

FIRST INTERSTATE BANCSYSTEM INC  
Form 10-Q/A  
May 24, 2001

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

FORM 10-Q/A

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

For the quarterly period ended September 30, 1997.

OR

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

For the transaction period from \_\_\_\_\_ to \_\_\_\_\_

COMMISSION FILE NUMBER 333-3250  
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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.)

PO Box 30918, 401 North 31st Street, Billings, MT 59116-0918

-----  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code 406/255-5300  
-----

N/A

-----  
(Former name, former address, and former fiscal year,  
if changed since last report)

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

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requirements for the past 90 days Yes X No

The Registrant had 8,038,336 shares of common stock and 20,000 shares of preferred stock outstanding on November 1, 1997.

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

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## RESTATEMENT EXPLANATORY NOTE

In 2000, the Company determined it was necessary to restate the Company's 2000, 1999, 1998 and 1997 consolidated quarterly financial statements to change the accounting treatment for awards made pursuant to its Nonqualified Stock Option and Stock Appreciation Rights Plan ("Stock Option Plan") from fixed to variable plan accounting.

This Amendment No. 1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1997 amends and restates the previously filed Form 10-Q in its entirety. In order to preserve the nature and character of the disclosures set forth in the Form 10-Q as originally filed, no attempt has been made in this Amendment No. 1 to modify or update such disclosures except as required to reflect the effects of the restatement and to make nonsubstantial revisions to the notes to the unaudited consolidated financial statements. For additional information regarding the restatement, see "Notes to Unaudited Consolidated Financial Statements - Restatement" included in Part I, Item 1.

Effective October 7, 1997, the Company's parent company effected a four-for-one stock split of the parent company's existing common stock. All periods presented have been restated to give effect to the stock split.

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## FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES

Consolidated Balance Sheets  
(Dollars in thousands, except per share data)  
(Unaudited)

Assets	September 30, 1997 (Restated)	December 31, 1996
	-----	-----
Cash and due from banks	\$ 170,043	160,962
Federal funds sold	38,070	4,945
Interest bearing deposits in banks	42	6,545
Investment securities:		
Available-for-sale	128,590	124,502
Held-to-maturity	256,197	279,069

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	-----	-----
	384,787	403,571
Loans, net	1,467,153	1,375,479
Less allowance for loan losses	28,456	27,797
	-----	-----
Net loans	1,438,697	1,347,682
Premises and equipment, net	59,297	58,183
Accrued interest receivable	24,084	19,573
Goodwill	33,493	39,010
Other real estate owned, net	1,006	1,546
Deferred tax asset	7,534	4,921
Other assets	12,993	16,899
	-----	-----
Total assets	\$ 2,170,046	2,063,837
	=====	=====
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest bearing	\$ 376,039	385,371
Interest bearing	1,375,453	1,294,053
	-----	-----
Total deposits	1,751,492	1,679,424
Federal funds purchased	20,100	13,450
Securities sold under repurchase agreements	152,974	129,137
Accounts payable and accrued expenses	21,971	18,027
Other borrowed funds	9,845	13,071
Long-term debt	54,081	64,667
	-----	-----
Total liabilities	2,010,463	1,917,776
Stockholders' equity:		
Non-voting noncumulative 8.53% preferred stock without par value; authorized 100,000 shares; issued and outstanding 20,000 shares	20,000	20,000
Common stock without par value; authorized 20,000,000 shares; issued 7,952,748 shares at September 30, 1997 (unaudited) and 7,913,072 shares at December 31, 1996	10,035	8,941
Retained earnings	128,886	116,613
Unrealized holding gain on investment securities available-for-sale, net	662	507
	-----	-----
Total stockholders' equity	159,583	146,061
	-----	-----
Total liabilities and stockholders' equity	\$ 2,170,046	2,063,837
	=====	=====

See accompanying notes to unaudited consolidated financial statements.

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FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES

Consolidated Statements of Income  
(Dollars in thousands, except per share data)  
(Unaudited)

	For the three months ended September 30,		For the nine months ended September 30,	
	1997 (Restated)	1996	1997 (Restated)	1996
Interest income:				
Interest and fees on loans	\$ 36,186	23,509	104,419	68,109
Interest and dividends on investment securities:				
Taxable	5,454	3,187	16,216	10,118
Exempt from Federal taxes	272	243	799	741
Interest on deposit with banks	10	43	107	268
Interest on Federal funds sold	388	239	1,099	839
Total interest income	42,310	27,221	122,640	80,075
Interest expense:				
Interest on deposits	14,799	9,794	42,269	29,250
Interest on Federal funds purchased	381	178	1,466	437
Interest on securities sold under repurchase agreements	1,688	1,049	4,499	3,155
Interest on other borrowed funds	231	88	750	229
Interest on long-term debt	1,198	246	3,686	835
Total interest expense	18,297	11,355	52,670	33,906
Net interest income	24,013	15,866	69,970	46,169
Provision for loan losses	1,007	700	3,288	1,852
Net interest income after provision for loan losses	23,006	15,166	66,682	44,317
Other operating income:				
Income from fiduciary activities	981	659	3,003	2,182
Service charges on deposit accounts	2,459	1,851	7,369	5,369
Data processing	1,811	1,781	5,478	5,603
Other service charges, commissions, and fees	977	732	2,916	2,025
Net investment securities (losses) gains	(1)	--	72	2
Other income	396	318	1,270	900
Total other operating income	6,623	5,341	20,108	16,081
Other operating expenses:				
Salaries and wages	7,487	5,089	21,689	14,986
Employee benefits	2,347	1,272	7,338	3,935
Occupancy expense, net	1,554	1,019	4,635	3,059
Furniture and equipment expenses	1,908	1,532	5,662	4,283
Other real estate income, net	(362)	(3)	(477)	(162)
FDIC insurance	54	1	155	4

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Other expenses	5,682	3,148	16,814	9,160
	-----	-----	-----	-----
Total other operating expenses	18,670	12,058	55,816	35,265
	-----	-----	-----	-----
Income before income taxes	10,959	8,449	30,974	25,133
Income tax expense	4,153	3,237	11,777	9,651
	-----	-----	-----	-----
Net income	\$ 6,806	5,212	19,197	15,482
	=====	=====	=====	=====
Income per common share	\$ 0.80	0.66	2.25	1.97
	=====	=====	=====	=====
Dividends paid per common share	\$ 0.25	0.19	.71	.57
	=====	=====	=====	=====
Weighted average common shares outstanding	7,955,388	7,952,340	7,955,452	7,881,780
	=====	=====	=====	=====

See accompanying notes to unaudited consolidated financial statements.

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FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows  
(Dollars in thousands)  
(Unaudited)

	For the nine months ended September 30,	
	1997	1996
	(Restated)	
	-----	-----
Cash flows from operating activities:		
Net income	\$ 19,197	15,482
Adjustments to reconcile net income to net cash provided by operating activities:		
Provisions for loan and other real estate losses	3,284	1,831
Depreciation and amortization	6,538	3,464
Net premium amortization on investment securities	311	843
Gain on sale of investments	(72)	(2)
Gain on sale of other real estate owned	(479)	(229)
(Gain) loss on sale of property and equipment	(23)	4
Provision for deferred income taxes	(2,921)	(1,274)
Increase in interest receivable	(4,511)	(1,802)
Decrease (increase) in other assets	3,906	(361)
Increase in accounts payable and accrued expenses	7,365	523

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Net cash provided by operating activities	32,595	18,479
Cash flows from investing activities: Purchases of investment securities:		
Held-to-maturity	(421,733)	(50,164)
Available-for-sale	(51,006)	(11,509)
Proceeds from maturities and pay downs of investment securities:		
Held-to-maturity	444,692	70,673
Available-for-sale	15,790	12,352
Proceeds from sales of available-for-sale investment securities	31,265	--
Decrease in interest bearing deposits in banks	6,503	17,005
Extensions of credit to customers, net of repayments	(97,440)	(80,325)
Recoveries on loans charged-off	2,320	909
Proceeds from sale of other real estate owned	1,840	796
Capital expenditures, net	(5,487)	(4,252)
Net cash used by investing activities	(73,256)	(44,515)
Cash flows from financing activities:		
Net increase in deposits	72,068	7,738
Net increase (decrease) in federal funds and repurchase agreements	30,487	(8,249)
Net (decrease) increase in other borrowed funds	(3,226)	5,296
Proceeds from long-term borrowings	3,500	424
Repayment of long-term debt	(14,086)	(6,057)
Proceeds from issuance of common stock	2,245	3,478
Payments to retire common stock	(1,197)	(998)
Dividends paid on common stock	(5,648)	(4,463)
Dividends paid on preferred stock	(1,276)	--
Net cash provided (used) by financing activities	82,867	(2,831)
Net increase (decrease) in cash and cash equivalents	42,206	(28,867)
Cash and cash equivalents at beginning of period	165,907	143,042
Cash and cash equivalents at end of period	\$208,113	114,175

Noncash Investing and Financing Activities:

The Company transferred loans of \$817 and \$569 to other real estate owned during the nine months ended September 30, 1997 and 1996, respectively. In conjunction with stock option exercises, the Company transferred \$46 from accrued liabilities to stockholders' equity during the nine months ended September 30, 1997.

See accompanying notes to unaudited consolidated financial statements.

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In the opinion of management, the accompanying unaudited, restated consolidated financial statements contain all adjustments (all of which are of a normal recurring nature) necessary to present fairly the consolidated financial position at September 30, 1997, and the results of consolidated operations and cash flows for each of the three and nine month periods ended September 30, 1997 and 1996 in conformity with generally accepted accounting principles. The balance sheet information at December 31, 1996 is derived from audited consolidated financial statements, however, certain reclassifications have been made to conform to the September 30, 1997 presentation. For additional information regarding the restatement, see Note 10.

Effective October 7, 1997, First Interstate BancSystem of Montana, Inc. (the "Parent Company") changed its name to "First Interstate BancSystem, Inc."

(2) Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and Federal funds sold for one-day-periods.

(3) Computation of Earnings Per Share

Earnings per common share are computed by dividing net income less preferred stock dividends by the weighted average number of shares of common stock outstanding during the period presented including dilutive stock options outstanding.

(4) Cash Dividends

On October 16, 1997, the Company paid a cash dividend on third quarter earnings of \$0.26 per share to stockholders of record on that date. It has been the Company's practice to pay quarterly dividends based upon earnings. The October 1997 dividend represents 30% of the Company's net income for the quarter ended September 30, 1997 without taking into effect compensation expense related to stock options.

(5) Allowance for Loan Losses

Transactions in the allowance for loan losses for the three month and nine month periods ended September 30, 1997 and 1996 are summarized below:

	For the three months ended September 30,		For the nine months ended September 30,	
	1997	1996	1997	1996
	-----	-----	-----	-----
Balance at beginning of period	\$ 28,757	15,406	27,797	15,171
Provision charged to operating expense	1,007	700	3,288	1,852
Less loans charged-off	(1,975)	(451)	(4,949)	(2,016)
Add back recoveries of loans previously charged-off	667	261	2,320	909
	-----	-----	-----	-----
Balance at end of period	\$ 28,456	15,916	28,456	15,916



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

(6) Other Real Estate Owned (OREO)

Other real estate owned consists of the following:

	September 30, 1997	December 31, 1996
	-----	-----
Other real estate	\$ 1,468	2,057
Less allowance for OREO losses	462	511
	-----	-----
	\$ 1,006	1,546
	=====	=====

A summary of transactions in the allowance for OREO losses follows:

	For the three months ended September 30,		For the nine months ended September 30,	
	1997	1996	1997	1996
	-----	-----	-----	-----
Balance at beginning of period	\$ 462	548	511	554
Provision reversal during period	--	(21)	(4)	(21)
Loss on dispositions	--	(16)	(45)	(22)
Balance at end of period	\$ 462	511	462	511
	=====	=====	=====	=====

Changes in the balance of other real estate owned for the nine months ended September 30, 1997 and 1996 are summarized as follows: Nine months ended September 30,

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	Nine months ended September 30,	
	1997	1996
	-----	-----
Balance at beginning of period	\$ 2,057	1,903
Add transfers from loans	817	569
Less writedowns charged to reserves	(45)	--
Cash proceeds from sales	1,840	796
Less gains on sales	479	229
	-----	-----
Net basis of OREO sold	(1,361)	(567)
	-----	-----
Balance at end of period	\$ 1,468	1,905
	=====	=====

(7) Acquisitions

On February 5, 1997, First Interstate Bank of Montana, N.A. purchased the assets of Mountain Financial, a loan production office located in Eureka, Montana. The total cash purchase price of the assets acquired aggregated \$1,726, of which \$166 was for premises and equipment and the remaining \$1,560 was for loans acquired.

During June 1997, the Company finalized its allocation of purchase price related to the 1996 acquisitions of First Interstate Bank of Montana, N.A., First Interstate Bank of Wyoming, N.A. and Mountain Bank of Whitefish. Changes in preliminary estimates of the fair value of loans, other assets and other liabilities resulted in a \$3.4 million decrease in goodwill.

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

(8) Commitments and Contingencies

In the normal course of business, the Company is named or threatened to be named as defendant in various lawsuits, some of which involve claims for substantial amounts of actual and/or punitive damages. With respect to each of these suits it is the opinion of management, following consultation with legal counsel, the suits are without merit or in the event the plaintiff prevails, the ultimate liability or disposition thereof will not have a material adverse effect on the consolidated financial condition or the results of operations.

During 1985, the Company entered into a partnership agreement for the purpose of purchasing certain land and building with an aggregate cost of approximately \$20,000. The Company is a tenant in the building and owns a 50% undivided interest in the property. Indebtedness of the partnership in the amount of \$10,512 at September 30, 1997 is guaranteed by each of the partners.

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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. These instruments involve, in varying degrees, elements of credit and interest rate risk in excess of amounts recorded in the consolidated balance sheet.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Most commitments extend for no more than two years. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company holds various collateral supporting those commitments for which collateral is deemed necessary.

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. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

### (9) Accounting Pronouncements Not Yet Adopted

In February 1997, the FASB issued SFAS No. 128, "Earnings per Share," which revises the manner in which earnings per share is calculated. The statement is effective for financial statements issued for periods ending after December 15, 1997 and is not expected to have a significant impact on the Company's earnings per share.

In February 1997, the FASB issued SFAS No. 129, "Disclosure of Information about Capital Structure," which lists required disclosures about capital structure that had been included in a number of previously existing separate statements and opinions. SFAS No. 129 is effective for financial statements for periods ending after December 15, 1997.

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

In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income," which establishes standards for reporting and display of comprehensive income and its components (revenues, expenses, gains, and losses) in a full set of general-purpose financial statements. This statement requires that all items required to be recognized under

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accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. This statement does not require a specific format for that financial statement but requires that an entity display an amount representing comprehensive income for the period in that financial statement. This statement is effective for fiscal years beginning after December 15, 1997. Reclassification of financial statements for earlier periods provided for comparative purposes is required.

### (10) Restatement

In 2000, the Company determined that fixed plan accounting treatment historically afforded its Stock Option Plan was not consistent with certain elements of the Stock Option Plan's operations and accounting guidance contained in APB Opinion 25 and related interpretations. Accordingly, the Company has restated the accompanying unaudited 1997 consolidated financial statements to reflect variable plan accounting treatment for awards made pursuant to its Stock Option Plan.

The following is a summary of the effect of such restatement on the Company's consolidated financial statements:

	September 30, 1997	
	Originally Reported	Restated
 Consolidated Balance Sheets		
Deferred tax asset	\$ 6,905	7,534
Other assets	13,013	12,993
Total assets	2,169,437	2,170,046
Accounts payable and accrued expenses	20,859	21,971
Common stock	9,665	10,035
Retained earnings	129,759	128,886
	=====	=====

	For the three months ended September 30, 1997	
	Originally Reported	Restated
 Consolidated Statements of Income		
Employee benefits	\$ 2,066	2,347
	=====	=====
Income before income taxes	\$ 11,240	10,959
Income tax expense	4,264	4,153
	-----	-----
Net income	\$ 6,976	6,806
	=====	=====
Net income per common share	\$ 0.82	0.80

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

	For the nine months ended September 30, 1997	
	----- Originally Reported -----	----- Restated -----
Consolidated Statements of Income		
Employee benefits	\$ 5,898 =====	7,338 =====
Income before income taxes	\$ 32,414	30,974
Income tax expense	12,344 -----	11,777 -----
Net income	\$ 20,070 =====	19,197 =====
Net income per common share	\$ 2.36 =====	2.25 =====

Included in the 1997 restated financial statement amounts for the nine months ended September 30, 1997 are compensation expense of \$1,000 and a reduction in tax expense of \$394 related to periods prior to 1997. The impact on 1997 net income and earnings per share is a decrease to net income of \$606 and a decrease of \$0.08 to income per common share.

ITEM 2.

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

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(Dollars in thousands)

The following discussion focuses on significant factors affecting the financial condition and results of operations of First Interstate BancSystem, Inc. and Subsidiaries ("the Company") during the three and nine month periods ended September 30, 1997, with comparisons to 1996 as applicable.

### FORWARD LOOKING STATEMENTS

Certain statements contained in this review are "forward looking statements" that involve risk and uncertainties. The Company wishes to caution readers that the following factors, among others, may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include general economic and business conditions in those areas in which the Company operates, credit quality, demographic changes, competition, fluctuations in interest rates, changes in business strategy or development plans, and changes in governmental regulations.

### ACQUISITION ACTIVITY

On October 1, 1996, the Company acquired First Interstate Bank of Montana, N.A. and First Interstate Bank of Wyoming, N.A., which collectively included six branch banks (the "FIB Banks"). In December 1996, the Company acquired Mountain Bank of Whitefish ("FIB Whitefish"), which included two branch locations. Immediately prior to the acquisitions, the FIB Banks had assets of \$553.2 million and deposits of \$423.9 million, and FIB Whitefish had assets of \$66.9 million and deposits of \$54.4 million. In connection with the acquisitions, the Company increased its staffing at both the holding company and branch levels to provide administrative, data processing and other operational support to facilitate integration and operation of such banks. The FIB Banks and FIB Whitefish are collectively referred to as the "Acquired Banks" throughout this discussion.

### ASSET LIABILITY MANAGEMENT

The primary objective of the company's asset liability management process is to optimize net interest income while prudently managing balance sheet risks by understanding the levels of risk accompanying its decisions and monitoring and managing these risks. The ability to optimize net interest income is largely dependent on the Company's ability to manage the sensitivity of net interest income to actual or potential changes in interest rates. The Company uses interest sensitivity "gap" analysis, income simulation models, and, to a limited extent, duration analysis (including estimation of borrower prepayment options) to evaluate the potential effects of changing interest rates on its interest margin.

### EARNING ASSETS

Earning assets of \$1.9 billion at September 30, 1997 increased \$99.5 million, or 5.6%, from December 31, 1996 primarily due to growth in loan volume. The mix of earning assets changed little from December 31, 1996 with net loans comprising approximately 78%, held-to-maturity investment securities comprising approximately 14% and interest bearing deposits, available-for-sale investment securities and federal funds sold comprising the remaining 8%.

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Loans. Total loans increased 6.3% to \$1,467.2 million as of September 30, 1997 from \$1,379.9 million as of December 31, 1996. All major categories of loans showed increases in volumes during this period due to continued strong economic conditions in the Company's markets, internal growth resulting from the Company's marketing activities, and certain seasonal increases, particularly in agricultural lending following traditional pay-downs during the fourth quarter. The growth in loans during the first nine months of 1997 was slightly lower than the growth rate during the first nine months of 1996 due primarily to a slowing in the growth of consumer and real estate loans.

Investment Securities. The Company's investment portfolio is managed to meet the Company's liquidity needs and is utilized for pledging requirements for deposits of state and political subdivisions and securities sold under repurchase agreements. The portfolio is comprised of U.S. Treasury securities, U.S. government agency securities, tax exempt securities, corporate securities, other mortgage-backed securities, and other equity securities.

Investment securities decreased 4.7% to \$384.8 million as of September 30, 1997, as compared to \$403.6 million as of December 31, 1996. Cash proceeds from maturities, sales and principal payments during the first nine months of 1997 were generally used to provide additional liquidity to fund increases in other earning assets.

Federal Funds Sold. Federal funds sold increased approximately \$33.1 million to \$38.1 million as of September 30, 1997 from \$4.9 million as of December 31, 1996. The Company's banking subsidiaries use federal funds sold to fund the cash requirements of correspondent banks. Average federal funds sold through September 30, 1997 of \$26.1 million reflects a slight variance from 1996 average federal funds sold of \$25.5 million.

Income from Earning Assets. Income from earning assets increased 53.2% to \$122.6 million for the nine months ended September 30, 1997 from \$80.1 million for the comparable period in 1996. The increase was due primarily to the significant increase in loans, the Company's highest yielding asset. Loan volume increases resulted principally from the Acquired Banks. Without taking into account the Acquired Banks, interest income for the nine months ended September 30, 1997 would have been approximately \$80.9 million, an increase of \$800 from the same period in the prior year. This increase generally reflects a higher volume of loans processed as a result of the Company's promotional and customer development activities. The yield on average interest earning assets for the first nine months of 1997 was 8.88% compared to 8.96% for the same period in the prior year.

Income from earnings assets of \$42.3 million for the quarter ended September 30, 1997 increased \$15.1 million from \$27.2 million for the same period in the prior year. Approximately 80% of this increase is related to the Acquired Banks.

### FUNDING SOURCES

The Company utilizes various traditional funding sources to support its earning asset portfolio including deposits, borrowings, federal funds purchased and repurchase agreements.

Deposits. Total deposits increased 4.3% to \$1,751.5 million as of September 30, 1997 from \$1,679.4 million as of December 31, 1996. Increases of \$81.4 million in interest-bearing deposits for the first nine months of 1997 were partially offset by decreases of \$9.3 million in non-interest bearing deposits during the same period. The Company historically has experienced similar seasonal cycles in overall deposit growth during the first nine months of the year.

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Federal Funds Purchased and Other Borrowed Funds. Federal funds purchased for one day periods and other borrowed funds consisting primarily of short-term borrowings from the Federal Home Loan Bank increased \$3.4 million to \$29.9 million as of September 30, 1997 from \$26.5 million as of December 31, 1996. The increased borrowings were the result of funding requirements related to increases in loans and Federal funds sold during the first nine months of 1997.

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Long Term Debt. During the first nine months of 1997, the Company reduced its long-term indebtedness by \$10.6 million or 16.4%. Payments of approximately \$10.0 million on the Company's revolving term debt were funded by earnings of the Parent Company's banking subsidiaries.

Expense of Interest Bearing Liabilities. Interest expense increased 55.3% to \$52.7 million for the nine months ended September 30, 1997 from \$33.9 million for the comparable period in 1996. This increase was due primarily to the customer deposits and indebtedness incurred in connection with the Acquired Banks. Without the Acquired Banks, interest expense would have increased approximately \$2.5 million due to higher levels of interest bearing liabilities associated with internal growth. The rate on average interest bearing liabilities of 4.48% in the first nine months of 1997 decreased 5 basis points from 4.53% for the same period in the prior year.

The Company's interest expense for the three months ended September 30, 1997 was \$18.3 million, a \$6.9 million or 61.1% increase over the same period in 1996. Interest expense of the Acquired Banks and additional interest costs of funding their acquisitions accounted for nearly all of the increase.

Net Interest Income. Net interest income is derived from interest, dividends and fees received from interest-earning assets, less interest expense incurred on interest bearing liabilities. Net interest margin increased 51.5% to \$70.0 million for the nine months ended September 30, 1997 from \$46.2 million for the same period in the prior year. This increase resulted primarily from the incremental net interest income provided by the Acquired Banks. Without giving effect to the Acquired Banks, management estimates net interest income for the nine months ended September 30, 1997 would have been approximately \$46.6 million.

Provision for Loan Losses. The provision for loan losses is maintained at a level that is, in management's judgment, adequate to absorb losses inherent in the loan portfolio given past, present and expected conditions. Fluctuations in the provision for loan losses result from management's assessment of the adequacy of the allowance for loan losses. Actual loan losses may vary from current estimates.

The provision for loan losses increased 77.5% to \$3.3 million for the nine months ended September 30, 1997 from \$1.9 million for the same period in the prior year. Approximately \$1.3 million of the increase is attributable to the Acquired Banks. The remaining increase resulted from higher loan volumes and an increase in classified assets.

The provision for loan losses increased \$307 for the quarter ended September 30, 1997 from the same period in the prior year. This increase relates



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principally to the Acquired Banks.

### LIQUIDITY

The Company actively manages its liquidity position through established policies and procedures. Management has also developed contingency plans to address potential liquidity needs. The Company's current liquidity position is supported largely through core deposits and from its investment portfolio.

The current investment portfolio contains a mix of maturities which provide a structured flow of maturing and reinvestable funds that can be converted to cash, should the need arise. Maturing balances in the loan portfolio also provide options for managing cash flows and provide an important source of intermediate and long-term liquidity.

Alternate sources of liquidity are provided by Federal funds lines carried with upstream and downstream correspondent banks. Additional liquidity could also be generated through borrowings from the Federal Reserve Bank of Minneapolis and the Federal Home Loan Bank of Seattle. Additionally, the Company had \$8.8 million available on its revolving term loan at September 30, 1997.

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### OTHER OPERATING INCOME AND EXPENSE

#### OTHER OPERATING INCOME

Principal sources of other operating income include service charges on deposit accounts, data processing fees, income from fiduciary activities, comprised principally of fees earned on trust assets, and other service charges, commissions and fees. Other operating income increased 25.0% to \$20.1 million for the nine months ended September 30, 1997 from \$16.1 million for the nine months ended September 30, 1996. Exclusive of income attributable to the Acquired Banks, other operating income for the three and nine months ended September 30, 1997 was comparable to the same period in the prior year.

All categories of other operating income increased quarter-to-date and year-to-date except data processing income. Increases in data processing income for the nine months ended September 30, 1997 compared to the same period in 1996 were more than offset by non-recurring accounting adjustments made in January 1996.

#### OTHER OPERATING EXPENSES

Other operating expenses increased 54.5% to \$18.7 million for the quarter ended September 30, 1997 from \$12.1 for the same period in 1996. Year-to-date other operating expenses increased 58.1% to \$55.8 million for the nine months ended September 30, 1997 from \$35.3 million for the same period in the prior year. These increases resulted primarily from both direct and indirect expenses attributable to the Acquired Banks. Direct expenses totaled approximately \$19.3 million for the first nine months of 1997. A significant portion of the remaining increase was due to various indirect expenses associated with the Company's need to increase its data processing support and other operating services to the Acquired Banks which had operated as dependent branch offices prior to their acquisition by the Company. Increases in administrative personnel and other resources to provide such support and services were necessary to facilitate integration of the Acquired Banks into the

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Company's operations. In addition, goodwill including core deposit intangible, associated with the acquisition of the banks resulted in increased amortization expense of approximately \$1.5 million for the nine months ended September 30, 1997. Also during the first quarter of 1997, the Company recorded compensation expense related to stock options of \$1.0 million for periods prior to 1997 as a result of restating the financial statements to reflect variable plan accounting for awards made pursuant to the Company's stock option plan. For additional information regarding the restatement, see "Restatement Explanatory Note" included in Part I and "Notes to Unaudited Consolidated Financial Statements-Restatement" included in Part I, Item 1.

Salaries and benefits expense. Salaries and benefits expense of \$29.0 million for the nine months ended September 30, 1997 increased 53.4% over the same period in 1996. Salaries and benefits expenses for the three month period ended September 30, 1997 increased 54.6% from the third quarter of the prior year. These increases are primarily due to the direct and indirect expenses attributable to the Acquired Banks, as discussed above. The indirect expenses were related particularly to the Company's data processing division and bank operation centers. In addition, \$1.0 million of the increase relates to periods prior to 1997 and is the result of the restatement previously discussed. The remainder of the increase in salaries and benefits expense was principally inflationary in nature.

Furniture, equipment and occupancy expense. Exclusive of increases directly related to the acquired banks, occupancy, furniture and equipment expenses increased approximately \$295 or 11.6% during the three month period ended September 30, 1997 and \$945 or 12.9% for the nine month period ended September 30, 1997. Increases are primarily the result of higher depreciation, maintenance and other costs related the expansion of the ATM network, additions of data processing equipment and various other computer hardware and software, including upgrades, used in the Company's operations.

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Other real estate owned. Other real estate owned ("OREO") losses, including provision for losses on OREO, are included net of any gains on sales of OREO. Variations in net OREO expense during the periods resulted principally from fluctuations in such gains. OREO expense is directly related to prevailing economic conditions, and such expense could increase significantly should an unfavorable shift occur in the economic conditions of the Company's markets.

Federal deposit insurance. Federal Deposit Insurance Corporation ("FDIC") deposit insurance premiums increased to \$155 for the nine months ended September 30, 1997 from \$4 for the same prior-year period. This increase resulted from an increase in FDIC premium assessments which became effective January 1, 1997.

Other expenses. Other expenses increased \$2.5 million for the three months ended September 30, 1997 compared to the same period in the prior year. Approximately \$1.9 million of the increase related directly to the acquired banks. The remaining increase resulted primarily from a non-recurring accrual for post-employment benefits related to the resignation of a key officer.

Other expenses increased \$7.7 million for the nine months ended September 30, 1997 compared to the same period in the prior year. Company management estimates approximately \$6.3 million of the year-to-date increase related directly to the Acquired Banks. The remaining increase is principally

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due to the non-recurring accrual discussed above, budgeted increases in advertising costs, increases in postage, supply and telephone expenses resulting from growth in the Company's deposit base, and increases in legal and professional fees due principally to revision of the Company's job evaluation system and corporate financial planning activities.

Other quarter-to-date and year-to-date variances in other expense from the same periods in the previous year are not considered individually significant.

### CAPITAL MANAGEMENT

On November 7, 1997, the Company issued \$40.0 million of 8.625% Trust Preferred Securities, through FIB Capital, a business trust subsidiary organized in October 1997. A portion of the proceeds were used to redeem the \$20.0 million non-voting, noncumulative preferred stock. The remainder of the proceeds of the offering will be used to reduce revolving term debt. In conjunction with the redemption of the Company's preferred stock, a \$500 prepayment penalty was incurred.

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### PART II. OTHER INFORMATION

ITEM 1 LEGAL PROCEEDINGS

None

ITEM 2 CHANGES IN SECURITIES

None

ITEM 3 DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5 OTHER INFORMATION

Not applicable or not required

ITEM 6 EXHIBITS AND REPORTS OF FORM 8-K

(a) Exhibits.

27 Financial Data Schedule.

(b) No reports of Form 8-K were filed for the quarter ended September 30, 1997.

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SIGNATURES

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

FIRST INTERSTATE BANCSYSTEM, INC.

Date May 16, 2001  
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/s/ Thomas W. Scott  
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Thomas W. Scott  
Chief Executive Officer

Date May 16, 2001  
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/s/ Terrill R. Moore  
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Terrill R. Moore  
Senior Vice President  
and Chief Financial Officer