgage loans held for sale were recorded at cost. The Company is required to disclose the fair value of financial instruments for which it is practical to estimate fair value. The methodologies for estimating the fair value of financial instruments that are measured at fair value on a recurring or non-recurring basis are discussed above. The methodologies for estimating the fair value of other financial instruments are discussed below. For financial instruments bearing a variable interest rate where no credit risk exists, it is presumed that recorded book values are reasonable estimates of fair value.

**Financial Assets.** Carrying values of cash, cash equivalents and accrued interest receivable approximate fair values due to the liquid and/or short-term nature of these instruments. Fair values for investment securities held-to-maturity are obtained from an independent pricing service, which considers observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Fair values of fixed rate loans are calculated by discounting scheduled cash flows adjusted for prepayment estimates using discount rates based on secondary market sources, if available, or based on estimated market discount rates that reflect the credit and interest rate risk inherent in the loan category. Fair values of adjustable rate loans approximate the carrying values of these instruments due to frequent repricing, provided there have been no changes in credit quality since origination.

**Financial Liabilities.** The fair values of demand deposits, savings accounts, federal funds purchased, securities sold under repurchase agreements and accrued interest payable are the amount payable on demand at the reporting date. The fair values of fixed-maturity certificates of deposit are estimated using external market rates currently offered for deposits with similar remaining maturities. The carrying values of the interest bearing demand notes to the United States Treasury are deemed an approximation of fair values due to the frequent repayment and repricing at market rates. The revolving term loans, floating rate subordinated debentures, floating rate subordinated term loan and

unsecured demand notes bear interest at floating market rates and, as such, carrying amounts are deemed to approximate fair values. The fair values of notes payable to the FHLB, fixed rate subordinated term debt and capital lease obligations are estimated by discounting future cash flows using current rates for advances with similar characteristics.

**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements***(In thousands, except share and per share data)*

*Commitments to Extend Credit and Standby Letters of Credit.* The fair value of commitments to extend credit and standby letters of credit, based on fees currently charged to enter into similar agreements, is not significant.

A summary of the estimated fair values of financial instruments follows:

|   | As of June 30,<br>2009 |                         | As of December 31,<br>2008 |                         |
|---|------------------------|-------------------------|----------------------------|-------------------------|
|   | Carrying<br>Amount     | Estimated<br>Fair Value | Carrying<br>Amount         | Estimated<br>Fair Value |
| <b>Financial assets:</b>                          |                        |                         |                            |                         |
| Cash and cash equivalents                         | \$ 551,907             | \$ 551,907              | \$ 314,030                 | \$ 314,030              |
| Investment securities available-for-sale          | 953,977                | 953,977                 | 961,914                    | 961,914                 |
| Investment securities held-to-maturity            | 101,615                | 101,545                 | 110,362                    | 109,809                 |
| Net loans   | 4,567,155              | 4,575,096               | 4,685,497                  | 4,696,287               |
| Accrued interest receivable                       | 38,272                 | 38,272                  | 38,694                     | 38,694                  |
| Mortgage servicing rights, net                    | 20,565                 | 21,018                  | 11,002                     | 11,832                  |
| <b>Total financial assets</b>                     | <b>\$ 6,233,491</b>    | <b>\$ 6,241,815</b>     | <b>\$ 6,121,499</b>        | <b>\$ 6,132,566</b>     |
| <b>Financial liabilities:</b>                     |                        |                         |                            |                         |
| Total deposits, excluding time deposits           | \$ 3,394,237           | \$ 3,394,237            | \$ 3,243,756               | \$ 3,243,756            |
| Time deposits                                     | 2,131,078              | 2,139,881               | 1,930,503                  | 1,934,296               |
| Federal funds purchased                           |                        |                         | 30,625                     | 30,625                  |
| Securities sold under repurchase agreements       | 368,442                | 368,442                 | 525,501                    | 525,501                 |
| Accrued interest payable                          | 22,694                 | 22,694                  | 20,531                     | 20,531                  |
| Other borrowed funds                              | 58,383                 | 58,383                  | 79,216                     | 79,216                  |
| Long-term debt                                    | 79,644                 | 80,669                  | 84,148                     | 88,255                  |
| Subordinated debentures held by subsidiary trusts | 123,715                | 126,636                 | 123,715                    | 119,608                 |
| <b>Total financial liabilities</b>                | <b>\$ 6,178,193</b>    | <b>\$ 6,190,942</b>     | <b>\$ 6,037,995</b>        | <b>\$ 6,041,788</b>     |

**(12) Segment Reporting**

An operating segment is defined as a component of a business for which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and evaluate performance. Beginning January 1, 2009, the Company has one operating segment, community banking, which encompasses commercial and consumer banking and financial services offered to individuals, businesses, municipalities and other entities. Activities conducted by the Parent Company and its nonbank subsidiaries are incidental to community banking and, therefore, are not considered operating segments.

Prior to 2009, the Company reported two operating segments, community banking and technology services.

Technology services encompassed services provided through i\_Tech Corporation ( i\_Tech ), the Company's wholly-owned technology services subsidiary, to affiliated and non-affiliated customers. On December 31, 2008, the Company sold i\_Tech and moved certain operational functions previously provided by i\_Tech to First Interstate Bank, a banking subsidiary of the Company.

**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements***(In thousands, except share and per share data)*

The following table presents prior year segment information. The other category includes the net funding costs and other expenses of the Parent Company, the operational results of consolidated nonbank subsidiaries and intercompany eliminations.

|   | Three Months Ended June 30, 2008 |                        |           |           |
|---|----------------------------------|------------------------|-----------|-----------|
|   | Community<br>Banking             | Technology<br>Services | Other     | Total     |
| Net interest income (expense)                             | \$61,156                         | \$ 17                  | \$(2,802) | \$58,371  |
| Provision for loan losses                                 | 5,321                            |                        |           | 5,321     |
| Net interest income (expense) after provision             | 55,835                           | 17                     | (2,802)   | 53,050    |
| Non-interest income:                                      |                                  |                        |           |           |
| External sources  | 20,345                           | 4,363                  | 517       | 25,225    |
| Internal sources  |                                  | 3,066                  | (3,066)   |           |
| Total non-interest income                                 | 20,345                           | 7,429                  | (2,549)   | 25,225    |
| Non-interest expense                                      | 42,898                           | 6,736                  | 27        | 49,661    |
| Income (loss) before income taxes                         | 33,282                           | 710                    | (5,378)   | 28,614    |
| Income tax expense (benefit)                              | 11,699                           | 287                    | (1,998)   | 9,988     |
| Net income (loss)   | \$21,583                         | \$ 423                 | \$(3,380) | \$18,626  |
| Depreciation and core deposit intangibles<br>amortization | \$ 4,441                         | \$                     | \$ 54     | \$ 4,495  |
|   |                                  |                        |           |           |
|   | Six Months Ended June 30, 2008   |                        |           |           |
|   | Community<br>Banking             | Technology<br>Services | Other     | Total     |
| Net interest income (expense)                             | \$121,198                        | \$ 48                  | \$(6,072) | \$115,174 |
| Provision for loan losses                                 | 7,684                            |                        |           | 7,684     |
| Net interest income (expense) after provision             | 113,514                          | 48                     | (6,072)   | 107,490   |
| Non-interest income:                                      |                                  |                        |           |           |
| External sources  | 40,866                           | 9,606                  | 1,122     | 51,594    |
| Internal sources  | 1                                | 6,296                  | (6,297)   |           |
| Total non-interest income                                 | 40,867                           | 15,902                 | (5,175)   | 51,594    |
| Non-interest expense                                      | 91,011                           | 13,346                 | (1,541)   | 102,816   |
| Income (loss) before income taxes                         | 63,370                           | 2,604                  | (9,706)   | 56,268    |
| Income tax expense (benefit)                              | 22,173                           | 1,036                  | (3,643)   | 19,566    |

|  |           |          |           |           |
|--|-----------|----------|-----------|-----------|
| Net income (loss)                                      | \$ 41,197 | \$ 1,568 | \$(6,063) | \$ 36,702 |
| Depreciation and core deposit intangibles amortization | \$ 8,834  | \$       | \$ 145    | \$ 8,979  |

**(13) Recent Accounting Pronouncements**

**Statement of Financial Accounting Standards.** In December 2007, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standard ( SFAS ) No. 141(revised 2007), Business Combinations, which establishes principles and requirements for the reporting entity in a business combination, including recognition and measurement in the financial statements of the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. In April 2008, the FASB issued Staff Position ( FSP ) No. 141(R)-1, amending and clarifying SFAS No. 141(revised) on initial recognition and measurement, subsequent measurements and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The provisions of SFAS No. 141(revised 2007) and FSP No. 141(R)-1 are applicable to the Company's accounting for business combinations closing on or after January 1, 2009.

**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements**

*(In thousands, except share and per share data)*

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB 51. SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, changes in a parent's ownership of a noncontrolling interest, calculation and disclosure of the consolidated net income attributable to the parent and the noncontrolling interest, changes in a parent's ownership interest while the parent retains its controlling financial interest and fair value measurement of any retained noncontrolling equity investment. Adoption of SFAS No. 160 on January 1, 2009 did not impact the Company's consolidated financial statements, results of operations or liquidity.

In March 2008, the FASB issued SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133. SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. Adoption of SFAS No. 161 on January 1, 2009 did not impact the Company's consolidated financial statements, results of operations or liquidity.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events. SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. SFAS No. 165 defines (i) the period after the balance sheet date during which a reporting entity's management should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and (iii) the disclosures an entity should make about events or transactions that occurred after the balance sheet date. The adoption of SFAS No. 165, effective for financial statements for periods ending after June 15, 2009, did not have a significant impact on the Company's consolidated financial statements.

In June 2009, the FASB issued SFAS No. 166, Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140. SFAS No. 166 amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, to enhance reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. SFAS No. 166 eliminates the concept of a qualifying special-purpose entity and changes the requirements for derecognizing financial assets. SFAS No. 166 also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. SFAS No. 166 will be effective January 1, 2010 and is not expected to have a significant impact on the Company's consolidated financial statements, results of operations or liquidity.

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R). SFAS No. 167 amends FIN 46 (Revised December 2003), Consolidation of Variable Interest Entities, to change how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity's purpose and design and a company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. SFAS No. 167 requires additional disclosures about the reporting entity's involvement with variable-interest entities and any significant changes in risk exposure due to that involvement as well as its affect on the entity's financial statements. SFAS No. 167 will become effective January 1, 2010 and is not expected to have a significant impact on the Company's consolidated financial statements, results of operations or liquidity.

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles, a Replacement of FASB Statement No. 162. SFAS No. 168 replaces SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles and establishes the FASB Accounting Standards Codification (the Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial statements in conformity with generally

accepted accounting principles. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative guidance for SEC registrants. All guidance contained in the Codification carries an equal level of authority. All non-grandfathered, non-SEC accounting literature not included in the Codification is superseded and deemed non-authoritative. SFAS No. 168 will become effective for the Company's financial statements for periods ending after September 15, 2009. SFAS No. 168 will not have a significant impact on the Company's consolidated financial statements.

**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES**  
**Notes to Unaudited Consolidated Financial Statements**

*(In thousands, except share and per share data)*

**Emerging Issues Task Force.** In September 2008, the FASB ratified EITF Issue No. 08-5 ( EITF 08-5 ), Issuer s Accounting for Liabilities Measured at Fair Value With a Third-Party Credit Enhancement. EITF 08-5 provides guidance for measuring liabilities issued with an attached third-party credit enhancement such as a guarantee and clarifies that the issuer of a liability with a third-party credit enhancement should not include the effect of the credit enhancement in the fair value measurement of the liability. Adoption of EITF 08-5 on January 1, 2009 did not impact the Company s consolidated financial statements, results of operations or liquidity.

**FASB Staff Positions.** In February 2008, the FASB issued FSP No. 157-2, Effective Date of FASB Statement No. 157 ( FSP 157-2 ) to allow for the deferral of the adoption date of SFAS No. 157 for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company was required to adopt SFAS No. 157 for the assets and liabilities within the scope of FSP 157-2 effective January 1, 2009. The adoption did not have a material impact on the Company s consolidated financial statements, results of operations or liquidity.

In April 2008, the FASB issued FSP 142-3, Determination of the Useful Life of Intangible Assets. FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets. Adoption of FSP 142-3 on January 1, 2009 did not impact the Company s consolidated financial statements, results of operations or liquidity.

In June 2008, the FASB issued FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. FSP EITF 03-6-1 clarified that all outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends participate in undistributed earnings with common shareholders. Awards of this nature are considered participating securities and the two-class method of computing basic and diluted earnings per share must be applied. Adoption of FSP EITF 03-6-1 on January 1, 2009 did not have a significant impact on the Company s consolidated financial statements, results of operations or liquidity.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments, requiring all publicly traded companies to include disclosures about the fair value of financial instruments whenever it issues summarized financial information for interim reporting periods. In addition, entities must disclose, in the body or in the accompanying notes of their summarized financial information for interim reporting periods and in their financial statements for annual reporting periods, the fair value of all financial instruments for which it is practicable to estimate that value, whether recognized or not recognized in the statement of financial position, as required by SFAS 107, Disclosures About Fair Value of Financial Instruments. FSP FAS 107-1 and APB 28-1 is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The adoption of FSP SFAS 107-1 and APB 28-1 on June 30, 2009 did not have a significant impact on the Company s consolidated financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments, amending other-than-temporary impairment guidance in U.S. GAAP for debt securities, making the guidance for determining other-than-temporary impairment more operational and improving the financial statements presentation and disclosure of other-than-temporary impairments on debt and equity securities. Under the guidance in FSP FAS 115-2 and FAS 124-2, other-than-temporary impairment must be recorded if either of the following conditions is met: (a) the entity has the intent to sell an impaired debt security or (b) it is more likely than not that the entity will be required to sell an impaired debt security before its anticipated recovery. Under FSP SFAS 115-2 and SFAS 124-2, declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses. The amount of the impairment related to other factors is recognized in other comprehensive income. FSP FAS 115-2 and FAS 124-2 is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The adoption of FSP FAS 115-2 and FAS 124-2 on June 30, 2009 did not have a significant impact on the Company s consolidated financial statements, results of operations or liquidity.





**FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES**

**Notes to Unaudited Consolidated Financial Statements**

*(In thousands, except share and per share data)*

In April 2009, the FASB issued FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*. FSP FAS 157-4 provides additional guidance for estimating fair value in accordance with SFAS No. 157, *Fair Value Measurements* and identifying circumstances that indicate a transaction is not orderly. FSP FAS 157-4 also amends the disclosure requirements of SFAS No. 157 to require reporting entities to (a) disclose in interim and annual periods that inputs and valuation techniques used to measure fair value and discuss changes in valuation techniques and related inputs, if any, during the period and (b) define major categories for equity and debt securities to be major security types as described in paragraph 19 of SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, as amended. FSP FAS 157-4 shall be applied prospectively and is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The adoption of FSP FAS 157-4 on June 30, 2009 did not have a significant impact on the Company's consolidated financial statements, results of operations or liquidity.

In April 2009, the FASB issued FSP SFAS 141R-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*. FSP SFAS 141R-1 amends the guidance in SFAS 141R to require that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value if fair value can be reasonably estimated. If fair value of such an asset or liability cannot be reasonably estimated, the asset or liability would generally be recognized in accordance with SFAS 5, *Accounting for Contingencies*, and FASB Interpretation (FIN) No. 14, *Reasonable Estimation of the Amount of a Loss*. FSP SFAS 141R-1 removes subsequent accounting guidance for assets and liabilities arising from contingencies from SFAS 141R and requires entities to develop a systematic and rational basis for subsequently measuring and accounting for assets and liabilities arising from contingencies. FSP SFAS 141R-1 eliminates the requirement to disclose an estimate of the range of outcomes of recognized contingencies at the acquisition date. For unrecognized contingencies, entities are required to include only the disclosures required by SFAS 5. FSP SFAS 141R-1 also requires that contingent consideration arrangements of an acquiree assumed by the acquirer in a business combination be treated as contingent consideration of the acquirer and should be initially and subsequently measured at fair value in accordance with SFAS 141R. FSP SFAS 141R-1 is effective for assets or liabilities arising from contingencies the Company acquires in business combinations occurring after January 1, 2009.

**(14) Subsequent Events**

Subsequent events have been evaluated through August 7, 2009, the date financial statements are filed with the Securities and Exchange Commission. Through that date, there were no events requiring disclosure.

**Item 2.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2008, including the audited financial statements contained therein, filed with the Securities and Exchange Commission.

When we refer to we, our, and us in this report, we mean First Interstate BancSystem, Inc. and our consolidated subsidiaries, unless the context indicates that we refer only to the parent company, First Interstate BancSystem, Inc. When we refer to Banks in this report, we mean First Interstate Bank, First Western Bank and The First Western Bank Sturgis, our bank subsidiaries.

**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Rule 175 promulgated thereunder, and Section 21E of the Securities Exchange Act of 1934, as amended, and Rule 3b-6 promulgated thereunder, that involve inherent risks and uncertainties. Any statements about our plans, objectives, expectations, strategies, beliefs, or future performance or events constitute forward-looking statements. Such statements are identified as those that include words or phrases such as believes, expects, anticipates, plans, trend, objective, continue, or similar expressions or future or conditional verbs such as will, would, could, might, may, likely or similar expressions. Forward-looking statements involve known and unknown risks, uncertainties, assumptions, estimates and other important factors that could cause actual results to differ materially from any results, performance or events expressed or implied by such forward-looking statements. All forward-looking statements are qualified in their entirety by reference to the factors discussed in this report and the following risk factors discussed more fully in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2008: (i) credit losses; (ii) concentrations of real estate loans; (iii) commercial loan risk; (iv) economic conditions in Montana, Wyoming and South Dakota; (v) adequacy of the allowance for loan losses; (vi) soundness of other financial institutions; (vii) recent market developments; (viii) recent legislative and regulatory efforts to stabilize financial markets; (ix) changes in interest rates; (x) inability to meet liquidity requirements; (xi) disruptions and illiquidity in credit markets; (xii) inability of our bank subsidiaries to pay dividends; (xiii) failure to meet debt covenants; (xiv) competition; (xv) inability to manage risks in turbulent and dynamic market conditions; (xvi) inability to grow our business; (xvii) environmental remediation and other costs; (xviii) breach in information system security; (xix) failure of technology; (xx) failure to effectively implement technology-driven products and services; (xxi) ineffective internal operational controls; (xxii) dependence on our management team; (xxiii) impairment of goodwill; (xxiv) the ability to attract and retain qualified employees; (xxv) disruption of vital infrastructure and other business interruptions; (xxvi) litigation pertaining to fiduciary responsibilities; (xxvii) changes in or noncompliance with governmental regulations; (xxviii) capital required to support our bank subsidiaries; (xxix) increases in deposit premiums; and, (xxx) investment risks affecting holders of common stock.

Because the foregoing factors could cause actual results or outcomes to differ materially from those expressed or implied in any forward-looking statements, undue reliance should not be placed on any forward-looking statements. Further, any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of future events or developments.

**CRITICAL ACCOUNTING ESTIMATES AND SIGNIFICANT ACCOUNTING POLICIES**

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States and follow general practices within the industries in which we operate. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ significantly from those estimates.

Our accounting policies are fundamental to understanding Management's Discussion and Analysis of Financial Condition and Results of Operations. The most significant accounting policies we follow are presented in Note 1 of the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended

December 31, 2008.

Our critical accounting estimates are summarized below. Management considers an accounting estimate to be critical if: (1) the accounting estimate requires management to make particularly difficult, subjective and/or complex judgments about matters that are inherently uncertain, and (2) changes in the estimate that are reasonably likely to occur from period to period, or the use of different estimates that management could have reasonably used in the current period, would have a material impact on our consolidated financial statements, results of operations or liquidity.

*Allowance for Loan Losses*

The allowance for loan losses represents management's estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of subjective measurements, including management's assessment of the internal risk classifications of loans, changes in the nature of the loan portfolio, industry concentrations and the impact of current local, regional and national economic factors on the quality of the loan portfolio. Changes in these estimates and assumptions are reasonably possible and may have a material impact on our consolidated financial statements, results of operations or liquidity. The allowance for loan losses is maintained at an amount we believe is sufficient to provide for estimated losses inherent in our loan portfolio at each balance sheet date. Management continuously monitors qualitative and quantitative trends in the loan portfolio, including changes in the levels of past due, internally classified and non-performing loans. Note 1 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2008 describes the methodology used to determine the allowance for loan losses. A discussion of the factors driving changes in the amount of the allowance for loan losses is included herein under the heading *Asset Quality*.

*Goodwill*

The excess purchase price over the fair value of net assets from acquisitions, or goodwill, is evaluated for impairment at the reporting unit level at least annually, or on an interim basis if an event or circumstance indicates that it is likely an impairment has occurred. In testing for impairment, the fair value of each reporting unit is estimated based on an analysis of market-based trading and transaction multiples of selected banks in the western and central regions of the United States; and, if required, the estimated fair value is allocated to the assets and liabilities of each reporting unit. Determining the fair value of goodwill is considered a critical accounting estimate because of its sensitivity to market-based trading and transaction multiples. In addition, any allocation of the fair value of goodwill to assets and liabilities requires significant management judgment and the use of subjective measurements. Variability in the market and changes in assumptions or subjective measurements used to allocated fair value are reasonably possible and may have a material impact on our consolidated financial statements, results of operations or liquidity. Note 1 of the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2008 describes our accounting policy with regard to goodwill.

*Valuation of Mortgage Servicing Rights*

We recognize as assets the rights to service mortgage loans for others, whether acquired or internally originated. Mortgage servicing rights are initially recorded at fair value and are amortized over the period of estimated servicing income. Mortgage servicing rights are carried on the consolidated balance sheet at the lower of amortized cost or fair value. We utilize the expertise of a third-party consultant to estimate the fair value of our mortgage servicing rights quarterly. In evaluating the mortgage servicing rights, the consultant uses discounted cash flow modeling techniques, which require estimates regarding the amount and timing of expected future cash flows, including assumptions about loan repayment rates, costs to service, as well as interest rate assumptions that contemplate the risk involved. Management believes the valuation techniques and assumptions used by the consultant are reasonable.

Determining the fair value of mortgage servicing rights is considered a critical accounting estimate because of the assets' sensitivity to changes in estimates and assumptions used, particularly loan prepayment speeds and discount rates. Changes in these estimates and assumptions are reasonably possible and may have a material impact on our consolidated financial statements, results of operations or liquidity. Notes 1 and 7 of the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2008 describe the methodology we use to determine fair value of mortgage servicing rights.

**EXECUTIVE OVERVIEW**

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Net income available to common shareholders was \$12.5 million, or \$1.57 per diluted share, for the quarter ended June 30, 2009, a decrease of \$5.3 million, or 29.8%, compared to \$17.8 million, or \$2.22 per diluted common share, for the same period in 2008. For the six months ended June 30, 2009, net income available to common shareholders was \$28.3 million, or \$3.56 per diluted common share, a decrease of \$6.8 million, or 19.3%, compared to \$35.1 million, or \$4.36 per diluted share, for the same period in 2008.

Difficult economic conditions continue to have a direct negative impact on businesses and consumers in our market areas. General declines in the real estate and housing markets resulted in significant deterioration in the credit quality of our loan portfolio, which is reflected by increases in non-performing and internally risk classified loans. Our non-performing loans increased to \$135.5 million, or 2.90% of total loans, as of June 30, 2009 from \$90.9 million, or 1.90% of total loans, as of December 31, 2008. Loan charge-offs, net of recoveries, totaled \$10.2 million during the first half of 2009, as compared to \$1.9 million during the same period in 2008, with all major loan categories reflecting increases. Based on our assessment of the adequacy of our allowance for loan losses, we recorded provisions for loan losses of \$11.7 million, during second quarter 2009, compared to \$9.6 million during first quarter 2009 and \$5.3 million during second quarter 2008. Increased provisions for loan losses reflect our estimation of the effect of current economic conditions on our loan portfolio.

Declining market interest rates over the past eighteen months have reduced our yield on interest earning assets, but have also resulted in a reduction in our cost of funds, resulting in an increase in net interest income during the three and six months ended June 30, 2009, as compared to the same periods in 2008. Our net interest income, on a fully taxable equivalent, or FTE, basis, increased \$767 thousand, or 1.3%, to \$60.4 million for the three months ended June 30, 2009 as compared to \$59.7 million for the same period in 2008; and, net FTE interest income increased \$2.9 million, or 2.5%, to \$120.8 million for the six months ended June 30, 2009 as compared to \$117.8 million for the same period in 2008. These increases in net FTE interest income are driven by organic growth in interest earning assets.

Despite growth in net FTE interest income, we experienced lower interest rate spreads and compression of our net FTE interest margin during the three and six month ended June 30, 2009, as compared to the same periods in 2008. Our net FTE interest margin was 4.04% during second quarter 2009, compared to 4.12% during first quarter 2009 and 4.27% during second quarter 2008. During the six months ended June 30, 2009, our net FTE interest margin decreased 20 basis points to 4.08%, as compared to 4.28% for the same period in 2008. During the first six months of 2009, our focus on balancing growth to improve liquidity resulted in higher federal funds sold balances, which produce lower yields than other interest earnings assets. In addition, interest-free and low cost funding sources, such as demand deposits, federal funds purchased and short-term borrowings comprised a smaller percentage of our total funding base, which further compressed our net FTE interest margin.

Income from the origination and sale of loans increased \$7.0 million, or 211.7%, to \$10.4 million for the three months ended June 30, 2009, as compared to \$3.3 million for the same period in 2008. Income from the origination and sale of loans increased \$13.9 million, or 207.3%, to \$20.6 million for the six months ended June 30, 2009, as compared to \$6.7 million for the same period in 2008. Low market interest rates increased demand for residential mortgage loans, which we generally sell into the secondary market with servicing rights retained. During June 2009, long-term interest rates increased substantially. We expect this will cause a dramatic slowdown in application activity associated with fixed rate secondary market loans. If long-term rates remain at or near their existing levels, income from the origination and sale of loans will likely decrease substantially in future quarters. Increases in long-term interest rates resulted in the reversal of previously recorded impairment of mortgage servicing rights of \$7.3 million during the six months ended June 30, 2009, as compared to reversal of \$745 thousand during the same period in 2008.

During second quarter 2009, we accrued a special FDIC insurance premium assessed to all insured institutions of \$3.1 million, or 5 basis points of our total assets less tier 1 regulatory capital. In addition, our regular FDIC insurance premiums increased \$1.7 million and \$3.3 million during the three and six months ended June 30, 2009, as compared to the same periods in 2008, due to changes in assessment rates in 2009 and the full utilization of available credits to offset assessments during the first six months of 2008. We expect FDIC insurance premiums to remain elevated in 2009, as compared to 2008.

In response to the current recession and uncertain market conditions, we implemented changes to our capital management practices to ensure our long-term success and conserve capital. During second quarter 2009, we decreased quarterly dividends to \$.45 per common share, a decrease of \$.20 per common share from quarterly dividends paid during 2008 and first quarter 2009. In addition, we limited repurchase of common stock outside of our 401(k) retirement plan to no more than 600 shares per shareholder requesting redemption during second quarter 2009 and 500 shares per shareholder requesting redemption during first quarter 2009. On April 13, 2009, we received

notification that our application for participation in the TARP Capital Purchase Program was approved. We elected not to participate in this capital opportunity and are continuing to evaluate other alternative sources of additional capital.

On December 16, 2008, federal banking regulators approved a final rule permitting banking organizations to reduce the amount of goodwill deducted from tier 1 capital by the amount of any associated deferred tax liability. This rule, which became effective in January 2009, significantly increased our tier 1 and total risk-based capital ratios. Our June 30, 2009 tier 1 risk-based capital ratio was 10.01%, compared to 8.57% as of December 31, 2008, and our total risk-based capital ratio was 11.93%, compared to 10.49% as of December 31, 2008.

The following discussion and analysis is intended to provide greater details of the results of our operations and financial condition.



**RESULTS OF OPERATIONS**

*Net Interest Income.* Net interest income, our largest source of operating income, is derived from interest, dividends and fees received on interest earning assets, less interest expense incurred on interest bearing liabilities. The most significant impact on our net interest income between periods is derived from the interaction of changes in the volume of and rates earned or paid on interest earning assets and interest bearing liabilities (spread). The volume of loans, investment securities and other interest earning assets, compared to the volume of interest bearing deposits and indebtedness, combined with the spread, produces changes in the net interest income between periods. Non-interest bearing sources of funds, such as demand deposits and stockholders' equity, also support earning assets. The impact of free funding sources is captured in the net interest margin, which is calculated as net interest income divided by average earning assets. Given the interest free nature of free funding sources, the net interest margin is generally higher than the spread.

The following table presents, for the periods indicated, condensed average balance sheet information, together with interest income and yields earned on average interest earning assets and interest expense and rates paid on average interest bearing liabilities.

**Average Balance Sheets, Yields and Rates**

(Dollars in thousands)

|   | Three Months Ended June 30, |                     |                 |                     |                     |                 |
|---|-----------------------------|---------------------|-----------------|---------------------|---------------------|-----------------|
|   | 2009                        |                     |                 | 2008                |                     |                 |
|   | Average<br>Balance          | Average<br>Interest | Average<br>Rate | Average<br>Balance  | Average<br>Interest | Average<br>Rate |
| <b>Interest earning assets:</b>                   |                             |                     |                 |                     |                     |                 |
| Loans (1)   | \$ 4,693,750                | \$ 70,116           | 5.99%           | \$ 4,458,678        | \$ 75,632           | 6.82%           |
| Investment securities (1)                         | 1,030,885                   | 12,119              | 4.72            | 1,108,133           | 13,444              | 4.88            |
| Federal funds sold                                | 269,892                     | 163                 | 0.24            | 44,253              | 261                 | 2.37            |
| Interest bearing deposits in banks                | 1,509                       | 4                   | 1.06            | 4,944               | 37                  | 3.01            |
| <b>Total interest earning assets</b>              | <b>5,996,036</b>            | <b>82,402</b>       | <b>5.51%</b>    | <b>5,616,008</b>    | <b>89,374</b>       | <b>6.40%</b>    |
| Non-interest earning assets                       | 689,942                     |                     |                 | 676,388             |                     |                 |
| <b>Total assets</b>                               | <b>\$ 6,685,978</b>         |                     |                 | <b>\$ 6,292,396</b> |                     |                 |
| <b>Interest bearing liabilities:</b>              |                             |                     |                 |                     |                     |                 |
| Demand deposits                                   | \$ 1,087,671                | \$ 1,072            | 0.40%           | \$ 1,163,838        | \$ 3,414            | 1.18%           |
| Savings deposits                                  | 1,283,953                   | 2,495               | 0.78            | 1,121,819           | 4,455               | 1.60            |
| Time deposits                                     | 2,109,479                   | 15,362              | 2.92            | 1,623,799           | 16,134              | 4.00            |
| Federal funds purchased                           | 3                           |                     |                 | 92,893              | 491                 | 2.13            |
| Borrowings (2)                                    | 444,717                     | 593                 | 0.53            | 585,596             | 2,145               | 1.47            |
| Long-term debt                                    | 81,575                      | 798                 | 3.92            | 90,712              | 1,145               | 5.08            |
| Subordinated debentures                           | 123,715                     | 1,638               | 5.31            | 123,715             | 1,913               | 6.22            |
| <b>Total interest bearing liabilities</b>         | <b>5,131,113</b>            | <b>21,958</b>       | <b>1.72%</b>    | <b>4,802,372</b>    | <b>29,697</b>       | <b>2.49%</b>    |
| Non-interest bearing deposits                     | 938,467                     |                     |                 | 924,519             |                     |                 |
| Other non-interest bearing liabilities            | 66,249                      |                     |                 | 59,186              |                     |                 |
| Stockholders' equity                              | 550,149                     |                     |                 | 506,319             |                     |                 |
| <b>Total liabilities and stockholders' equity</b> | <b>\$ 6,685,978</b>         |                     |                 | <b>\$ 6,292,396</b> |                     |                 |

|  |           |           |
|--|-----------|-----------|
| Net FTE interest   | 60,444    | 59,677    |
| Less FTE adjustments                                       | (1,254)   | (1,306)   |
| Net interest income from consolidated statements of income | \$ 59,190 | \$ 58,371 |
| Interest rate spread                                       | 3.79%     | 3.91%     |
| Net FTE yield on interest earning assets (3)               | 4.04%     | 4.27%     |

(1) Interest income and average rates for tax exempt loans and securities are presented on a fully-taxable equivalent, or FTE, basis.

(2) Includes interest on securities sold under repurchase agreements and other borrowed funds. Excludes long-term debt.

(3) Net FTE yield on interest earning assets during the period equals (i) the difference between annualized interest income on interest earning assets and annualized interest expense on interest bearing liabilities, divided by (ii) average interest earning

assets for the  
period.

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|   | Six Months Ended June 30, |                   |                 |                     |                   |                 |
|---|---------------------------|-------------------|-----------------|---------------------|-------------------|-----------------|
|   | 2009                      |                   | 2008            |                     | 2008              |                 |
|   | Average<br>Balance        | Interest          | Average<br>Rate | Average<br>Balance  | Interest          | Average<br>Rate |
| <b>Interest earning assets:</b>   |                           |                   |                 |                     |                   |                 |
| Loans (1)   | \$ 4,727,885              | \$ 140,685        | 6.00%           | \$ 4,352,490        | \$ 153,660        | 7.10%           |
| Investment securities (1)   | 1,032,171                 | 24,608            | 4.81            | 1,112,715           | 27,219            | 4.92            |
| Federal funds sold  | 206,835                   | 248               | 0.24            | 57,799              | 787               | 2.74            |
| Interest bearing deposits<br>in banks                                     | 1,452                     | 8                 | 1.11            | 8,558               | 165               | 3.88            |
| <b>Total interest earning<br/>assets</b>                                  | <b>5,968,343</b>          | <b>165,549</b>    | <b>5.59%</b>    | <b>5,531,562</b>    | <b>181,831</b>    | <b>6.61%</b>    |
| Non-interest earning<br>assets  | 676,803                   |                   |                 | 647,240             |                   |                 |
| <b>Total assets</b>   | <b>\$ 6,645,146</b>       |                   |                 | <b>\$ 6,178,802</b> |                   |                 |
| <b>Interest bearing liabilities:</b>                                      |                           |                   |                 |                     |                   |                 |
| Demand deposits   | \$ 1,076,304              | \$ 2,341          | 0.44%           | \$ 1,148,412        | \$ 7,878          | 1.38%           |
| Savings deposits  | 1,263,128                 | 5,138             | 0.82            | 1,103,884           | 9,988             | 1.82            |
| Time deposits   | 2,060,118                 | 30,954            | 3.03            | 1,593,425           | 33,272            | 4.20            |
| Federal funds purchased   | 7,730                     | 10                | 0.26            | 65,617              | 772               | 2.37            |
| Borrowings (2)  | 481,752                   | 1,394             | 0.58            | 579,667             | 5,528             | 1.92            |
| Long-term debt  | 81,864                    | 1,639             | 4.04            | 88,758              | 2,352             | 5.33            |
| Subordinated debentures   | 123,715                   | 3,302             | 5.38            | 122,939             | 4,213             | 6.89            |
| <b>Total interest bearing<br/>liabilities</b>                             | <b>5,094,611</b>          | <b>44,778</b>     | <b>1.77%</b>    | <b>4,702,702</b>    | <b>64,003</b>     | <b>2.74%</b>    |
| Non-interest bearing<br>deposits  | 937,209                   |                   |                 | 921,731             |                   |                 |
| Other non-interest bearing<br>liabilities                                 | 67,781                    |                   |                 | 58,576              |                   |                 |
| Stockholders equity   | 545,545                   |                   |                 | 495,793             |                   |                 |
| <b>Total liabilities and<br/>stockholders equity</b>                      | <b>\$ 6,645,146</b>       |                   |                 | <b>\$ 6,178,802</b> |                   |                 |
| Net FTE interest  |                           | 120,771           |                 |                     | 117,828           |                 |
| Less FTE adjustments  |                           | (2,518)           |                 |                     | (2,654)           |                 |
| <b>Net interest income from<br/>consolidated statements<br/>of income</b> |                           | <b>\$ 118,253</b> |                 |                     | <b>\$ 115,174</b> |                 |
| Interest rate spread  |                           |                   | 3.82%           |                     |                   | 3.87%           |

|  |       |       |
|--|-------|-------|
| Net FTE yield on interest earning assets (3) | 4.08% | 4.28% |
|--|-------|-------|

(1) Interest income and average rates for tax exempt loans and securities are presented on a fully-taxable equivalent, or FTE, basis.

(2) Includes interest on securities sold under repurchase agreements and other borrowed funds. Excludes long-term debt.

(3) Net FTE yield on interest earning assets during the period equals (i) the difference between annualized interest income on interest earning assets and annualized interest expense on interest bearing liabilities, divided by (ii) average interest earning assets for the period.

Declining market interest rates over the past eighteen months have reduced our yield on interest earning assets, but have also resulted in a reduction in our cost of funds, resulting in an increase in net interest income during the three and six months ended June 30, 2009, as compared to the same periods in 2008. Our net interest income, on a fully taxable equivalent, or FTE, basis, increased \$767 thousand, or 1.3%, to \$60.4 million for the three months ended June 30, 2009 as compared to \$59.7 million for the same period in 2008; and, net FTE interest income increased

\$2.9 million, or 2.5%, to \$120.8 million for the six months ended June 30, 2009 as compared to \$117.8 million for the same period in 2008. These increases are primarily due to organic growth in interest earning assets.

Despite growth in net FTE interest income, we experienced lower interest rate spreads and compression of our net FTE interest margin during the three and six month ended June 30, 2009, as compared to the same periods in 2008. Our net FTE interest margin was 4.04% during second quarter 2009, compared to 4.12% during first quarter 2009 and 4.27% during second quarter 2008. During the six months ended June 30, 2009, our net FTE interest margin decreased 20 basis points to 4.08%, as compared to 4.28% for the same period in 2008. During the first six months of 2009, our focus on balancing growth to improve liquidity resulted in higher federal funds sold balances, which produce lower yields than other interest earnings assets. In addition, interest-free and low cost funding sources, such as demand deposits, federal funds purchased and short-term borrowings comprised a smaller percentage of our total funding base, which further compressed our net FTE interest margin.

The table below sets forth, for the periods indicated, a summary of the changes in interest income and interest expense resulting from estimated changes in average asset and liability balances (volume) and estimated changes in average interest rates (rate). Changes which are not due solely to volume or rate have been allocated to these categories based on the respective percent changes in average volume and average rate as they compare to each other.

**Analysis of Interest Changes Due To Volume and Rates**

*(Dollars in thousands)*

|  | Three Months Ended June 30,<br>2009 Compared with 2008 |                 |                | Six Months Ended June 30,<br>2009 Compared with 2008 |                   |                 |
|--|--|-----------------|----------------|--|-------------------|-----------------|
|  | Volume   | Rate            | Net            | Volume   | Rate              | Net             |
| <b>Interest earning assets:</b>                |  |                 |                |  |                   |                 |
| Loans (1)                                      | \$3,998  | \$ (9,514)      | \$(5,516)      | \$13,216   | \$(26,191)        | \$(12,975)      |
| Investment securities<br>(1)                   | (940)  | (385)           | (1,325)        | (1,965)  | (646)             | (2,611)         |
| Federal funds sold                             | 1,334  | (1,432)         | (98)           | 2,026  | (2,565)           | (539)           |
| Interest bearing<br>deposits in banks          | (26)   | (7)             | (33)           | (137)  | (20)              | (157)           |
| <b>Total change</b>                            | <b>4,366</b>   | <b>(11,338)</b> | <b>(6,972)</b> | <b>13,140</b>  | <b>(29,422)</b>   | <b>(16,282)</b> |
| <b>Interest bearing<br/>liabilities:</b>       |  |                 |                |  |                   |                 |
| Demand deposits                                | (224)  | (2,118)         | (2,342)        | (493)  | (5,044)           | (5,537)         |
| Savings deposits                               | 646  | (2,606)         | (1,960)        | 1,437  | (6,287)           | (4,850)         |
| Time deposits                                  | 4,839  | (5,611)         | (772)          | 9,718  | (12,036)          | (2,318)         |
| Federal funds<br>purchased                     | (492)  | 1               | (491)          | (679)  | (83)              | (762)           |
| Borrowings (2)                                 | (517)  | (1,035)         | (1,552)        | (931)  | (3,203)           | (4,134)         |
| Long-term debt                                 | (116)  | (231)           | (347)          | (182)  | (531)             | (713)           |
| Subordinated<br>debentures                     |  | (275)           | (275)          | 13   | (924)             | (911)           |
| <b>Total change</b>                            | <b>4,136</b>   | <b>(11,875)</b> | <b>(7,739)</b> | <b>8,883</b>   | <b>(28,108)</b>   | <b>(19,225)</b> |
| <b>Increase in FTE net<br/>interest income</b> | <b>\$ 230</b>  | <b>\$ 537</b>   | <b>\$ 767</b>  | <b>\$ 4,257</b>                                      | <b>\$ (1,314)</b> | <b>\$ 2,943</b> |

(1) Interest income and average rates for tax exempt loans and securities are presented on a FTE basis.

(2)

Includes interest  
on securities  
sold under  
repurchase  
agreements and  
other borrowed  
funds.

*Provision for Loan Losses.* The provision for loan losses creates an allowance for loan losses known and inherent in the loan portfolio at each balance sheet date. We perform a quarterly assessment of the risks inherent in our loan portfolio, as well as a detailed review of each significant asset with identified weaknesses. Based on this analysis, we record a provision for loan losses in order to maintain the allowance for loan losses at appropriate levels. Fluctuations in the provision for loan losses result from management's assessment of the adequacy of the allowance for loan losses. Ultimate loan losses may vary from current estimates. For additional information concerning the provision for loan losses, see *Critical Accounting Estimates and Significant Accounting Policies* above.

The provision for loan losses was \$11.7 million for second quarter 2009, as compared to \$9.6 million during first quarter 2009 and \$5.3 million for second quarter 2008. The provision for loan losses increased \$13.6 million, or 177.2%, to \$21.3 million for the six months ended June 30, 2009, compared to \$7.7 million for the same period in 2008. Fluctuations in provisions for loan losses reflect our assessment of the estimated effects of current economic conditions on our loan portfolio. Ongoing stress from weakening economic conditions has particularly affected the performance of many of our real estate development loans. For additional information regarding non-performing loans, see *Non-Performing Assets* included herein.

*Non-interest Income.* Our principal sources of non-interest income include other service charges, commissions and fees; service charges on deposit accounts; revenues from financial services; and, income from the origination and sale of loans. Non-interest income increased \$1.4 million, or 5.5%, to \$26.6 million for the three months ended June 30, 2009, as compared to \$25.2 million for the same period in 2008. Non-interest income increased \$967 thousand, or 1.9%, to \$52.6 million for the six months ended June 30, 2009, as compared to \$51.6 million for the same period in 2008. Significant components of these changes are discussed below.



Income from the origination and sale of loans includes origination and processing fees on residential real estate loans held for sale and gains on residential real estate loans sold to third parties. Fluctuations in market interest rates have a significant impact on revenues generated from the origination and sale of loans. Higher interest rates can reduce the demand for home loans and loans to refinance existing mortgages. Conversely, lower interest rates generally stimulate refinancing and home loan origination. Income from the origination and sale of loans increased \$7.0 million, or 211.7%, to \$10.4 million for the three months ended June 30, 2009, as compared to \$3.3 million for the same period in 2008. Income from the origination and sale of loans increased \$13.9 million, or 207.3%, to \$20.6 million for the six months ended June 30, 2009, as compared to \$6.7 million for the same period in 2008. Low market interest rates increased demand for residential mortgage loans, which we generally sell into the secondary market. During second quarter 2009, we sold \$436 million of loans into the secondary market, compared to \$424 million during first quarter 2009 and \$156 million during second quarter 2008. During June 2009, long-term interest rates increased substantially. This increase in rates caused a dramatic slowdown in application activity associated with fixed rate secondary market loans. If long-term rates remain at or near their existing levels, income from the origination and sale of loans will likely decrease substantially in future quarters.

Wealth management revenues are comprised principally of fees earned for management of trust assets and investment services revenues. Fees earned for management of trust assets are generally based on the market value of assets managed. Wealth management revenues decreased \$641 thousand, or 19.4%, to \$2.7 million for the three months ended June 30, 2009, as compared to \$3.3 million for the same period in 2008. Wealth management revenues decreased \$1.3 million, or 20.6%, to \$5.2 million for the six months ended June 30, 2009, as compared to \$6.5 million for the same period in 2008. Quarter-to-date and year-to-date decreases in wealth management revenues are due to reductions in the market values of assets under trust management.

Other income primarily includes company-owned life insurance revenues, check printing income, agency stock dividends and gains on sales of assets other than investment securities. Other income decreased \$184 thousand, or 8.8%, to \$1.9 million for the three months ended June 30, 2009, as compared to \$2.1 million for the same period in 2008. Other income decreased \$2.4 million, or 41.9%, to \$3.3 million for the six months ended June 30, 2009, as compared to \$5.7 million for the same period in 2008. The year-to-date decrease in other income is primarily due to first quarter 2008 non-recurring gains of \$1.6 million on the mandatory redemption of our class B shares of Visa, Inc. and \$1.1 million from the release of escrow funds related to the December 2006 sale of our interest in an internet bill payment company.

On December 31, 2008, we completed the sale of i\_Tech to Fiserv Solutions, Inc. We recorded a \$27.1 million net gain on the sale in 2008. i\_Tech provided technology support services to us, our banks and non-bank subsidiaries, and to non-affiliated customers in our market areas and nine additional states. During the three and six months ended June 30, 2008, i\_Tech generated \$4.4 million and \$8.7 million, respectively, in non-affiliate revenues. Subsequent to the sale, we no longer receive technology services revenues from non-affiliates.

*Non-interest Expense.* Non-interest expense increased \$4.4 million, or 8.9%, to \$54.1 million for the three months ended June 30, 2009, as compared to \$49.7 million for the same period in 2008. Non-interest expense increased \$1.4 million, or 1.4%, to \$104.3 million for the six months ended June 30, 2009, as compared to \$102.8 million for the same period in 2008. Significant components of these changes are discussed below.

Furniture and equipment expense decreased \$1.9 million, or 38.4%, to \$3.0 million for the three months ended June 30, 2009, as compared to \$4.9 million for the same period in 2008. Furniture and equipment expense decreased \$3.5 million, or 36.7%, to \$6.0 million for the six months ended June 30, 2009, as compared to \$9.5 million for the same period in 2008. Decreases in equipment maintenance and depreciation expense during the three and six months ended June 30, 2009, as compared to the same periods in 2008, were due primarily to the sale of i\_Tech in December 2008.

Mortgage servicing rights are amortized in proportion to and over the period of estimated net servicing income. Changes in estimated servicing period and growth in the serviced loan portfolio cause amortization expense to vary between periods. The period of estimated net servicing income is significantly influenced by market interest rates. We project our amortization of mortgage servicing rights based on quarterly prepayment assumptions. Significant declines in long-term interest rates during December 2008 caused prepayment assumptions to be adjusted upward leading to a

reduction in the anticipated period of estimated net servicing income. These changes resulted in additional mortgage servicing rights amortization during the three and six months ended June 30, 2009. Mortgage servicing rights amortization increased \$714 thousand, or 49.9%, to \$2.1 million for the three months ended June 30, 2009, as compared to \$1.4 million for the same period in 2008. Mortgage servicing rights amortization increased \$2.3 million, or 81.2%, to \$5.1 million for the six months ended June 30, 2009, as compared to \$2.8 million for the same period in 2008.

Mortgage servicing rights are evaluated quarterly for impairment based on the fair value of the mortgage servicing rights. The fair value of mortgage servicing rights is estimated by discounting the expected future cash flows, taking into consideration the estimated level of prepayments based on current industry expectations and the predominant risk characteristics of the underlying loans. During a period of declining interest rates, the fair value of mortgage servicing rights is expected to decline due to anticipated prepayments within the portfolio. Alternatively, during a period of rising interest rates, the fair value of mortgage servicing rights is expected to increase because prepayments of the underlying loans would be anticipated to decline. Impairment adjustments are recorded through a valuation allowance. The valuation allowance is adjusted for changes in impairment through a charge to current period earnings. During second quarter 2009, we reversed previously recorded impairment of \$4.4 million, compared to a reversal of impairment of \$4.3 million during second quarter 2008. During the six months ended June 30, 2009, we reversed previously recorded impairment of \$7.3 million, as compared to a reversal of impairment of \$745 thousand during the same period in 2008.

FDIC insurance premiums increased \$4.8 million, or 668.8%, to \$5.5 million for the three months ended June 30, 2009, compared to \$719 thousand for the same period in 2008. FDIC insurance premiums increased \$6.5 million, or 710.1%, to \$7.4 million for the six months ended June 30, 2009, compared to \$909 thousand for the same period in 2008. These increases in deposit insurance expense were due to increases in the fee assessment rates during 2009 and a special assessment applied to all insured institutions as of June 30, 2009 described below. The increases were also partly related to the additional 10 basis point per annum assessment paid on covered transaction accounts exceeding \$250 thousand under the deposit insurance coverage guarantee program and the full utilization of available credits to offset assessments during the first six months of 2008. We expect FDIC insurance premiums to remain elevated in 2009, as compared to 2008.

In May 2009, the FDIC issued a final rule which levied a special assessment applicable to all insured depository institutions totaling 5 basis points of each institution's total assets less tier 1 capital as of June 30, 2009, not to exceed 10 basis points of domestic deposits. The special assessment is part of the FDIC's efforts to rebuild the Deposit Insurance Funds, or DIF. Our FDIC insurance premium expense during the three and six months ended June 30, 2009 includes a \$3.1 million accrual related to this special assessment. The final rule also allows the FDIC to impose up to two additional 5 basis point special assessments if needed. Any additional special assessments imposed would also be capped at 10 basis points of domestic deposits.

Outsourced technology services expense increased \$2.4 million, or 290.4%, to \$3.2 million for the three months ended June 30, 2009, compared to \$841 thousand for the same period in 2008. Outsourced technology services expense increased \$4.1 million, or 221.3%, to \$6.0 million for the six months ended June 30, 2009, compared to \$1.9 million for the same period in 2008. Concurrent with the December 31, 2008 sale of i\_Tech, we entered into a service agreement with Fiserv Solutions, Inc. to receive data processing, electronic funds transfer and other technology services previously provided by i\_Tech.

*Income Tax Expense.* Our effective federal income tax rate was 29.4% for the six months ended June 30, 2009 and 30.4% for the six months ended June 30, 2008. State income tax applies primarily to pretax earnings generated within Montana and South Dakota. Our effective state tax rate was 4.2% for the six months ended June 30, 2009, and 4.4% for the six months ended June 30, 2008. Changes in effective federal and state income tax rates are primarily fluctuations in tax exempt interest income as a percentage of total income.

## **OPERATING SEGMENT RESULTS**

Our only operating segment is community banking, which encompasses commercial and consumer banking services offered to individuals, businesses, municipalities and other entities. Activities conducted by the Parent Company and its nonbank subsidiaries are incidental to community banking and, therefore, are not considered operating segments as defined by SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*.

Prior to 2009, we reported two operating segments, community banking and technology services. Technology services encompassed services provided through i\_Tech to affiliated and non-affiliated customers. On December 31, 2008, we sold i\_Tech and moved certain operational functions previously provided by i\_Tech to our banking subsidiaries.

**FINANCIAL CONDITION**

Total assets increased \$149 million, or 2.2%, to \$6,777 million as of June 30, 2009, from \$6,628 million as of December 31, 2008, due to the deployment of funds generated through organic deposit growth.

*Loans.* Our loan portfolio consists of a mix of real estate, consumer, commercial, agricultural and other loans, including fixed and variable rate loans. Fluctuations in the loan portfolio are directly related to the economies of the communities we serve.

The following table presents the composition of our loan portfolio as of the dates indicated:

**Loan Portfolio**

*(Dollars in thousands)*

|                                    | June 30,<br>2009    | Percent<br>of<br>Total | December<br>31,<br>2008 | Percent<br>of<br>Total |
|------------------------------------|---------------------|------------------------|-------------------------|------------------------|
| <b>Real estate loans:</b>          |                     |                        |                         |                        |
| Residential                        | \$ 557,196          | 11.9%                  | \$ 587,464              | 12.3%                  |
| Agricultural                       | 199,583             | 4.3                    | 191,831                 | 4.0                    |
| Commercial                         | 1,543,640           | 33.1                   | 1,483,967               | 31.1                   |
| Construction                       | 715,572             | 15.4                   | 790,177                 | 16.5                   |
| Mortgage loans originated for sale | 46,370              | 1.0                    | 47,076                  | 1.0                    |
| <b>Total real estate loans</b>     | <b>3,062,361</b>    | <b>65.7</b>            | <b>3,100,515</b>        | <b>64.9</b>            |
| <b>Consumer:</b>                   |                     |                        |                         |                        |
| Indirect consumer loans            | 429,300             | 9.2                    | 417,243                 | 8.7                    |
| Credit card loans                  | 55,366              | 1.2                    | 54,164                  | 1.1                    |
| Other consumer loans               | 179,341             | 3.8                    | 198,324                 | 4.2                    |
| <b>Total consumer loans</b>        | <b>664,007</b>      | <b>14.2</b>            | <b>669,731</b>          | <b>14.0</b>            |
| Commercial                         | 785,478             | 16.8                   | 853,798                 | 17.9                   |
| Agricultural                       | 149,658             | 3.2                    | 145,876                 | 3.1                    |
| Other loans, including overdrafts  | 4,046               | 0.1                    | 2,893                   | 0.1                    |
| <b>Total loans</b>                 | <b>\$ 4,665,550</b> | <b>100.0%</b>          | <b>\$ 4,772,813</b>     | <b>100.0%</b>          |

Total loans decreased \$107 million, or 2.2%, to \$4,666 million as of June 30, 2009 from \$4,773 million as of December 31, 2008, with all major loan categories showing decreases with the exception of commercial real estate loans. Management attributes low loan demand during the first six months of 2009 to the continuing impact of the broad recession on borrowers in our market areas and, to a lesser extent, the movement of lower-quality loans out of our loan portfolio through charge-off, pay-off or foreclosure.

Commercial real estate loans increased \$60 million, or 4.02%, to \$1,544 million as of June 30, 2009 from \$1,484 million as of December 31, 2008. Management attributes this increase to continued funding for infrastructure on projects under construction as of December 31, 2008.

*Investment Securities.* We manage our investment portfolio to obtain the highest yield possible, while meeting our risk tolerance and liquidity guidelines and satisfying the pledging requirements for deposits of state and political subdivisions and securities sold under repurchase agreements. Investment securities decreased \$17 million, or 1.6%, to \$1,056 million as of June 30, 2009 from \$1,072 million as of December 31, 2008. During the first six months of 2009, we managed our investment portfolio to provide additional liquidity to offset anticipated decreases in deposits and increases in loans that historically have occurred during the first half of the year. During 2009, this historical trend

did not occur and our deposits grew while loan demand diminished. As such, proceeds from maturities, calls and principal paydowns of investment securities were reinvested primarily into federal funds sold. Management expects investment securities to increase in future quarters as excess liquidity is reinvested in investments securities.

We evaluate our investment portfolio quarterly for other-than-temporary declines in the market value of individual investment securities. This evaluation includes monitoring credit ratings; market, industry and corporate news; volatility in market prices; and, determining whether the market value of a security has been below its cost for an extended period of time. As of June 30, 2009, we had investment securities with fair values of \$18 million that had been in a continuous loss position more than twelve months. Gross unrealized losses on these securities totaled \$634 thousand as of June 30, 2009, and were primarily attributable to changes in interest rates. No impairment losses were recorded during the three and six months ended June 30, 2009 or 2008.

*Cash and Cash Equivalents.* Cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold for one day periods and interest bearing deposits in banks with original maturities of less than three months. Cash and cash equivalents increased \$238 million, or 75.7%, to \$552 million as of June 30, 2009 from \$314 million as of December 31, 2008, largely due to management's focus on increasing liquidity through balanced internal growth combined with decreased loan demand during the first six months of 2009.

*Mortgage Servicing Rights.* Mortgage servicing rights are initially recorded at fair value based on comparable market quotes and are amortized over the period of estimated net servicing income. Mortgage servicing rights are evaluated quarterly for impairment. Impairment adjustments, if any, are recorded through a valuation allowance. Net mortgage servicing rights increased \$10 million, or 86.9%, to \$21 million as of June 30, 2009 from \$11 million as of December 31, 2008. Recent low market interest rates increased demand for residential real estate loans, which we generally sell into the secondary market with servicing rights retained. In addition, increases in long-term interest rates in June 2009 resulted in a recovery of previously recorded impairment, which increased the carrying value of our mortgage servicing rights.

*Other Real Estate Owned.* Other real estate owned, or OREO, consists of real property acquired through foreclosure on the related collateral underlying defaulted loans. We record OREO at the lower of carrying value or fair value less estimated costs to sell. Upon initial recognition, write-downs based on the foreclosed asset's fair value less estimated selling costs at foreclosure are reported through charges to the allowance for loan losses. Estimated losses that result from the ongoing periodic valuation of these properties are charged against earnings in the period in which they are identified. OREO increased \$26 million, or 427.6%, to \$32 million as of June 30, 2009 from \$6 million as of December 31, 2008, primarily due to the foreclosure on collateral securing the loans of three residential real estate developers and one commercial real estate borrower. For additional information regarding OREO, see

Non-Performing Assets included herein.

*Deposits.* Our deposits consist of non-interest bearing and interest bearing demand, savings, individual retirement and time deposit accounts. The following table summarizes our deposits as of the dates indicated:

#### Deposits

(Dollars in thousands)

|  | June 30,<br>2009 | Percent<br>of<br>Total | December<br>31,<br>2008 | Percent<br>of<br>Total |
|--|------------------|------------------------|-------------------------|------------------------|
| Non-interest bearing demand                  | \$ 986,830       | 17.9%                  | \$ 985,155              | 19.0%                  |
| Interest bearing:                            |                  |                        |                         |                        |
| Demand                                       | 1,072,445        | 19.4                   | 1,059,818               | 20.5                   |
| Savings                                      | 1,334,962        | 24.2                   | 1,198,783               | 23.2                   |
| Time certificates of deposit, \$100 and over | 880,104          | 15.9                   | 821,437                 | 15.9                   |
| Other time deposits                          | 1,250,974        | 22.6                   | 1,109,066               | 21.4                   |
| Total interest bearing                       | 4,538,485        | 82.1                   | 4,189,104               | 81.0                   |
| Total deposits                               | \$ 5,525,315     | 100.0%                 | \$ 5,174,259            | 100.0%                 |

Total deposits increased \$351 million, or 6.8%, to \$5,525 million as of June 30, 2009 from \$5,174 million as of December 31, 2008. All categories of deposits demonstrated growth during first quarter 2009. During the first six months of 2009, there was a shift in the mix of deposits from interest-free and lower-cost deposits to higher costing savings and time deposits. Management attributes our organic deposit growth to ongoing business development in our market areas. In addition, we participate in the CDARS program, which allows us to provide competitive certificate of deposit products while maintaining FDIC insurance for customers with larger balances.

*Federal Funds Purchased.* In addition to deposits, we use federal funds purchased as a source of funds to meet the daily liquidity needs of our customers, maintain required reserves with the Federal Reserve Bank and fund growth in earning assets. As of June 30, 2009, our federal funds purchased were zero. As of December 31, 2008, we had federal funds purchased of \$31 million.

*Repurchase Agreements.* Under repurchase agreements with commercial depositors, customer deposit balances are invested in short-term U.S. government agency securities overnight and are then repurchased the following day. All outstanding repurchase agreements are due in one day. Repurchase agreements decreased \$157 million, or 29.9%, to \$368 million as of June 30, 2009 from \$526 million as of December 31, 2008, primarily due to fluctuations in the liquidity needs of our customers and the introduction of full FDIC deposit insurance coverage for certain non-interest bearing transaction deposits under the Temporary Liquidity Guarantee Program.



from \$79 million as of December 31, 2008. The decrease was due to the scheduled repayments of short-term borrowings from the Federal Home Loan Bank.

*Accounts Payable and Accrued Expenses.* Accounts payable and accrued expenses decreased \$6 million, or 12.5%, to \$45 million as of June 30, 2009 from \$51 million as of December 31, 2008 primarily due to timing of corporate income tax payments.

#### ASSET QUALITY

*Non-performing Assets.* Non-performing assets include loans past due 90 days or more and still accruing interest, non-accrual loans, loans renegotiated in troubled debt restructurings and OREO. Restructured loans are loans on which we have granted a concession on the interest rate or original repayment terms due to financial difficulties of the borrower. OREO consists of real property acquired through foreclosure on the collateral underlying defaulted loans.

The following table sets forth information regarding non-performing assets as of the dates indicated:

#### Non-Performing Assets

(Dollars in thousands)

|   | June 30,<br>2009 | March<br>31,<br>2009 | December<br>31,<br>2008 | September<br>30,<br>2008 | June 30,<br>2008 |
|---|------------------|----------------------|-------------------------|--------------------------|------------------|
| Non-performing loans:                         |                  |                      |                         |                          |                  |
| Non-accrual loans                             | \$ 120,500       | 90,852               | 85,632                  | 84,244                   | 71,100           |
| Accruing loans past due 90 days or more       | 13,954           | 11,348               | 3,828                   | 3,676                    | 20,276           |
| Restructured loans                            | 1,030            | 1,453                | 1,462                   | 1,880                    | 1,027            |
| Total non-performing loans                    | 135,484          | 103,653              | 90,922                  | 89,800                   | 92,403           |
| OREO  | 31,789           | 18,647               | 6,025                   | 3,171                    | 2,705            |
| Total non-performing assets                   | \$ 167,273       | 122,300              | 96,947                  | 92,971                   | 95,108           |
| Non-performing loans to total loans           | 2.90%            | 2.19%                | 1.90%                   | 1.89%                    | 2.02%            |
| Non-performing assets to total loans and OREO | 3.56%            | 2.58%                | 2.03%                   | 1.96%                    | 2.08%            |

Total non-performing loans increased \$45 million, or 49.0%, to \$135 million as of June 30, 2009 from \$91 million as of December 31, 2008. The increase in non-performing loans was spread primarily among the real estate construction, commercial real estate and residential real estate development categories and is attributable to general declines in markets dependent upon resort communities and second home sales, declines in real estate prices and increases in foreclosures. In addition, increasing unemployment has negatively impacted the credit performance of consumer and real estate related loans, in general. This market turmoil and tightening of credit has led to increased levels of delinquency, a lack of consumer confidence, increased market volatility and a widespread reduction of general business activities in our market areas. We expect the continuing impact of the current difficult economic conditions and rising unemployment levels in our market areas to further increase non-performing loans in future quarters. During the first six months of 2009, approximately \$39 million in relationships which were classified as non-performing at December 31, 2008 were removed from the non-performing loan classification. Approximately \$23 million of these loans were removed because we acquired the underlying collateral of the loans through foreclosure. In contrast, during the first six months of 2009, we classified approximately \$83 million of credit relationships as non-performing for the first time. Approximately \$60 million, or 96.4%, of these first-time non-performing loans were related to eighteen credit relationships.

OREO increased \$26 million, or 427.6%, to \$32 million as of June 30, 2009 from \$6 million as of December 31, 2008. Approximately 80% of this increase relates to three real estate development properties and one commercial property transferred from non-accrual loans to OREO during the first six months of 2009.

Potential problem loans consist of performing loans that have been internally risk classified due to uncertainties regarding the borrowers' ability to continue to comply with the contractual repayment terms of the loans. These loans are not included in the non-performing assets table above. There can be no assurance that we have identified and internally risk classified all of our potential problem loans. Furthermore, we cannot predict the extent to which economic conditions in our market areas may continue or worsen or the full impact such conditions may have on our loan portfolio. Accordingly, there may be other loans that will become 90 days or more past due, be placed on non-accrual, be renegotiated or become OREO in the future. Given the current economic environment and trends of increasing unemployment, we expect the level of problem loans to continue to increase in future quarters.

*Allowance for Loan Losses.* In determining the allowance for loan losses, we estimate losses on specific loans, or groups of loans, where the probable loss can be identified and reasonably determined. The balance of the allowance for loan losses is based on internally assigned risk classifications of loans, historical loan loss rates, changes in the nature of the loan portfolio, overall portfolio quality, industry concentrations, delinquency trends, current economic factors and the estimated impact of current economic conditions on certain historical loan loss rates.

The following table sets forth information regarding our allowance for loan losses as of and for the periods indicated.

### **Allowance for Loan Losses**

*(Dollars in thousands)*

|   | Three Months Ended |                   |                         |                          |                  |
|---|--------------------|-------------------|-------------------------|--------------------------|------------------|
|   | June 30,<br>2009   | March 31,<br>2009 | December<br>31,<br>2008 | September<br>30,<br>2008 | June 30,<br>2008 |
| Balance at beginning of period                      | \$ 92,223          | \$ 87,316         | \$ 77,094               | \$ 72,650                | \$ 68,415        |
| Allowance of acquired banking offices               |                    |                   |                         |                          |                  |
| Provision charged to operating expense              | 11,700             | 9,600             | 20,036                  | 5,636                    | 5,321            |
| Less loans charged off                              | (6,350)            | (5,194)           | (10,118)                | (1,653)                  | (1,627)          |
| Add back recoveries of loans previously charged off | 822                | 501               | 304                     | 461                      | 541              |
| Net loans charged-off                               | (5,528)            | (4,693)           | (9,814)                 | (1,192)                  | (1,086)          |
| Balance at end of period                            | \$ 98,395          | \$ 92,223         | \$ 87,316               | \$ 77,094                | \$ 72,650        |
| Period end loans                                    | \$ 4,665,550       | \$ 4,725,681      | \$ 4,772,813            | \$ 4,744,675             | \$ 4,570,655     |
| Average loans                                       | 4,693,750          | 4,762,021         | 4,527,987               | 4,672,200                | 4,458,678        |
| Annualized net loans charged off to average loans   | 0.48%              | 0.40%             | 0.86%                   | 0.09%                    | 0.09%            |
| Allowance to period end loans                       | 2.11%              | 1.95%             | 1.83%                   | 1.62%                    | 1.59%            |

The allowance for loan losses as a percent of total loans increased to 2.11% as of June 30, 2009 compared to 1.83% as of December 31, 2008. The increase in the allowance for loan losses as a percentage of total loans was primarily attributable to additional reserves recorded based on the estimated effects of current economic conditions on our loan portfolio and increases in past due, non-performing and internally risk classified loans. Although we believe that we have established our allowance for loan losses in accordance with accounting principles generally accepted in the United States and that the allowance for loan losses was adequate to provide for known and inherent losses in the portfolio at all times, future provisions will be subject to on-going evaluations of the risks in the loan portfolio.

### **CAPITAL RESOURCES AND LIQUIDITY MANAGEMENT**

*Capital Resources.* Stockholders' equity is influenced primarily by earnings, dividends, sales and redemptions of common stock and, to a lesser extent, changes in the unrealized holding gains or losses, net of taxes, on available-for-sale investment securities. Stockholders' equity increased \$15 million, or 2.7%, to \$554 million as of June 30, 2009 from \$539 million as of December 31, 2008, due to the retention of earnings and fluctuations in unrealized gains on available-for-sale investment securities. We paid aggregate cash dividends of \$8.7 million to

common shareholders and \$1.7 million to preferred shareholders during the six months ended June 30, 2009.

In response to the current recession and uncertain market conditions, we implemented changes to our capital management practices to ensure our long-term success and conserve capital. During second quarter 2009, we decreased quarterly dividends to \$.45 per common share, a decrease of \$.20 per common share from quarterly dividends paid during 2008 and first quarter 2009. In addition, we limited repurchase of common stock outside of our 401(k) retirement plan to no more than 600 shares per shareholder requesting redemption during second quarter 2009 and 500 shares per shareholder requesting redemption during first quarter 2009.

Pursuant to the Federal Deposit Insurance Corporation Improvement Act, the Federal Reserve and FDIC have adopted regulations setting forth a five-tier system for measuring the capital adequacy of the financial institutions they supervise. At June 30, 2009 and December 31, 2008, our bank subsidiaries each had capital levels that, in all cases, exceeded the well-capitalized guidelines. On December 16, 2008, federal banking regulators approved a final rule permitting banking organizations to reduce the amount of goodwill deducted from tier 1 capital by the amount of any associated deferred tax liability. This rule, which became effective in January 2009, significantly increased our tier 1 and total risk-based capital ratios. Our June 30, 2009 tier 1 risk-based capital ratio was 10.01%, compared to 8.57% as of December 31, 2008, and our total risk-based capital ratio was 11.93%, compared to 10.49% as of December 31, 2008. For additional information concerning our capital levels, see Notes to Consolidated Financial Statements Regulatory Capital contained herein.

In recent years, we have experienced significant growth in earning assets through a combination of organic loan and deposit growth in our existing market areas and expansion into new market areas through acquisition. To support this growth and preserve our well-capitalized status with the federal banking agencies, our board of directors, with the assistance of management, is evaluating alternative sources of additional capital. On April 13, 2009, we received notification that our application for participation in the TARP Capital Purchase Program was approved. We have elected not to participate in this program and will continue to evaluate alternative sources of additional capital.

As of June 30, 2009, we had \$39 million outstanding under a syndicated credit agreement. The syndicated credit agreement contains various covenants that, among other things, establish minimum capital and financial performance ratios; and, place certain restrictions on capital expenditures, indebtedness, redemptions or repurchases of common stock, and the amount of dividends payable to shareholders. As of June 30, 2009 we were in violation of two financial performance covenants related to non-performing assets. Additionally, as of March 31, 2009, we were in violation of one financial performance covenant related to non-performing assets. We have requested, and expect to obtain, a waiver and modification of these covenants in the near term. If we are not able to obtain a waiver and modification, we will be in default and our creditors will be entitled to pursue their remedies under the syndicated credit agreement including the possibility of an acceleration of the full amount due thereunder. If the syndicated credit agreement is not modified, management expects that similar waivers will be required in future periods.

*Liquidity.* Liquidity is our ability to meet current and future cash flow needs on a timely basis and at a reasonable cost. We manage our liquidity position to meet the daily cash flow needs of customers, while maintaining an appropriate balance between assets and liabilities to meet the return on investment objectives of our shareholders. Our liquidity position is supported by management of liquid assets and liabilities. Liquid assets include cash, interest bearing deposits in banks, federal funds sold, available-for-sale investment securities and maturing or prepaying balances in our held-to-maturity investment and loan portfolios. Liquid liabilities include core deposits, federal funds purchased, securities sold under repurchase agreements and borrowings. We do not engage in derivatives or hedging activities to support our liquidity position.

Our short-term and long-term liquidity requirements are primarily to fund on-going operations, including payment of interest on deposits and debt, extensions of credit to borrowers, capital expenditures and shareholder dividends. These liquidity requirements are met primarily through cash flow from operations, redeployment of prepaying and maturing balances in our loan and investment portfolios, debt financing and increases in customer deposits.

Other sources of liquidity are available should they be needed. These sources include the sale of loans, the ability to acquire additional national market, non-core deposits, the issuance of additional collateralized borrowings such as FHLB advances, the issuance of debt securities, additional borrowings through the Federal Reserve's discount window and the issuance of preferred or common securities.

As a holding company, we are a corporation separate and apart from our subsidiary banks and, therefore, we provide for our own liquidity. Our main sources of funding include management fees and dividends declared and paid by our subsidiaries and access to capital markets. There are statutory, regulatory and debt covenant limitations that affect the ability of our subsidiary banks to pay dividends to us.

#### **ASSET LIABILITY MANAGEMENT**

The goal of asset liability management is the prudent control of market risk, liquidity and capital. Asset liability management is governed by policies, goals and objectives adopted and reviewed by each subsidiary bank's board of

directors. The board delegates its responsibility for development of asset liability management strategies to achieve these goals and objectives to the Asset Liability Committee, or ALCO, which is comprised of members of senior management.

We target a mix of interest earning assets and interest bearing liabilities such that no more than 5% of the net interest margin will be at risk over a one-year period should short-term interest rates shift up or down 2%. As of June 30, 2009, our income simulation model predicted net interest income would decrease \$9.0 million, or 3.3%, assuming a 2% increase in short-term market interest rates and 1.0% increase in long-term interest rates. This scenario predicts that our funding sources will reprice faster than our interest earning assets.

We did not simulate a decrease in interest rates due to the extremely low rate environment as of June 30, 2009. Prime rate has historically been set at a rate of 300 basis points over the targeted federal funds rate, which is currently set between 0 and 25 basis points. Our income simulation model has an assumption that prime will continue to be set at a rate of 300 basis points over the targeted federal funds rate. Additionally, rates that are currently below 2% are modeled not to fall below 0% with an overall decrease of 2% in interest rates. In a declining rate environment, our income simulation model predicts our net interest income and net interest rate spread will decrease and our net interest margin will compress because interest expense will not decrease in direct proportion to a simulated downward shift in interest rates.

#### **RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

See Note 13 Recent Accounting Pronouncements in the accompanying Notes to Unaudited Consolidated Financial Statements included in this report for details of recently issued accounting pronouncements and their expected impact on our financial statements.

#### **Item 3.**

### **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

As of June 30, 2009, there have been no material changes in the quantitative and qualitative information about market risk provided pursuant to Item 305 of Regulation S-K as presented in our Annual Report on Form 10-K for the year ended December 31, 2008.

#### **Item 4T.**

### **CONTROLS AND PROCEDURES**

#### **Disclosure Controls and Procedures**

Our management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined under Rules 13a-15(e) and 15d-15(e) of the Exchange Act. As of June 30, 2009, an evaluation was performed, under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of June 30, 2009, were effective in ensuring that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the time periods required by the SEC's rules and forms.

#### **Changes in Internal Control Over Financial Reporting**

There were no changes in our internal controls over financial reporting for the quarter ended June 30, 2009, that have materially affected, or are reasonably likely to materially affect, such controls.

#### **Limitations on Controls and Procedures**

The effectiveness of our disclosure controls and procedures and our internal control over financial reporting is subject to various inherent limitations, including cost limitations, judgments used in decision making, assumptions about the likelihood of future events, the soundness of our systems, the possibility of human error, and the risk of fraud. Moreover, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions and the risk that the degree of compliance with policies or procedures may deteriorate over time. Because of these limitations, any system of disclosure controls and procedures or internal control over financial reporting may not be successful in preventing all errors or fraud or in making all material information known in a timely manner to the appropriate levels of management.

### **PART II.**

## OTHER INFORMATION

### Item 1. Legal Proceedings

There have been no material changes in legal proceedings as described in our Annual Report on Form 10-K for the year ended December 31, 2008.

### Item 1A. Risk Factors

There have been no material changes in risk factors described in our Annual Report on Form 10-K for the year ended December 31, 2008.

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

(a) There were no unregistered sales of equity securities during the three months ended June 30, 2009.

(b) Not applicable.

(c) The following table provides information with respect to purchases made by or on behalf of us or any affiliated purchases (as defined in Rule 10b-18(a)(3) under the Exchange Act), of our common stock during the three months ended June 30, 2009.

| Period     | Total<br>Number<br>of Shares<br>Purchased | Average<br>Price Paid<br>Per Share | Total Number<br>of<br>Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Plans<br>or Programs<br>(1) | Maximum<br>Number<br>of Shares that<br>May Yet Be<br>Purchased<br>Under the<br>Plans or<br>Programs |
|------------|---|------------------------------------|---|---|
| April 2009 | 14,434                                    | \$ 74.50                           | 0   | Not Applicable  |
| May 2009   | 2,107                                     | 61.00                              | 0   | Not Applicable  |
| June 2009  | 8,150                                     | 61.00                              | 0   | Not Applicable  |
| Total      | 24,691                                    | \$ 68.89                           | 0   | Not Applicable  |

(1) Our common stock is not actively traded, and there is no established trading market for the stock. There is only one class of common stock. As of June 30, 2009, approximately 90% of our common stock was subject to contractual



transfer restrictions set forth in shareholder agreements. We have a right of first refusal to repurchase the restricted stock. Additionally, under certain conditions we may call restricted stock held by our officers, directors and employees. We have no obligation to purchase restricted or unrestricted stock, but have historically purchased such stock. All purchases indicated in the table above were effected pursuant to private transactions.

**Item 3. Defaults upon Senior Securities**

None.

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

(a) The Annual Meeting of Shareholders of First Interstate BancSystem, Inc. was held on May 8, 2009.

(b) Five directors were elected to serve three year terms. Lyle R. Knight, James R. Scott, Jonathan R. Scott, Julie A. Scott and Ross E. Leckie were elected as directors with terms expiring in 2012. The following directors remained in office: David H. Crum, William B. Ebzery, Charles M. Heyneman, Terry W. Payne and Sandra A. Scott Suzor with terms expiring in 2010; and, Steven J. Corning, Charles E. Hart, James W. Haugh, Randall I. Scott, Thomas W. Scott, Michael J. Sullivan and Martin A. White with terms expiring in 2011.

(c) The following matters were submitted to a vote of security holders at the Annual Meeting of Shareholders:

| Matter                | Withheld/ |         | Not Voted |
|-----------------------|-----------|---------|-----------|
|                       | For       | Against |           |
| Election of Directors |           |         |           |
| Lyle R. Knight        | 6,629,268 | 558     |           |
| James R. Scott        | 6,629,363 | 463     |           |
| Jonathan R. Scott     | 6,628,386 | 1,440   |           |
| Julie A. Scott        | 6,627,745 | 2,081   |           |
| Ross E. Leckie        | 6,629,453 | 373     |           |

**Item 5. Other Information**

Not applicable or required.

**Item 6. Exhibits**

- 2.1(1) Stock Purchase Agreement dated as of September 18, 2007, by and between First Interstate BancSystem, Inc. and First Western Bancorp., Inc.
- 2.2(2) First Amendment to Stock Purchase Agreement dated as of January 10, 2008, between First Interstate BancSystem, Inc. and Christen Group, Inc. formerly known as First Western Bancorp., Inc.
- 3.1(3) Restated Articles of Incorporation dated February 27, 1986
- 3.2(4) Articles of Amendment to Restated Articles of Incorporation dated September 26, 1996
- 3.3(4) Articles of Amendment to Restated Articles of Incorporation dated September 26, 1996
- 3.4(5) Articles of Amendment to Restated Articles of Incorporation dated October 7, 1997
- 3.5(6) Articles of Amendment to Restated Articles of Incorporation dated January 9, 2008.
- 3.6(7) Restated Bylaws of First Interstate BancSystem, Inc. dated July 29, 2004
- 4.1(8) Specimen of common stock certificate of First Interstate BancSystem, Inc.
- 4.2(6) Specimen of Series A preferred stock certificate of First Interstate BancSystem, Inc.
- 4.3(3) Shareholder s Agreement for non-Scott family members
- 4.4(9) Shareholder s Agreement for non-Scott family members dated August 24, 2001
- 4.5(10) Shareholder s Agreement for non-Scott family members dated August 19, 2002
- 4.6(11) First Interstate Stockholders Agreements with Scott family members dated January 11, 1999
- 4.7(11) Specimen of Charity Shareholder s Agreement with Charitable Shareholders
- 10.1(2) Credit Agreement dated as of January 10, 2008, among First Interstate BancSystem, Inc., as Borrower; Various Lenders; and Wells Fargo Bank, National Association, as Administrative Agent.
- 10.2(12) First Amendment to Credit Agreement dated as of October 3, 2008 among First Interstate BancSystem, Inc., as Borrower, Various Lenders and Wells Fargo Bank, National Association, as Administrative Agent
- 10.3(2) Security Agreement dated as of January 10, 2008, between First Interstate BancSystem, Inc. and Wells Fargo Bank, National Association, as Administrative Agent.
- 10.4(2) Credit Agreement Re: Subordinated Term Note dated as of January 10, 2008, between First Interstate BancSystem, Inc. and First Midwest Bank.
- 10.5(3) Lease Agreement Between Billings 401 Joint Venture and First Interstate Bank Montana and addendum thereto

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- 10.6(3) Stock Option and Stock Appreciation Rights Plan of First Interstate BancSystem, Inc., as amended
- 10.7(13) 2001 Stock Option Plan
- 10.8(14) Employee Stock Purchase Plan of First Interstate BancSystem, Inc., as amended and restated effective April 30, 2008
- 10.9(15) First Interstate BancSystem, Inc. Executive Non-Qualified Deferred Compensation Plan dated November 20, 1998
- 10.10(16) First Interstate BancSystem s Deferred Compensation Plan dated December 6, 2000
- 10.11(9) First Interstate BancSystem, Inc. 2004 Restricted Stock Award Plan
- 10.12(17) First Interstate BancSystem, Inc. 2006 Equity Compensation Plan
- 10.13(18) Form of First Interstate BancSystem, Inc. 2006 Equity Compensation Plan Restricted Stock Agreement (Time) for Certain Executive Officers
- 10.14(18) Form of First Interstate BancSystem, Inc. 2006 Equity Compensation Plan Restricted

|           |   |
|-----------|---|
| 10.15     | Stock Agreement (Performance) for Certain Executive Officers<br>First Interstate BancSystem, Inc. 2006 Equity Compensation Plan Restricted Stock Agreement (Performance) for Lyle R. Knight   |
| 10.16(18) | First Interstate BancSystem, Inc. 2006 Equity Compensation Plan Restricted Stock Agreement for Lyle R. Knight   |
| 10.17(18) | Relocation Services Agreement between First Interstate BancSystem, Inc. and NRI Relocation, Inc. dated April 25, 2008 for the benefit of Julie Castle, and related Memorandum Agreement between First Interstate BancSystem, Inc. and Julie Castle dated May 23, 2008 |
| 10.18(19) | Trademark License Agreements between Wells Fargo & Company and First Interstate BancSystem, Inc.  |
| 14.1(20)  | Code of Ethics for Chief Executive Officer and Senior Financial Officers  |
| 31.1      | Certification of Quarterly Report on Form 10-Q pursuant to Section 302 of the Sarbanes-Oxley Act of 2002<br>by Chief Executive Officer  |
| 31.2      | Certification of Quarterly Report on Form 10-Q pursuant to Section 302 of the Sarbanes-Oxley Act of 2002<br>by Chief Financial Officer  |
| 32        | Certification of Quarterly Report on Form 10-Q pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |

Management contract or compensatory plan or arrangement.

- (1) Incorporated by reference to the Registrant's Form 8-K dated September 18, 2007.
- (2) Incorporated by reference to the Registrant's Form 8-K dated January 10, 2008.
- (3) Incorporated by reference to the Registrant's Registration Statement on Form S-1, No. 33-84540.

- (4) Incorporated by reference to the Registrant's Form 8-K dated October 1, 1996.
- (5) Incorporated by reference to the Registrant's Registration Statement on Form S-1, No. 333-37847.
- (6) Incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 2007.
- (7) Incorporated by reference to Registrant's Post-Effective Amendment No. 4 to Registration Statement of Form S-8, No. 333-76825.
- (8) Incorporated by reference to the Registrant's Registration Statement on Form S-1, No. 333-3250.
- (9) Incorporated by reference to the Registrant's Post-Effective Amendment No. 1 to Registration Statement on Form S-8,

No. 333-76825.

- (10) Incorporated by reference to the Registrant's Post-Effective Amendment No. 2 to Registration Statement on Form S-8, No. 333-76825.
- (11) Incorporated by reference to the Registrant's Registration Statement on Form S-8, No. 333-76825.
- (12) Incorporated by reference to the Registrant's Form 8-K dated October 3, 2008.
- (13) Incorporated by reference to the Registrant's Registration Statement on Form S-8, No. 333-106495.
- (14) Incorporated by reference to the Registrant's Registration Statement on Form S-8, No. 333-153064.
- (15) Incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 1999.

- (16) Incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 2002.
- (17) Incorporated by reference to the Registrant's Proxy Statement on Schedule 14A related to the Registrant's Annual Meeting of Shareholders to be held May 5, 2006.
- (18) Incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 2008.
- (19) Incorporated by reference to the Registrant's Registration Statement on Form S-1, No. 333-25633.
- (20) Incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 2004.

**SIGNATURES**

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

FIRST INTERSTATE BANCSYSTEM, INC.

Date August 7, 2009

/s/ LYLE R. KNIGHT  
Lyle R. Knight  
President and Chief Executive Officer

Date August 7, 2009

/s/ TERRILL R. MOORE  
Terrill R. Moore  
Executive Vice President and  
Chief Financial Officer

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