

FIRST INTERSTATE BANCSYSTEM INC

Form 10-Q

November 09, 2011

[Table of Contents](#)

**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 September 30, 2011

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 001-34653

**First Interstate BancSystem, Inc.**

(Exact name of registrant as specified in its charter)

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|  |   |
|--|---|
| <b>Montana</b><br>(State or other jurisdiction of<br>incorporation or organization)    | <b>81-0331430</b><br>(IRS Employer<br>Identification No.) |
| <b>401 North 31st Street, Billings, MT</b><br>(Address of principal executive offices) | <b>59116-0918</b><br>(Zip Code)                           |
| <b>Registrant's telephone number, including area code: 406/255-5390</b>                |   |

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 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 <input type="checkbox"/> | Accelerated filer <input checked="" type="checkbox"/> |
| Non-accelerated filer <input type="checkbox"/>   | Smaller reporting company <input type="checkbox"/>    |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the Registrant's classes of common stock:

|                    |                      |            |
|--------------------|----------------------|------------|
| September 30, 2011 | Class A common stock | 16,336,108 |
| September 30, 2011 | Class B common stock | 26,643,624 |

**Table of Contents**

FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES

Quarterly Report on Form 10-Q

Index

|                                      | Page  |
|--------------------------------------|---|
| <b>Part I. Financial Information</b> |   |
| Item 1                               | Financial Statements (unaudited)  |
|                                      | <u>Consolidated Balance Sheets September 30, 2011 and December 31, 2010</u> 3                                     |
|                                      | <u>Consolidated Statements of Income Three and nine months ended September 30, 2011 and 2010</u> 4                |
|                                      | <u>Consolidated Statements of Changes in Stockholders' Equity Nine months ended September 30, 2011 and 2010</u> 5 |
|                                      | <u>Consolidated Statements of Cash Flows Nine months ended September 30, 2011 and 2010</u> 6                      |
|                                      | <u>Notes to Unaudited Consolidated Financial Statements</u> 8   |
| Item 2                               | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 27                   |
| Item 3                               | <u>Quantitative and Qualitative Disclosures about Market Risk</u> 44  |
| Item 4                               | <u>Controls and Procedures</u> 44   |
| <b>Part II. Other Information</b>    |   |
| Item 1                               | <u>Legal Proceedings</u> 45   |
| Item 1A                              | <u>Risk Factors</u> 45  |
| Item 2                               | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 45   |
| Item 3                               | <u>Defaults Upon Senior Securities</u> 45   |
| Item 4                               | <u>(Removed and Reserved)</u> 45  |
| Item 5                               | <u>Other Information</u> 45   |
| Item 6                               | <u>Exhibits</u> 45  |
|                                      | <b><u>Signatures</u></b> 47   |

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

(Unaudited)

|  | September 30,<br>2011 | December 31,<br>2010 |
|--|-----------------------|----------------------|
| <b>Assets</b>  |                       |                      |
| Cash and due from banks  | \$ 135,229            | \$ 107,035           |
| Federal funds sold   | 2,119                 | 2,114                |
| Interest bearing deposits in banks   | 366,879               | 576,469              |
| <b>Total cash and cash equivalents</b>   | <b>504,227</b>        | <b>685,618</b>       |
| Investment securities:   |                       |                      |
| Available-for-sale   | 1,896,385             | 1,786,335            |
| Held-to-maturity (estimated fair values of \$157,639 as of September 30, 2011 and \$146,508 as of December 31, 2010) | 149,411               | 147,068              |
| <b>Total investment securities</b>   | <b>2,045,796</b>      | <b>1,933,403</b>     |
| Loans held for investment  | 4,223,229             | 4,321,501            |
| Mortgage loans held for sale   | 52,488                | 46,408               |
| <b>Total loans</b>   | <b>4,275,717</b>      | <b>4,367,909</b>     |
| <b>Less allowance for loan losses</b>  | <b>120,303</b>        | <b>120,480</b>       |
| <b>Net loans</b>   | <b>4,155,414</b>      | <b>4,247,429</b>     |
| Premises and equipment, net of accumulated depreciation  | 185,742               | 188,138              |
| Goodwill   | 183,673               | 183,673              |
| Company-owned life insurance   | 74,362                | 73,056               |
| Accrued interest receivable  | 34,994                | 33,628               |
| Other real estate owned ( OREO ), net of write-downs   | 25,080                | 33,632               |
| Mortgage servicing rights, net of accumulated amortization and impairment reserve                                    | 11,909                | 13,191               |
| Deferred tax asset   | 8,393                 | 18,472               |
| Core deposit intangibles, net of accumulated amortization  | 7,719                 | 8,803                |
| Other assets   | 69,845                | 81,927               |
| <b>Total assets</b>  | <b>\$ 7,307,154</b>   | <b>\$ 7,500,970</b>  |
| <b>Liabilities and Stockholders' Equity</b>  |                       |                      |
| Deposits:  |                       |                      |
| Non-interest bearing   | \$ 1,243,703          | \$ 1,063,869         |
| Interest bearing   | 4,607,616             | 4,861,844            |
| <b>Total deposits</b>  | <b>5,851,319</b>      | <b>5,925,713</b>     |

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|   |              |              |
|---|--------------|--------------|
| Securities sold under repurchase agreements   | 475,522      | 620,154      |
| Accounts payable and accrued expenses   | 37,266       | 38,915       |
| Accrued interest payable  | 8,786        | 13,178       |
| Long-term debt  | 37,469       | 37,502       |
| Other borrowed funds  | 5,122        | 4,991        |
| Subordinated debentures held by subsidiary trusts   | 123,715      | 123,715      |
| <br>  |              |              |
| Total liabilities   | 6,539,199    | 6,764,168    |
| <br>  |              |              |
| Stockholders' equity:   |              |              |
| Nonvoting noncumulative preferred stock without par value;  |              |              |
| authorized 100,000 shares; issued and outstanding 5,000 shares as of September 30, 2011 and December 31, 2010 | 50,000       | 50,000       |
| Common stock  | 266,317      | 264,174      |
| Retained earnings   | 427,556      | 413,253      |
| Accumulated other comprehensive income, net   | 24,082       | 9,375        |
| <br>  |              |              |
| Total stockholders' equity  | 767,955      | 736,802      |
| <br>  |              |              |
| Total liabilities and stockholders' equity  | \$ 7,307,154 | \$ 7,500,970 |

*See accompanying notes to unaudited consolidated financial statements.*

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

(Unaudited)

|   | For the three months<br>ended September 30, |               | For the nine months<br>ended September 30, |                |
|---|---|---------------|--|----------------|
|   | 2011  | 2010          | 2011                                       | 2010           |
| <b>Interest income:</b>                                       |   |               |  |                |
| Interest and fees on loans                                    | \$ 61,372                                   | \$ 67,033     | \$ 185,238                                 | \$ 201,428     |
| <b>Interest and dividends on investment securities:</b>       |   |               |  |                |
| Taxable   | 10,721                                      | 10,540        | 31,281                                     | 32,673         |
| Exempt from federal taxes                                     | 1,188                                       | 1,137         | 3,553                                      | 3,476          |
| Interest on deposits in banks                                 | 200   | 252           | 794  | 733            |
| Interest on federal funds sold                                | 2   | 3             | 11   | 21             |
| <b>Total interest income</b>                                  | <b>73,483</b>                               | <b>78,965</b> | <b>220,877</b>                             | <b>238,331</b> |
| <b>Interest expense:</b>                                      |   |               |  |                |
| Interest on deposits  | 7,905                                       | 12,973        | 26,679                                     | 42,747         |
| Interest on securities sold under repurchase agreements       | 137   | 209           | 545  | 632            |
| Interest on other borrowed funds                              |   | 1             |  | 3              |
| Interest on long-term debt                                    | 498   | 512           | 1,482                                      | 1,940          |
| Interest on subordinated debentures held by subsidiary trusts | 1,451                                       | 1,526         | 4,354                                      | 4,420          |
| <b>Total interest expense</b>                                 | <b>9,991</b>                                | <b>15,221</b> | <b>33,060</b>                              | <b>49,742</b>  |
| <b>Net interest income</b>                                    | <b>63,492</b>                               | <b>63,744</b> | <b>187,817</b>                             | <b>188,589</b> |
| Provision for loan losses                                     | 14,000                                      | 18,000        | 44,400                                     | 49,400         |
| <b>Net interest income after provision for loan losses</b>    | <b>49,492</b>                               | <b>45,744</b> | <b>143,417</b>                             | <b>139,189</b> |
| <b>Non-interest income:</b>                                   |   |               |  |                |
| Other service charges, commissions and fees                   | 8,479                                       | 7,821         | 23,627                                     | 22,073         |
| Service charges on deposit accounts                           | 4,609                                       | 4,497         | 13,104                                     | 13,854         |
| Income from origination and sale of loans                     | 5,512                                       | 7,355         | 13,066                                     | 14,841         |
| Wealth management revenues                                    | 3,202                                       | 3,091         | 9,980                                      | 9,304          |
| Investment securities gains, net                              | 38  | 66            | 56   | 108            |
| Other income  | 1,285                                       | 2,025         | 5,042                                      | 5,220          |
| <b>Total non-interest income</b>                              | <b>23,125</b>                               | <b>24,855</b> | <b>64,875</b>                              | <b>65,400</b>  |
| <b>Non-interest expense:</b>                                  |   |               |  |                |
| Salaries, wages and employee benefits                         | 26,888                                      | 27,994        | 82,479                                     | 83,451         |
| Occupancy, net  | 4,180                                       | 3,939         | 12,408                                     | 12,044         |
| Furniture and equipment                                       | 3,018                                       | 3,411         | 9,367                                      | 10,108         |
| Outsourced technology services                                | 2,235                                       | 2,402         | 6,688                                      | 7,100          |
| FDIC insurance premiums                                       | 1,631                                       | 2,337         | 5,726                                      | 7,460          |
| OREO expense, net of income                                   | 2,878                                       | 2,608         | 6,631                                      | 6,129          |
| Mortgage servicing rights amortization                        | 807   | 1,221         | 2,285                                      | 3,469          |

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|   |           |          |           |           |
|---|-----------|----------|-----------|-----------|
| Mortgage servicing rights impairment        | 1,168     | 1,991    | 848       | 2,212     |
| Core deposit intangibles amortization       | 362       | 437      | 1,085     | 1,316     |
| Other expenses                              | 11,874    | 11,670   | 34,674    | 32,892    |
| Total non-interest expense                  | 55,041    | 58,010   | 162,191   | 166,181   |
| Income before income tax expense            | 17,576    | 12,589   | 46,101    | 38,408    |
| Income tax expense                          | 5,655     | 3,860    | 14,820    | 11,890    |
| Net income                                  | 11,921    | 8,729    | 31,281    | 26,518    |
| Preferred stock dividends                   | 862       | 862      | 2,559     | 2,559     |
| Net income available to common stockholders | \$ 11,059 | \$ 7,867 | \$ 28,722 | \$ 23,959 |
| Basic earnings per common share             | \$ 0.26   | \$ 0.18  | \$ 0.67   | \$ 0.61   |
| Diluted earnings per common share           | \$ 0.26   | \$ 0.18  | \$ 0.67   | \$ 0.61   |

*See accompanying notes to unaudited consolidated financial statements.*

**Table of Contents****FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES****Consolidated Statements of Changes in Stockholders' Equity**

(In thousands, except share and per share data)

(Unaudited)

|   | Preferred<br>stock | Common<br>stock | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>income | Total<br>stockholders<br>equity |
|---|--------------------|-----------------|----------------------|---|---------------------------------|
| Balance at December 31, 2010  | \$ 50,000          | \$ 264,174      | \$ 413,253           | \$ 9,375  | \$ 736,802                      |
| Comprehensive income:   |                    |                 |                      |   |                                 |
| Net income  |                    |                 | 31,281               |   | 31,281                          |
| Other comprehensive income, net of tax  |                    |                 |                      | 14,707  | 14,707                          |
| <b>Total comprehensive income</b>   |                    |                 |                      |   | <b>45,988</b>                   |
| Common stock transactions:  |                    |                 |                      |   |                                 |
| 14,464 common shares purchased and retired  |                    | (197)           |                      |   | (197)                           |
| 15,440 common shares issued   |                    | 205             |                      |   | 205                             |
| 130,904 non-vested common shares issued   |                    |                 |                      |   |                                 |
| 20,039 non-vested common shares forfeited   |                    | (101)           |                      |   | (101)                           |
| Non-vested liability awards vesting during period   |                    | 195             |                      |   | 195                             |
| 67,197 stock options exercised, net of 114,211 shares tendered in<br>payment of option price and income tax withholding amounts |                    | 272             |                      |   | 272                             |
| Tax benefit of stock-based compensation   |                    | 204             |                      |   | 204                             |
| Stock-based compensation expense  |                    | 1,565           |                      |   | 1,565                           |
| Cash dividends declared:  |                    |                 |                      |   |                                 |
| Common (\$0.3375 per share)   |                    |                 | (14,419)             |   | (14,419)                        |
| Preferred (6.75% per share)   |                    |                 | (2,559)              |   | (2,559)                         |
| Balance at September 30, 2011   | \$ 50,000          | \$ 266,317      | \$ 427,556           | \$ 24,082                                       | \$ 767,955                      |
| Balance at December 31, 2009  | \$ 50,000          | \$ 112,135      | \$ 397,224           | \$ 15,075                                       | \$ 574,434                      |
| Comprehensive income:   |                    |                 |                      |   |                                 |
| Net income  |                    |                 | 26,518               |   | 26,518                          |
| Other comprehensive income, net of tax  |                    |                 |                      | 7,873   | 7,873                           |
| <b>Total comprehensive income</b>   |                    |                 |                      |   | <b>34,391</b>                   |
| Common stock transactions:  |                    |                 |                      |   |                                 |
| 246,596 common shares purchased and retired   |                    | (3,699)         |                      |   | (3,699)                         |
| 11,506,503 common shares issued   |                    | 153,120         |                      |   | 153,120                         |
| 117,140 non-vested common shares issued   |                    |                 |                      |   |                                 |
| 14,724 non-vested common shares forfeited   |                    | (80)            |                      |   | (80)                            |
| Non-vested liability awards vesting during period   |                    | 59              |                      |   | 59                              |
| 86,129 stock options exercised, net of 69,363 shares tendered in<br>payment of option price and income tax withholding amounts  |                    | 650             |                      |   | 650                             |
| Tax benefit of stock-based compensation   |                    | 234             |                      |   | 234                             |
| Stock-based compensation expense  |                    | 1,300           |                      |   | 1,300                           |
| Cash dividends declared:  |                    |                 |                      |   |                                 |
| Common (\$0.3375 per share)   |                    |                 | (13,147)             |   | (13,147)                        |



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|                               |           |            |            |           |            |         |
|-------------------------------|-----------|------------|------------|-----------|------------|---------|
| Preferred (6.75% per share)   |           |            |            | (2,559)   |            | (2,559) |
| Balance at September 30, 2010 | \$ 50,000 | \$ 263,719 | \$ 408,036 | \$ 22,948 | \$ 744,703 |         |

*See accompanying notes to unaudited consolidated financial statements.*

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

(Unaudited)

|   | For the nine months ended<br>September 30, |                     |
|---|--|---------------------|
|   | 2011                                       | 2010                |
| Cash flows from operating activities:   |  |                     |
| Net income  | \$ 31,281                                  | \$ 26,518           |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |                     |
| Provision for loan losses   | 44,400                                     | 49,400              |
| Net loss on disposal of property and equipment                                    | 28   | 408                 |
| Depreciation and amortization   | 12,997                                     | 15,172              |
| Net premium amortization on investment securities                                 | 7,373                                      | 4,103               |
| Net gains on investment securities transactions                                   | (56)                                       | (108)               |
| Net gains on sales of mortgage loans held for sale                                | (8,730)                                    | (9,561)             |
| Net gain on sale of student loan portfolio  |  | (249)               |
| Write-down of OREO, equipment pending disposal and investments                    | 5,972                                      | 5,643               |
| Net impairment on mortgage servicing rights                                       | 848  | 2,212               |
| Loss on early extinguishment of debt  |  | 306                 |
| Deferred income tax expense (benefit)   | 400  | (2,981)             |
| Net increase in cash surrender value of company-owned life insurance policies     | (1,306)                                    | (1,493)             |
| Stock-based compensation expense  | 1,648                                      | 1,390               |
| Tax benefits from stock-based compensation expense                                | 204  | 234                 |
| Excess tax benefits from stock-based compensation                                 | (129)                                      | (220)               |
| Changes in operating assets and liabilities:                                      |  |                     |
| Decrease (increase) in mortgage loans held for sale                               | 799  | (10,591)            |
| Increase in interest receivable   | (1,366)                                    | (128)               |
| Decrease in other assets  | 10,840                                     | 7,266               |
| Decrease in accrued interest payable  | (4,392)                                    | (2,344)             |
| Decrease in accounts payable and accrued expenses                                 | (1,404)                                    | (2,941)             |
| <b>Net cash provided by operating activities</b>                                  | <b>99,407</b>                              | <b>82,036</b>       |
| Cash flows from investing activities:   |  |                     |
| Purchases of investment securities:   |  |                     |
| Held-to-maturity  | (11,626)                                   | (19,339)            |
| Available-for-sale  | (704,619)                                  | (972,742)           |
| Proceeds from maturities and paydowns of investment securities:                   |  |                     |
| Held-to-maturity  | 8,940                                      | 11,482              |
| Available-for-sale  | 611,918                                    | 606,461             |
| Proceeds from sales of mortgage servicing rights, net of acquisitions             | 596  | 597                 |
| Proceeds from sale of student loan portfolio                                      |  | 24,829              |
| Extensions of credit to customers, net of repayments                              | 40,278                                     | 16,832              |
| Recoveries of loans charged-off   | 4,269                                      | 2,100               |
| Proceeds from sales of OREO   | 12,247                                     | 15,640              |
| Capital expenditures, net of sales  | (7,099)                                    | (7,761)             |
| <b>Net cash used in investing activities</b>                                      | <b>\$ (45,096)</b>                         | <b>\$ (321,901)</b> |



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

(Unaudited)

|   | For the nine months ended<br>September 30, |            |
|---|--|------------|
|   | 2011                                       | 2010       |
| <b>Cash flows from financing activities:</b>              |  |            |
| Net (decrease) increase in deposits                       | \$ (74,394)                                | \$ 78,125  |
| Net decrease in repurchase agreements                     | (144,632)                                  | (18,280)   |
| Net increase in short-term borrowings                     | 131  | 251        |
| Repayments of long-term debt                              | (33)                                       | (35,840)   |
| Common stock issuance costs                               |  | (13,733)   |
| Proceeds from issuance of common stock                    | 272  | 167,400    |
| Excess tax benefits from stock-based compensation         | 129  | 220        |
| Purchase and retirement of common stock                   | (197)                                      | (3,699)    |
| Dividends paid to common stockholders                     | (14,419)                                   | (13,147)   |
| Dividends paid to preferred stockholders                  | (2,559)                                    | (2,559)    |
| <br>  |  |            |
| Net cash (used in) provided by financing activities       | (235,702)                                  | 158,738    |
| <br>  |  |            |
| Net decrease in cash and cash equivalents                 | (181,391)                                  | (81,127)   |
| Cash and cash equivalents at beginning of period          | 685,618                                    | 623,482    |
| <br>  |  |            |
| Cash and cash equivalents at end of period                | \$ 504,227                                 | \$ 542,355 |
| <br>  |  |            |
| <b>Supplemental disclosures of cash flow information:</b> |  |            |
| Cash paid during the period for income taxes              | \$ 12,420                                  | \$ 15,300  |
| Cash paid during the period for interest expense          | \$ 37,452                                  | \$ 52,086  |

*See accompanying notes to unaudited consolidated financial statements.*

**Table of Contents****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. 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 September 30, 2011 and December 31, 2010, the results of operations for each of the three and nine month periods ended September 30, 2011 and 2010, and cash flows for the nine months ended September 30, 2011 and 2010, in conformity with U.S. generally accepted accounting principles. The balance sheet information at December 31, 2010 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 September 30, 2011 presentation. These reclassifications did not change previously reported net income or stockholders' equity.

These unaudited 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, 2010. Operating results for the three and nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

**(2) Investment Securities**

The amortized cost and approximate fair values of investment securities are summarized as follows:

| <i>Available-for-Sale</i>                          | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|--|-------------------|------------------------------|-------------------------------|----------------------------|
| September 30, 2011                                 |                   |                              |                               |                            |
| Obligations of U.S. government agencies            | \$ 1,006,051      | \$ 7,112                     | \$ (71)                       | \$ 1,013,092               |
| U.S. agency residential mortgage-backed securities | 848,075           | 34,535                       | (100)                         | 882,510                    |
| Private residential mortgage-backed securities     | 797               | 8                            | (22)                          | 783                        |
| Total  | \$ 1,854,923      | \$ 41,655                    | \$ (193)                      | \$ 1,896,385               |

| <i>Held-to-Maturity</i>                | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|--|-------------------|------------------------------|-------------------------------|----------------------------|
| September 30, 2011                     |                   |                              |                               |                            |
| State, county and municipal securities | \$ 149,235        | \$ 8,269                     | \$ (41)                       | \$ 157,463                 |
| Other securities                       | 176               |                              |                               | 176                        |
| Total                                  | \$ 149,411        | \$ 8,269                     | \$ (41)                       | \$ 157,639                 |

| <i>Available-for-Sale</i>                          | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|--|-------------------|------------------------------|-------------------------------|----------------------------|
| December 31, 2010                                  |                   |                              |                               |                            |
| Obligations of U.S. government agencies            | \$ 956,017        | \$ 3,337                     | \$ (5,934)                    | \$ 953,420                 |
| U.S. agency residential mortgage-backed securities | 812,372           | 24,107                       | (4,619)                       | 831,860                    |
| Private residential mortgage-backed securities     | 1,057             | 10                           | (12)                          | 1,055                      |

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Total \$ 1,769,446 \$ 27,454 \$ (10,565) \$ 1,786,335

*Held-to-Maturity*

|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|--|-------------------|------------------------------|-------------------------------|----------------------------|
| December 31, 2010                      |                   |                              |                               |                            |
| State, county and municipal securities | \$ 146,850        | \$ 1,375                     | \$ (1,935)                    | \$ 146,290                 |
| Other securities                       | 218               |                              |                               | 218                        |
| <b>Total</b>                           | <b>\$ 147,068</b> | <b>\$ 1,375</b>              | <b>\$ (1,935)</b>             | <b>\$ 146,508</b>          |

Gross gains of \$38 and \$69 were realized on the disposition of available-for-sale investment securities during the three months ended September 30, 2011 and 2010, respectively. Gross gains of \$56 and \$111 were realized on the disposition of available-for-sale investment securities during the nine months ended September 30, 2011 and 2010, respectively. Gross losses of \$0 and \$3 were realized on the disposition of available-for-sale investment securities during the three and nine months ended September 30, 2011 or 2010, respectively.

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

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 September 30, 2011 and December 31, 2010.

|  | Less than 12 Months |                         | 12 Months or More |                         | Total            |                         |
|--|---------------------|-------------------------|-------------------|-------------------------|------------------|-------------------------|
|  | Fair Value          | Gross Unrealized Losses | Fair Value        | Gross Unrealized Losses | Fair Value       | Gross Unrealized Losses |
| September 30, 2011                                 |                     |                         |                   |                         |                  |                         |
| <i>Available-for-Sale</i>                          |                     |                         |                   |                         |                  |                         |
| Obligations of U.S. government agencies            | \$ 46,896           | \$ (71)                 | \$                | \$                      | \$ 46,896        | \$ (71)                 |
| U.S. agency residential mortgage-backed securities | 17,300              | (100)                   |                   |                         | 17,300           | (100)                   |
| Private residential mortgage-backed securities     | 250                 | (14)                    | 187               | (8)                     | 437              | (22)                    |
| <b>Total</b>                                       | <b>\$ 64,446</b>    | <b>\$ (185)</b>         | <b>\$ 187</b>     | <b>\$ (8)</b>           | <b>\$ 64,633</b> | <b>\$ (193)</b>         |

|  | Less than 12 Months |                         | 12 Months or More |                         | Total      |                         |
|--|---------------------|-------------------------|-------------------|-------------------------|------------|-------------------------|
|  | Fair Value          | Gross Unrealized Losses | Fair Value        | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| September 30, 2011                     |                     |                         |                   |                         |            |                         |
| <i>Held-to-Maturity</i>                |                     |                         |                   |                         |            |                         |
| State, county and municipal securities | \$                  | \$                      | \$ 3,517          | \$ (41)                 | \$ 3,517   | \$ (41)                 |

|  | Less than 12 Months |                         | 12 Months or More |                         | Total             |                         |
|--|---------------------|-------------------------|-------------------|-------------------------|-------------------|-------------------------|
|  | Fair Value          | Gross Unrealized Losses | Fair Value        | Gross Unrealized Losses | Fair Value        | Gross Unrealized Losses |
| December 31, 2010                                  |                     |                         |                   |                         |                   |                         |
| <i>Available-for-Sale</i>                          |                     |                         |                   |                         |                   |                         |
| Obligations of U.S. government agencies            | \$ 498,344          | \$ (5,934)              | \$                | \$                      | \$ 498,344        | \$ (5,934)              |
| U.S. agency residential mortgage-backed securities | 160,161             | (4,619)                 |                   |                         | 160,161           | (4,619)                 |
| Private residential mortgage-backed securities     |                     |                         | 249               | (12)                    | 249               | (12)                    |
| <b>Total</b>                                       | <b>\$ 658,505</b>   | <b>\$ (10,553)</b>      | <b>\$ 249</b>     | <b>\$ (12)</b>          | <b>\$ 658,754</b> | <b>\$ (10,565)</b>      |

|  | Less than 12 Months |                         | 12 Months or More |                         | Total      |                         |
|--|---------------------|-------------------------|-------------------|-------------------------|------------|-------------------------|
|  | Fair Value          | Gross Unrealized Losses | Fair Value        | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| December 31, 2010                      |                     |                         |                   |                         |            |                         |
| <i>Held-to-Maturity</i>                |                     |                         |                   |                         |            |                         |
| State, county and municipal securities | \$ 42,178           | \$ (1,814)              | \$ 3,023          | \$ (121)                | \$ 45,201  | \$ (1,935)              |

The investment portfolio is evaluated quarterly for other-than-temporary declines in the market value of each individual investment security. The Company had 13 and 128 individual investment securities that were in an unrealized loss position as of September 30, 2011 and December 31, 2010, respectively. Unrealized losses as of September 30, 2011 and December 31, 2010 related primarily to fluctuations in the current interest rates. The Company does not have the intent to sell any of the available-for-sale securities in the above table and it is more likely than not that the Company will not be required to sell any such securities before a recovery of cost. No impairment losses were recorded during the three or

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nine months ended September 30, 2011 or 2010.



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

Maturities of investment securities at September 30, 2011 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.

| September 30, 2011                    | Available-for-Sale  |                         | Held-to-Maturity  |                         |
|---------------------------------------|---------------------|-------------------------|-------------------|-------------------------|
|                                       | Amortized<br>Cost   | Estimated<br>Fair Value | Amortized<br>Cost | Estimated<br>Fair Value |
| Within one year                       | \$ 334,816          | \$ 343,657              | \$ 5,509          | \$ 5,226                |
| After one year but within five years  | 1,241,788           | 1,264,013               | 26,447            | 27,270                  |
| After five years but within ten years | 181,081             | 187,534                 | 55,712            | 59,282                  |
| After ten years                       | 97,238              | 101,181                 | 61,567            | 65,685                  |
| <b>Total</b>                          | <b>1,854,923</b>    | <b>1,896,385</b>        | <b>149,235</b>    | <b>157,463</b>          |
| Investments with no stated maturity   |                     |                         | 176               | 176                     |
| <b>Total</b>                          | <b>\$ 1,854,923</b> | <b>\$ 1,896,385</b>     | <b>\$ 149,411</b> | <b>\$ 157,639</b>       |

**(3) Loans**

The following table presents loans by class as of the dates indicated.

|                                 | September 30,<br>2011 | December 31,<br>2010 |
|---------------------------------|-----------------------|----------------------|
| <b>Real estate loans:</b>       |                       |                      |
| Commercial                      | \$ 1,561,788          | \$ 1,565,665         |
| <b>Construction:</b>            |                       |                      |
| Land acquisition & development  | 296,407               | 329,720              |
| Commercial                      | 67,261                | 98,542               |
| Residential                     | 64,098                | 99,196               |
| <b>Total construction loans</b> | <b>427,766</b>        | <b>527,458</b>       |
| Residential                     | 586,425               | 549,604              |
| Agricultural                    | 177,121               | 182,794              |
| <b>Total real estate loans</b>  | <b>2,753,100</b>      | <b>2,825,521</b>     |
| <b>Consumer loans:</b>          |                       |                      |
| Indirect consumer loans         | 415,245               | 423,552              |
| Other consumer loans            | 151,611               | 162,137              |
| Credit card loans               | 60,283                | 60,891               |
| <b>Total consumer loans</b>     | <b>627,139</b>        | <b>646,580</b>       |

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|                                   |              |              |
|-----------------------------------|--------------|--------------|
| Commercial                        | 703,010      | 730,471      |
| Agricultural                      | 136,728      | 116,546      |
| Other loans, including overdrafts | 3,252        | 2,383        |
| Loans held for investment         | 4,223,229    | 4,321,501    |
| Mortgage loans held for sale      | 52,488       | 46,408       |
| Total loans                       | \$ 4,275,717 | \$ 4,367,909 |

Commercial real estate includes loans aggregating \$883,501 and \$867,510 as of September 30, 2011 and December 31, 2010, respectively, that are owner occupied.

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

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. The following tables present the contractual aging of the Company's recorded investment in past due loans by class as of the dates indicated.

|                                    | 30 - 59<br>Days Past<br>Due | 60 - 89<br>Days Past<br>Due | > 90<br>Due Days<br>Due | Total<br>Loans 30<br>or More<br>Days Past<br>Due | Current<br>Loans    | Total<br>Loans      | > 90<br>Days<br>Past<br>Due and<br>Accruing |
|------------------------------------|-----------------------------|-----------------------------|-------------------------|--|---------------------|---------------------|---|
| As of September 30, 2011           |                             |                             |                         |  |                     |                     |   |
| <b>Real estate</b>                 |                             |                             |                         |  |                     |                     |   |
| Commercial                         | \$ 25,436                   | \$ 5,176                    | \$ 26,879               | \$ 57,491  | \$ 1,504,297        | \$ 1,561,788        | \$ 393                                      |
| <b>Construction:</b>               |                             |                             |                         |  |                     |                     |   |
| Land acquisition & development     | 8,961                       | 5,284                       | 19,285                  | 33,530   | 262,877             | 296,407             | 1,001                                       |
| Commercial                         | 30                          | 1,149                       | 6,126                   | 7,305  | 59,956              | 67,261              |   |
| Residential                        | 848                         | 477                         | 396                     | 1,721  | 62,377              | 64,098              |   |
| <b>Total construction loans</b>    | <b>9,839</b>                | <b>6,910</b>                | <b>25,807</b>           | <b>42,556</b>                                    | <b>385,210</b>      | <b>427,766</b>      | <b>1,001</b>                                |
| Residential                        | 7,850                       | 515                         | 1,011                   | 9,376  | 577,049             | 586,425             | 284   |
| Agricultural                       | 1,508                       | 59                          | 1,261                   | 2,828  | 174,293             | 177,121             |   |
| <b>Total real estate loans</b>     | <b>44,633</b>               | <b>12,660</b>               | <b>54,958</b>           | <b>112,251</b>                                   | <b>2,640,849</b>    | <b>2,753,100</b>    | <b>1,678</b>                                |
| <b>Consumer:</b>                   |                             |                             |                         |  |                     |                     |   |
| Indirect consumer loans            | 2,868                       | 225                         | 90                      | 3,183  | 412,062             | 415,245             | 3   |
| Other consumer loans               | 1,300                       | 215                         | 196                     | 1,711  | 149,900             | 151,611             | 98  |
| Credit card loans                  | 574                         | 348                         | 511                     | 1,433  | 58,850              | 60,283              | 511   |
| <b>Total consumer loans</b>        | <b>4,742</b>                | <b>788</b>                  | <b>797</b>              | <b>6,327</b>                                     | <b>620,812</b>      | <b>627,139</b>      | <b>612</b>                                  |
| Commercial                         | 13,233                      | 2,040                       | 3,958                   | 19,231   | 683,779             | 703,010             | 711   |
| Agricultural                       | 656                         | 17                          | 40                      | 713  | 136,015             | 136,728             |   |
| Other loans, including overdrafts  |                             |                             |                         |  | 3,252               | 3,252               |   |
| <b>Loans held for investment</b>   | <b>63,264</b>               | <b>15,505</b>               | <b>59,753</b>           | <b>138,522</b>                                   | <b>4,084,707</b>    | <b>4,223,229</b>    | <b>3,001</b>                                |
| Mortgage loans originated for sale |                             |                             |                         |  | 52,488              | 52,488              |   |
| <b>Total loans</b>                 | <b>\$ 63,264</b>            | <b>\$ 15,505</b>            | <b>\$ 59,753</b>        | <b>\$ 138,522</b>                                | <b>\$ 4,137,195</b> | <b>\$ 4,275,717</b> | <b>\$ 3,001</b>                             |
| As of December 31, 2010            |                             |                             |                         |  |                     |                     |   |
| <b>Real estate</b>                 |                             |                             |                         |  |                     |                     |   |
| Commercial                         | \$ 18,743                   | \$ 6,798                    | \$ 13,047               | \$ 38,588  | \$ 1,527,077        | \$ 1,565,665        | \$  |

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|                                    |                  |                  |                  |                   |                     |                     |                 |
|------------------------------------|------------------|------------------|------------------|-------------------|---------------------|---------------------|-----------------|
| <b>Construction:</b>               |                  |                  |                  |                   |                     |                     |                 |
| Land acquisition & development     | 7,225            | 3,942            | 7,462            | 18,629            | 311,091             | 329,720             |                 |
| Commercial                         | 3,870            | 137              | 3,376            | 7,383             | 91,159              | 98,542              |                 |
| Residential                        | 3,142            | 239              | 992              | 4,373             | 94,823              | 99,196              |                 |
| <b>Total construction loans</b>    | <b>14,237</b>    | <b>4,318</b>     | <b>11,830</b>    | <b>30,385</b>     | <b>497,073</b>      | <b>527,458</b>      |                 |
| <b>Residential</b>                 | <b>1,370</b>     | <b>982</b>       | <b>359</b>       | <b>2,711</b>      | <b>546,893</b>      | <b>549,604</b>      |                 |
| <b>Agricultural</b>                | <b>3,492</b>     | <b>1,770</b>     | <b>392</b>       | <b>5,654</b>      | <b>177,140</b>      | <b>182,794</b>      |                 |
| <b>Total real estate loans</b>     | <b>37,842</b>    | <b>13,868</b>    | <b>25,628</b>    | <b>77,338</b>     | <b>2,748,183</b>    | <b>2,825,521</b>    |                 |
| <b>Consumer:</b>                   |                  |                  |                  |                   |                     |                     |                 |
| Indirect consumer loans            | 3,419            | 379              | 63               | 3,861             | 419,691             | 423,552             |                 |
| Other consumer loans               | 1,391            | 248              | 583              | 2,222             | 159,915             | 162,137             | 15              |
| Credit card loans                  | 613              | 392              | 759              | 1,764             | 59,127              | 60,891              | 759             |
| <b>Total consumer loans</b>        | <b>5,423</b>     | <b>1,019</b>     | <b>1,405</b>     | <b>7,847</b>      | <b>638,733</b>      | <b>646,580</b>      | <b>774</b>      |
| Commercial                         | 5,701            | 3,112            | 9,664            | 18,477            | 711,994             | 730,471             | 957             |
| Agricultural                       | 697              | 1,417            | 142              | 2,256             | 114,290             | 116,546             | 117             |
| Other loans, including overdrafts  |                  | 123              | 4                | 127               | 2,256               | 2,383               | 4               |
| <b>Loans held for investment</b>   | <b>49,663</b>    | <b>19,539</b>    | <b>36,843</b>    | <b>106,045</b>    | <b>4,215,456</b>    | <b>4,321,501</b>    | <b>1,852</b>    |
| Mortgage loans originated for sale |                  |                  |                  |                   | 46,408              | 46,408              |                 |
| <b>Total loans</b>                 | <b>\$ 49,663</b> | <b>\$ 19,539</b> | <b>\$ 36,843</b> | <b>\$ 106,045</b> | <b>\$ 4,261,864</b> | <b>\$ 4,367,909</b> | <b>\$ 1,852</b> |

Included in total loans 30 or more days past due in the table above are loans aggregating \$73,356 and \$47,182 that were on non-accrual status as of September 30, 2011 and December 31, 2011, respectively. Included in current loans in the table above are loans aggregating \$150,605 and \$148,160 that were on non-accrual status as of September 30, 2011 and December 31, 2010, respectively.

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

The following table presents the Company's recorded investment in non-accrual loans by class as of the dates indicated:

|                                | September 30,<br>2011 | December 31,<br>2010 |
|--------------------------------|-----------------------|----------------------|
| Real estate                    |                       |                      |
| Commercial                     | \$ 77,017             | \$ 68,948            |
| Construction:                  |                       |                      |
| Land acquisition & development | 63,347                | 41,547               |
| Commercial                     | 21,189                | 16,589               |
| Residential                    | 12,503                | 16,679               |
| Total construction loans       | 97,039                | 74,815               |
| Residential                    | 13,689                | 15,222               |
| Agricultural                   | 4,491                 | 2,497                |
| Total real estate loans        | 192,236               | 161,482              |
| Consumer:                      |                       |                      |
| Indirect consumer loans        | 463                   | 564                  |
| Other consumer loans           | 838                   | 1,337                |
| Credit card loans              | 27                    | 30                   |
| Total consumer loans           | 1,328                 | 1,931                |
| Commercial                     | 29,517                | 30,953               |
| Agricultural                   | 880                   | 976                  |
| Total                          | \$ 223,961            | \$ 195,342           |

The Company considers impaired loans to include all loans risk rated doubtful, loans placed on non-accrual status and loans renegotiated in troubled debt restructurings with the exception of consumer loans. The following table presents information on the Company's recorded investment in impaired loans as of dates indicated:

|              | As of September 30, 2011                |  |   |                                 |                      |
|--------------|---|--|---|---------------------------------|----------------------|
|              | Unpaid<br>Total<br>Principal<br>Balance | Recorded<br>Investment<br>With No<br>Allowance | Recorded<br>Investment<br>With<br>Allowance | Total<br>Recorded<br>Investment | Related<br>Allowance |
| Real estate: |   |  |   |                                 |                      |
| Commercial   | \$ 101,963                              | \$ 61,672                                      | \$ 28,817                                   | \$ 90,489                       | \$ 6,829             |

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|                                 |                   |                   |                   |                   |                  |
|---------------------------------|-------------------|-------------------|-------------------|-------------------|------------------|
| Construction:                   |                   |                   |                   |                   |                  |
| Land acquisition & development  | 74,808            | 16,153            | 48,039            | 64,192            | 14,469           |
| Commercial                      | 23,078            | 13,593            | 7,596             | 21,189            | 1,864            |
| Residential                     | 16,370            | 5,104             | 10,016            | 15,120            | 2,031            |
| <b>Total construction loans</b> | <b>114,256</b>    | <b>34,850</b>     | <b>65,651</b>     | <b>100,501</b>    | <b>18,364</b>    |
| Residential                     | 23,671            | 13,225            | 10,356            | 23,581            | 2,126            |
| Agricultural                    | 9,363             | 7,824             | 991               | 8,815             | 25               |
| <b>Total real estate loans</b>  | <b>249,253</b>    | <b>117,571</b>    | <b>105,815</b>    | <b>223,386</b>    | <b>27,344</b>    |
| Commercial                      | 38,298            | 11,038            | 20,432            | 31,470            | 9,422            |
| Agricultural                    | 880               | 550               | 330               | 880               | 239              |
| <b>Total</b>                    | <b>\$ 288,431</b> | <b>\$ 129,159</b> | <b>\$ 126,577</b> | <b>\$ 255,736</b> | <b>\$ 37,005</b> |

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

|                                | As of December 31, 2010                 |  |   |                                 |                      |
|--------------------------------|---|--|---|---------------------------------|----------------------|
|                                | Unpaid<br>Total<br>Principal<br>Balance | Recorded<br>Investment<br>With No<br>Allowance | Recorded<br>Investment<br>With<br>Allowance | Total<br>Recorded<br>Investment | Related<br>Allowance |
| Real estate:                   |   |  |   |                                 |                      |
| Commercial                     | \$ 79,193                               | \$ 31,925                                      | \$ 41,703                                   | \$ 73,628                       | \$ 10,315            |
| Construction:                  |   |  |   |                                 |                      |
| Land acquisition & development | 48,371                                  | 24,120   | 20,440                                      | 44,560                          | 8,064                |
| Commercial                     | 17,458                                  | 2,976  | 13,578                                      | 16,554                          | 3,877                |
| Residential                    | 18,632                                  | 2,993  | 13,721                                      | 16,714                          | 3,431                |
| Total construction loans       | 84,461                                  | 30,089   | 47,739                                      | 77,828                          | 15,372               |
| Residential                    | 8,951                                   | 1,741  | 7,110                                       | 8,851                           | 1,266                |
| Agricultural                   | 3,045                                   | 1,065  | 1,432                                       | 2,497                           | 128                  |
| Total real estate loans        | 175,650                                 | 64,820   | 97,984                                      | 162,804                         | 27,081               |
| Commercial                     | 36,251                                  | 11,354   | 24,168                                      | 35,522                          | 14,892               |
| Agricultural                   | 976                                     | 498  | 478   | 976                             | 253                  |
| Total                          | \$ 212,877                              | \$ 76,672                                      | \$ 122,630                                  | \$ 199,302                      | \$ 42,226            |

The following table presents the average recorded investment in and income recognized on impaired loans for the periods indicated:

|                                | Three months ended<br>September 30, 2011 |                      | Nine months ended<br>September 30, 2011 |                      | Year Ended<br>December 31, 2010   |
|--------------------------------|--|----------------------|---|----------------------|-----------------------------------|
|                                | Average<br>Recorded<br>Investment        | Income<br>Recognized | Average<br>Recorded<br>Investment       | Income<br>Recognized | Average<br>Recorded<br>Investment |
| Real estate:                   |  |                      |   |                      |                                   |
| Commercial                     | \$ 86,347                                | \$ 188               | \$ 83,479                               | \$ 390               | \$ 49,713                         |
| Construction:                  |  |                      |   |                      |                                   |
| Land acquisition & development | 66,470                                   | 3                    | 54,494                                  | 90                   | 34,871                            |
| Commercial                     | 23,441                                   |                      | 20,371                                  |                      | 21,086                            |
| Residential                    | 17,627                                   | 18                   | 17,248                                  | 55                   | 15,097                            |
| Total construction loans       | 107,538                                  | 21                   | 92,113                                  | 145                  | 71,054                            |
| Residential                    | 22,972                                   | 160                  | 19,101                                  | 257                  | 10,889                            |
| Agricultural                   | 7,694                                    | 56                   | 6,392                                   | 98                   | 1,737                             |

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|                         |            |        |            |        |            |
|-------------------------|------------|--------|------------|--------|------------|
| Total real estate loans | 224,551    | 425    | 201,085    | 890    | 133,393    |
| Commercial              | 33,634     | 31     | 32,634     | 96     | 22,017     |
| Agricultural            | 885        |        | 925        |        | 974        |
| Total                   | \$ 259,070 | \$ 456 | \$ 234,644 | \$ 986 | \$ 156,384 |

For the three and nine months ended September 30, 2011, the amount of interest income recognized by the Company within the period that the loans were impaired was primarily related to loans modified in a troubled debt restructuring that remained on accrual status. Interest payments received on non-accrual impaired loans are applied to principle. Interest income is subsequently recognized only to the extent cash payments are received in excess of principle due. If interest on all impaired loans had been accrued, interest income on impaired loans during the three and nine months ended September 30, 2011 would have been approximately \$3,729 and \$10,214, respectively. If interest on all impaired loans had been accrued, interest income on impaired loans during the three and nine months ended September 30, 2010 would have been approximately \$2,675 and \$6,882, respectively.

Collateralized impaired loans are recorded at the fair value of the underlying collateral using independent appraisals and management estimates of current market conditions. The change in present value attributable to the passage of time, if applicable, is recognized in the provision for loan losses and thus no interest income is recognized.



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

Modifications of performing loans are made in the ordinary course of business and are completed on a case-by-case basis as negotiated with the borrower. Loan modifications typically include interest rate concessions, interest only periods of less than twelve months, short-term payment deferrals and extension of amortization periods to provide payment relief. A loan modification is considered a troubled debt restructuring if the borrower is experiencing financial difficulties and the Company, for economic or legal reasons, grants a concession to the borrower that it would not otherwise consider. Certain troubled debt restructurings are on non-accrual status at the time of restructuring and are typically returned to accrual status after considering the borrower's sustained repayment performance in accordance with the restructuring agreement for a reasonable period of at least six months and management is reasonably assured of future performance. If the troubled debt restructuring meets these performance criteria and the interest rate granted at the modification is equal to or greater than the rate that the Company was willing to accept at the time of the restructuring for a new loan with comparable risk, then the loan will return to performing status.

The Company had troubled debt restructurings of \$119,574 as of September 30, 2011, of which \$83,958 were included in non-accrual loans and \$35,616 were on accrual status. The Company had troubled debt restructurings of \$53,700 as of December 31, 2010, of which \$40,210 were included in non-accrual loans and \$13,490 were on accrual status.

The following tables present information on the Company's troubled debt restructurings during the periods indicated:

|                                       | Number<br>of<br>Notes | Pre-Modification Investment |                         |          | Total     | Post-<br>Modification<br>Investment |
|---------------------------------------|-----------------------|-----------------------------|-------------------------|----------|-----------|-------------------------------------|
|                                       |                       | Interest rate<br>adjustment | Interest<br>only period | Other    |           |                                     |
| Three months ended September 30, 2011 |                       |                             |                         |          |           |                                     |
| Real estate                           |                       |                             |                         |          |           |                                     |
| Commercial                            | 23                    | \$ 516                      | \$ 6,685                | \$ 2,510 | \$ 9,711  | \$ 9,703                            |
| Construction:                         |                       |                             |                         |          |           |                                     |
| Land acquisition & development        | 3                     |                             | 380                     | 408      | 788       | 788                                 |
| Residential                           | 2                     |                             | 7,749                   |          | 7,749     | 7,732                               |
| Total construction loans              | 5                     | 0                           | 8,129                   | 408      | 8,537     | 8,520                               |
| Residential                           | 1                     |                             |                         | 54       | 54        | 53                                  |
| Agricultural                          | 2                     | 189                         | 1,970                   |          | 2,159     | 2,159                               |
| Total real estate loans               | 31                    | 705                         | 16,784                  | 2,972    | 20,461    | 20,435                              |
| Consumer:                             |                       |                             |                         |          |           |                                     |
| Other consumer loans                  | 1                     |                             |                         | 50       | 50        | 50                                  |
| Total consumer loans                  | 1                     |                             |                         | 50       | 50        | 50                                  |
| Commercial                            | 8                     | 165                         | 3,387                   | 1,298    | 4,850     | 4,844                               |
| Total                                 | 40                    | \$ 870                      | \$ 20,171               | \$ 4,320 | \$ 25,361 | \$ 25,329                           |



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

| Nine months ended September 30, 2011 | Number of Notes | Interest rate adjustment | Pre-Modification Investment |                  | Total            | Post-Modification Investment |
|--------------------------------------|-----------------|--------------------------|-----------------------------|------------------|------------------|------------------------------|
|                                      |                 |                          | Interest only period        | Other            |                  |                              |
| <b>Real estate</b>                   |                 |                          |                             |                  |                  |                              |
| Commercial                           | 55              | \$ 3,031                 | \$ 23,569                   | \$ 6,897         | \$ 33,497        | \$ 33,200                    |
| <b>Construction:</b>                 |                 |                          |                             |                  |                  |                              |
| Land acquisition & development       | 9               | 680                      | 995                         | 4,532            | 6,207            | 6,194                        |
| Residential                          | 5               | 234                      | 7,749                       | 878              | 8,861            | 8,835                        |
| <b>Total construction loans</b>      | <b>14</b>       | <b>914</b>               | <b>8,744</b>                | <b>5,410</b>     | <b>15,068</b>    | <b>15,029</b>                |
| Residential                          | 6               | 223                      | 9,771                       | 954              | 10,948           | 10,886                       |
| Agricultural                         | 6               | 189                      | 3,594                       | 517              | 4,300            | 4,298                        |
| <b>Total real estate loans</b>       | <b>81</b>       | <b>4,357</b>             | <b>45,678</b>               | <b>13,778</b>    | <b>63,813</b>    | <b>63,413</b>                |
| <b>Consumer:</b>                     |                 |                          |                             |                  |                  |                              |
| Indirect consumer loans              | 2               |                          |                             | 29               | 29               | 29                           |
| Other consumer loans                 | 3               |                          | 17                          | 61               | 78               | 76                           |
| <b>Total consumer loans</b>          | <b>5</b>        | <b>0</b>                 | <b>17</b>                   | <b>90</b>        | <b>107</b>       | <b>105</b>                   |
| Commercial                           | 37              | 662                      | 11,727                      | 2,789            | 15,178           | 8,959                        |
| Agricultural                         | 5               |                          |                             | 187              | 187              | 148                          |
| <b>Total</b>                         | <b>128</b>      | <b>\$ 5,019</b>          | <b>\$ 57,422</b>            | <b>\$ 16,844</b> | <b>\$ 79,285</b> | <b>\$ 72,625</b>             |

For troubled debt restructurings that were on non-accrual status before the modification, a specific reserve may already be recorded. In periods subsequent to modification, the Company continues to evaluate all troubled debt restructurings for possible impairment and recognizes impairment through the allowance. Financial effects of modifications of troubled debt restructurings may include principle loan forgiveness or other charge-offs. The Company had no charge-offs related to modifying troubled debt restructurings for the three and nine months ended September 30, 2011.

The following table presents information on the Company's troubled debt restructurings during the previous 12 months for which there was a payment default during the periods indicated. The Company considers a payment default to occur on troubled debt restructurings when the loan is 90 days or more past due or was placed on non-accrual status after the modification. All troubled debt restructurings with payment defaults in the following table are on non-accrual status.

|                    | Three months ended September 30, 2011 |                     | Nine months ended September 30, 2011 |                     |
|--------------------|---------------------------------------|---------------------|--------------------------------------|---------------------|
|                    | Number of Notes                       | Recorded Investment | Number of Notes                      | Recorded Investment |
| <b>Real estate</b> |                                       |                     |                                      |                     |
| Commercial         | 2                                     | \$ 1,032            | 6                                    | \$ 2,432            |

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|                                |          |                 |           |                 |
|--------------------------------|----------|-----------------|-----------|-----------------|
| <b>Construction:</b>           |          |                 |           |                 |
| Land acquisition & development |          |                 | 2         | 1,338           |
| Residential                    |          |                 | 1         | 302             |
|                                |          |                 |           |                 |
| Total construction loans       |          |                 | 3         | 1,640           |
|                                |          |                 |           |                 |
| Agricultural                   |          |                 | 2         | 152             |
|                                |          |                 |           |                 |
| Total real estate loans        | 2        | 1,032           | 11        | 4,224           |
|                                |          |                 |           |                 |
| Commercial                     | 1        | 14              | 4         | 161             |
| Agricultural                   |          |                 | 3         | 37              |
|                                |          |                 |           |                 |
| <b>Total</b>                   | <b>3</b> | <b>\$ 1,046</b> | <b>18</b> | <b>\$ 4,422</b> |

At September 30, 2011, there were no material commitments to lend additional funds to borrowers whose existing loans have been renegotiated or are classified as non-accrual.

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

As part of the on-going and continuous monitoring of the credit quality of the Company's loan portfolio, management tracks internally assigned risk classifications of loans. The Company adheres to a Uniform Classification System developed jointly by the various bank regulatory agencies to internally risk rate loans. The Uniform Classification System defines three broad categories of criticized assets, which the Company uses as credit quality indicators:

*Other Assets Especially Mentioned* includes loans that exhibit weaknesses in financial condition, loan structure or documentation, which if not promptly corrected, may lead to the development of abnormal risk elements.

*Substandard* includes loans that are inadequately protected by the current sound worth and paying capacity of the borrower. Although the primary source of repayment for a Substandard is not currently sufficient; collateral or other sources of repayment are sufficient to satisfy the debt. Continuance of a Substandard loan is not warranted unless positive steps are taken to improve the worthiness of the credit.

*Doubtful* includes loans that exhibit pronounced weaknesses to a point where collection or liquidation in full, on the basis of currently existing facts, conditions and values, is highly questionable and improbable. Doubtful loans are required to be placed on non-accrual status and are assigned a specific valuation allowance.

The following table presents the Company's recorded investment in criticized loans by class and credit quality indicator based on the most recent analyses performed as of the dates indicated.

| As of September 30, 2011        | Other Assets<br>Especially<br>Mentioned | Substandard    | Doubtful       | Total<br>Criticized<br>Loans |
|---------------------------------|---|----------------|----------------|------------------------------|
| <b>Real estate:</b>             |   |                |                |                              |
| Commercial                      | \$ 137,983                              | \$ 157,208     | \$ 30,283      | \$ 325,474                   |
| <b>Construction:</b>            |   |                |                |                              |
| Land acquisition & development  | 44,414                                  | 29,622         | 48,295         | 122,331                      |
| Commercial                      |   | 21,231         | 8,797          | 30,028                       |
| Residential                     | 7,650                                   | 5,214          | 10,016         | 22,880                       |
| <b>Total construction loans</b> | <b>52,064</b>                           | <b>56,067</b>  | <b>67,108</b>  | <b>175,239</b>               |
| Residential                     | 12,581                                  | 25,322         | 10,257         | 48,160                       |
| Agricultural                    | 12,435                                  | 22,740         | 801            | 35,976                       |
| <b>Total real estate loans</b>  | <b>215,063</b>                          | <b>261,337</b> | <b>108,449</b> | <b>584,849</b>               |
| <b>Consumer:</b>                |   |                |                |                              |
| Indirect consumer loans         | 1,082                                   | 1,721          | 371            | 3,174                        |
| Other consumer loans            | 778                                     | 1,499          | 557            | 2,834                        |
| Credit card loans               |   | 448            | 2,788          | 3,236                        |
| <b>Total consumer loans</b>     | <b>1,860</b>                            | <b>3,668</b>   | <b>3,716</b>   | <b>9,244</b>                 |
| Commercial                      | 38,465                                  | 34,949         | 21,872         | 95,286                       |
| Agricultural                    | 6,113                                   | 5,191          | 330            | 11,634                       |

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|       |            |            |            |            |
|-------|------------|------------|------------|------------|
| Total | \$ 261,501 | \$ 305,145 | \$ 134,367 | \$ 701,013 |
|-------|------------|------------|------------|------------|

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

| As of December 31, 2010         | Other Assets<br>Especially<br>Mentioned | Substandard       | Doubtful          | Total<br>Criticized<br>Loans |
|---------------------------------|---|-------------------|-------------------|------------------------------|
| <b>Real estate:</b>             |   |                   |                   |                              |
| Commercial                      | \$ 133,700                              | \$ 149,604        | \$ 41,662         | \$ 324,966                   |
| <b>Construction:</b>            |   |                   |                   |                              |
| Land acquisition & development  | 73,151                                  | 36,552            | 21,795            | 131,498                      |
| Commercial                      | 9,025                                   | 18,611            | 13,598            | 41,234                       |
| Residential                     | 9,083                                   | 9,842             | 13,721            | 32,646                       |
| <b>Total construction loans</b> | <b>91,259</b>                           | <b>65,005</b>     | <b>49,114</b>     | <b>205,378</b>               |
| Residential                     | 13,889                                  | 18,725            | 11,474            | 44,088                       |
| Agricultural                    | 12,683                                  | 20,885            | 1,432             | 35,000                       |
| <b>Total real estate loans</b>  | <b>251,531</b>                          | <b>254,219</b>    | <b>103,682</b>    | <b>609,432</b>               |
| <b>Consumer:</b>                |   |                   |                   |                              |
| Indirect consumer loans         | 768                                     | 1,964             | 315               | 3,047                        |
| Other consumer loans            | 903                                     | 1,499             | 1,131             | 3,533                        |
| Credit card loans               |   | 571               | 3,467             | 4,038                        |
| <b>Total consumer loans</b>     | <b>1,671</b>                            | <b>4,034</b>      | <b>4,913</b>      | <b>10,618</b>                |
| Commercial                      | 47,307                                  | 39,145            | 24,280            | 110,732                      |
| Agricultural                    | 5,416                                   | 6,255             | 478               | 12,149                       |
| <b>Total</b>                    | <b>\$ 305,925</b>                       | <b>\$ 303,653</b> | <b>\$ 133,353</b> | <b>\$ 742,931</b>            |

The Company maintains a credit review function, which is independent of the credit approval process, to assess assigned internal risk classifications and monitor compliance with internal lending policies and procedures. Written action plans with firm target dates for resolution of identified problems are prepared and reviewed on a quarterly basis for all criticized loans.

**Table of Contents****FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements***(In thousands, except share and per share data)***(4) Allowance For Loan Losses**

The following tables present a summary of changes in the allowance for loan losses by portfolio segment for the three and nine months ended September 30, 2011.

| Three months ended September 30, 2011               | Real Estate  | Consumer   | Commercial | Agriculture | Other    | Total        |
|---|--------------|------------|------------|-------------|----------|--------------|
| Allowance for loan losses:                          |              |            |            |             |          |              |
| Beginning balance                                   | \$ 90,243    | \$ 8,526   | \$ 24,434  | \$ 1,376    | \$       | \$ 124,579   |
| Provision charged to operating expense              | 9,984        | 1,676      | 2,206      | 134         |          | 14,000       |
| Less loans charged-off                              | (12,210)     | (1,682)    | (6,498)    | (15)        |          | (20,405)     |
| Add back recoveries of loans previously charged-off | 1,386        | 453        | 287        | 3           |          | 2,129        |
| Ending balance                                      | \$ 89,403    | \$ 8,973   | \$ 20,429  | \$ 1,498    | \$       | \$ 120,303   |
|   |              |            |            |             |          |              |
| Nine months ended September 30, 2011                | Real Estate  | Consumer   | Commercial | Agriculture | Other    | Total        |
| Allowance for loan losses:                          |              |            |            |             |          |              |
| Beginning balance                                   | \$ 84,181    | \$ 9,332   | \$ 25,354  | \$ 1,613    | \$       | \$ 120,480   |
| Provision charged to operating expense              | 33,080       | 2,927      | 8,461      | (68)        |          | 44,400       |
| Less loans charged-off                              | (29,598)     | (4,641)    | (14,547)   | (60)        |          | (48,846)     |
| Add back recoveries of loans previously charged-off | 1,740        | 1,355      | 1,161      | 13          |          | 4,269        |
| Ending balance                                      | \$ 89,403    | \$ 8,973   | \$ 20,429  | \$ 1,498    | \$       | \$ 120,303   |
|   |              |            |            |             |          |              |
| As of September 30, 2011                            | Real Estate  | Consumer   | Commercial | Agriculture | Other    | Total        |
| Individually evaluated for impairment               | \$ 27,344    | \$         | \$ 9,422   | \$ 239      | \$       | \$ 37,005    |
| Collectively evaluated for impairment               | 62,059       | 8,973      | 11,007     | 1,259       |          | 83,298       |
| Ending balance                                      | \$ 89,403    | \$ 8,973   | \$ 20,429  | \$ 1,498    | \$       | \$ 120,303   |
|   |              |            |            |             |          |              |
| Loans individually evaluated for impairment         | \$ 223,386   | \$         | \$ 31,470  | \$ 880      | \$       | \$ 255,736   |
| Loans collectively evaluated for impairment         | 2,582,202    | 627,139    | 671,540    | 135,848     | 3,252    | 4,019,981    |
| Total loans   | \$ 2,805,588 | \$ 627,139 | \$ 703,010 | \$ 136,728  | \$ 3,252 | \$ 4,275,717 |

The Company performs a quarterly assessment of the adequacy of its allowance for loan losses in accordance with generally accepted accounting principles. The methodology used to assess the adequacy is consistently applied to the Company's loan portfolio and consists of three elements: (1) specific valuation allowances based on probable losses on impaired loans; (2) historical valuation allowances based on loan loss experience for similar loans with similar characteristics and trends; and (3) general valuation allowances determined based on changes in the nature of the loan portfolio, overall portfolio quality, industry concentrations, delinquency trends, general economic conditions and other qualitative risk factors both internal and external to the Company.

Specific allowances are established for loans where management has determined that probability of a loss exists by analyzing the borrower's ability to repay amounts owed, collateral deficiencies and any relevant qualitative or environmental factors impacting the loan. Historical valuation allowances are determined by applying percentage loss factors to the credit exposures from outstanding loans. For commercial,



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agricultural and real estate loans, loss factors are applied based on the internal risk classifications of these loans. For consumer loans, loss factors are applied on a portfolio basis. For commercial, agriculture and real estate loans, loss factor percentages are based on a migration analysis of our historical loss experience. For consumer loans, loss factor percentages are based on a one-year loss history. General valuation allowances are determined by evaluating, on a quarterly basis, changes in the nature and volume of the loan portfolio, overall portfolio quality, industry concentrations, current economic and regulatory factors and the estimated impact of current economic, environmental and regulatory conditions on historical loss rates.

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

The following table presents a summary of changes in the allowance for loan losses for the three and nine months ended September 30, 2010:

|   | Three months ended<br>September 30, 2010 | Nine months ended<br>September 30, 2010 |
|---|--|---|
| Beginning balance                                   | \$ 114,328                               | \$ 103,030                              |
| Provision charged to operating expense              | 18,000                                   | 49,400                                  |
| Less loans charged-off                              | (12,789)                                 | (34,294)                                |
| Add back recoveries of loans previously charged-off | 697                                      | 2,100                                   |
| <b>Ending balance</b>                               | <b>\$ 120,236</b>                        | <b>\$ 120,236</b>                       |

**(5) Common Stock**

The Company had 16,336,108 and 15,598,632 shares of Class A common stock outstanding as of September 30, 2011 and December 31, 2010, respectively.

The Company had 26,643,624 and 27,202,062 shares of Class B common stock outstanding as of September 30, 2011 and December 31, 2010, respectively.

**(6) 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 nine month periods ended September 30, 2011 and 2010.

|  | Three Months Ended<br>September 30, |                 | Nine Months Ended September 30, |                  |
|--|-------------------------------------|-----------------|---------------------------------|------------------|
|  | 2011                                | 2010            | 2011                            | 2010             |
| Net income   | \$ 11,921                           | \$ 8,729        | \$ 31,281                       | \$ 26,518        |
| Less preferred stock dividends   | 862                                 | 862             | 2,559                           | 2,559            |
| <b>Net income available to common stockholders,<br/>basic and diluted</b>                      | <b>\$ 11,059</b>                    | <b>\$ 7,867</b> | <b>\$ 28,722</b>                | <b>\$ 23,959</b> |
| Weighted average common shares outstanding   | 42,774,259                          | 42,634,283      | 42,737,986                      | 38,986,458       |
| Weighted average common shares issuable upon<br>exercise of stock options and non-vested stock | 67,404                              | 150,587         | 111,368                         | 216,219          |

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awards

|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Weighted average common and common equivalent shares outstanding | 42,841,663 | 42,784,870 | 42,849,354 | 39,202,677 |
| Basic earnings per common share                                  | \$ 0.26    | \$ 0.18    | \$ 0.67    | \$ 0.61    |
| Diluted earnings per common share                                | \$ 0.26    | \$ 0.18    | \$ 0.67    | \$ 0.61    |

The Company had 2,918,480 and 2,888,192 stock options outstanding for the three and nine months ended September 30, 2011, respectively, that were not included in the computation of diluted earnings per common share because their effect would be anti-dilutive. The Company had 2,725,188 and 2,315,166 stock options outstanding for the three and nine months ended September 30, 2010, respectively, that were not included in the computation of diluted earnings per common share because their effect would be anti-dilutive.

**Table of Contents****FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements***(In thousands, except share and per share data)***(7) 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. 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 September 30, 2011 and December 31, 2010, the Company exceeded all capital adequacy requirements to which it is subject.

Actual capital amounts and ratios and selected minimum regulatory thresholds for the Company and its bank subsidiary, First Interstate Bank ( FIB ), as of September 30, 2011 and December 31, 2010 are presented in the following table:

|                            | Actual     |       | Adequately Capitalized |       | Well Capitalized |       |
|----------------------------|------------|-------|------------------------|-------|------------------|-------|
|                            | Amount     | Ratio | Amount                 | Ratio | Amount           | Ratio |
| As of September 30, 2011:  |            |       |                        |       |                  |       |
| Total risk-based capital:  |            |       |                        |       |                  |       |
| Consolidated               | \$ 791,403 | 16.3% | \$ 389,318             | 8.0%  | NA               | NA    |
| FIB                        | 654,062    | 13.5  | 387,292                | 8.0   | \$ 484,115       | 10.0% |
| Tier 1 risk-based capital: |            |       |                        |       |                  |       |
| Consolidated               | 694,838    | 14.3  | 194,659                | 4.0   | NA               | NA    |
| FIB                        | 577,809    | 11.9  | 193,646                | 4.0   | \$ 290,469       | 6.0   |
| Leverage capital ratio:    |            |       |                        |       |                  |       |
| Consolidated               | 694,838    | 9.8   | 284,492                | 4.0   | NA               | NA    |
| FIB                        | 577,809    | 8.2   | 283,580                | 4.0   | \$ 354,475       | 5.0   |

|                            | Actual     |       | Adequately Capitalized |       | Well Capitalized |       |
|----------------------------|------------|-------|------------------------|-------|------------------|-------|
|                            | Amount     | Ratio | Amount                 | Ratio | Amount           | Ratio |
| As of December 31, 2010:   |            |       |                        |       |                  |       |
| Total risk-based capital:  |            |       |                        |       |                  |       |
| Consolidated               | \$ 772,337 | 15.5% | \$ 398,720             | 8.0%  | NA               | NA    |
| FIB                        | 634,976    | 12.8  | 396,754                | 8.0   | \$ 495,943       | 10.0% |
| Tier 1 risk-based capital: |            |       |                        |       |                  |       |
| Consolidated               | 674,319    | 13.5  | 199,360                | 4.0   | NA               | NA    |
| FIB                        | 557,261    | 11.2  | 198,377                | 4.0   | \$ 297,566       | 6.0   |
| Leverage capital ratio:    |            |       |                        |       |                  |       |
| Consolidated               | 674,319    | 9.3   | 291,023                | 4.0   | NA               | NA    |
| FIB                        | 557,261    | 7.7   | 290,071                | 4.0   | \$ 362,589       | 5.0   |

**(8) Commitments and Contingencies**

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 is not expected to 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 \$4,507 as of September 30, 2011.

The Company had commitments to purchase held-to-maturity municipal investment securities of \$415 as of September 30, 2011.



**Table of Contents****FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES****Notes to Unaudited Consolidated Financial Statements***(In thousands, except share and per share data)***(9) 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 September 30, 2011, commitments to extend credit to existing and new borrowers approximated \$1,012,708, which includes \$280,563 on unused credit card lines and \$241,060 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 September 30, 2011, the Company had outstanding standby letters of credit of \$74,086. 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.

**(10) Supplemental Disclosures to Consolidated Statement of Cash Flows**

The Company transferred loans of \$9,148 and \$17,203 to OREO during the nine months ended September 30, 2011 and 2010, respectively.

The Company transferred premises and equipment pending disposal of \$1,513 to other assets during the nine months ended September 30, 2010.

The Company transferred accrued liabilities of \$195 and \$59 to common stock in conjunction with the vesting of liability-classified non-vested stock awards during the nine months ended September 30, 2011 and 2010, respectively.

The Company transferred internally originated mortgage servicing rights of \$1,850 and \$2,680 from loans to mortgage servicing assets during the nine months ended September 30, 2011 and 2010, respectively.

**(11) Other Comprehensive Income**

Total other comprehensive income for the nine months ended September 30, 2011 and 2010 is reported in the accompanying statements of changes in stockholders' equity. Total other comprehensive income for the three months ended September 30, 2011 and 2010 was \$13,606 and \$10,385, respectively.

Information related to net other comprehensive income is as follows:

| For the nine months ended September 30,   | 2011       | 2010       |
|---|------------|------------|
| <b>Other comprehensive income:</b>  |            |            |
| Investment securities available-for-sale:   |            |            |
| Change in net unrealized gain during the period                                   | \$ 24,200  | \$ 13,017  |
| Reclassification adjustment for gains included in income                          | (56)       | (108)      |
| Change in the net actuarial loss on defined benefit post-retirement benefit plans | 104        | 72         |
| <br>Total other comprehensive income  | <br>24,248 | <br>12,981 |
| Deferred tax expense  | 9,541      | 5,108      |

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|                                |           |          |
|--------------------------------|-----------|----------|
| Net other comprehensive income | \$ 14,707 | \$ 7,873 |
|--------------------------------|-----------|----------|

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

The components of accumulated other comprehensive income, net of income taxes, are as follows:

|   | September 30,<br>2011 | December 31,<br>2010 |
|---|-----------------------|----------------------|
| Net unrealized gain on investment securities available-for-sale     | \$ 25,603             | \$ 10,959            |
| Net actuarial loss on defined benefit post-retirement benefit plans | (1,521)               | (1,584)              |
| <b>Net accumulated other comprehensive income</b>                   | <b>\$ 24,082</b>      | <b>\$ 9,375</b>      |

**(12) Fair Value Measurements**

Financial assets and financial liabilities measured at fair value on a recurring basis are as follows:

|  | Fair Value Measurements at Reporting Date Using |   |  |   |
|--|---|---|--|---|
|  | Balance<br>as of<br>9/30/2011                   | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level3) |
| As of September 30, 2011                           |   |   |  |   |
| <b>Investment securities available-for-sale:</b>   |   |   |  |   |
| Obligations of U.S. government agencies            | \$ 1,013,092                                    | \$  | \$ 1,013,092                               | \$  |
| U.S. agency residential mortgage-backed securities | 882,510   |   | 882,510                                    |   |
| Private residential mortgage-backed securities     | 783   |   | 783  |   |
| Mortgage servicing rights                          | 12,250  |   | 12,250                                     |   |
| Derivative liability contract                      | 122   |   |  | 122   |

|  | Fair Value Measurements at Reporting Date Using |   |  |   |
|--|---|---|--|---|
|  | Balance<br>as of<br>9/30/2010                   | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level3) |
| As of December 31, 2010                            |   |   |  |   |
| <b>Investment securities available-for-sale:</b>   |   |   |  |   |
| Obligations of U.S. government agencies            | \$ 953,420                                      | \$  | \$ 953,420                                 | \$  |
| U.S. agency residential mortgage-backed securities | 831,860   |   | 831,860                                    |   |
| Private residential mortgage-backed securities     | 1,055   |   | 1,055                                      |   |
| Mortgage servicing rights                          | 13,694  |   | 13,694                                     |   |
| Derivative liability contract                      | 86  |   |  | 86  |



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The following table reconciles the beginning and ending balances of the derivative liability contract measured at fair value on a recurring basis using significant unobservable (Level 3) inputs during the nine months ended September 30, 2011 and 2010:

| For the Nine Months Ended September 30, | 2011   | 2010   |
|---|--------|--------|
| Balance, beginning of period            | \$ 86  | \$ 245 |
| Accruals during the period              | 164    | 155    |
| Cash payments during the period         | (128)  | (118)  |
| Balance, end of period                  | \$ 122 | \$ 282 |

The methodologies used by the Company in determining the fair values of each class of financial instruments are based primarily on the use of independent, market-based data to reflect a value that would be reasonably expected in an orderly transaction between market participants at the measurement date. The Company obtains fair value measurements for investment securities from an independent pricing service and evaluates mortgage servicing rights for impairment using an independent valuation service. The vendors chosen by the Company are widely recognized vendors whose evaluations support the pricing functions of financial institutions, investment and mutual funds, and portfolio managers. The Company

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

has documented and evaluated the pricing methodologies used by the vendors and maintains internal processes that regularly test valuations. These internal processes include obtaining and reviewing available reports on internal controls, evaluating the prices for reasonableness given market changes, investigating anomalies and confirming determinations through discussions with the vendor. For investment securities, if needed, a broker may be utilized to determine the reported fair value. Further details on the methods used to estimate the fair value of each class of financial instruments above are discussed below:

*Investment Securities Available-for-Sale.* 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 investment'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 market 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.

*Derivative Liability Contract.* In conjunction with the sale of all of its Class B shares of Visa, Inc. ( Visa ) common stock in 2009, the Company entered into a derivative liability contract with the purchaser whereby the Company will make or receive cash payments based on subsequent changes in the conversion rate of the Class B shares into Class A shares of Visa. The conversion rate is dependent upon the resolution of certain litigation involving Visa U.S.A. Inc. card association or its affiliates. The value of the derivative liability contract is estimated based on the Company's expectations regarding the ultimate resolution of that litigation, which involves a high degree of judgment and subjectivity. On April 6, 2011, Visa disclosed it had provided additional funding to its litigation escrow account thereby reducing the conversion rate of the Class B shares into Class A shares. During the nine months ended September 30, 2011, the Company made cash payments to the purchaser of \$102 due to changes in conversion rates and \$26 to extend the derivative liability contract until all litigation is settled. In addition, during 2011 the Company revised its estimate of Visa's future litigation funding and increased its derivative liability contract by \$164.

Additionally, from time to time, certain assets are measured at fair value on a non-recurring basis. 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 on a non-recurring basis.

|                                 | Total      | Fair Value Measurements at Reporting Date Using                            |   |  |
|---------------------------------|------------|--|---|--|
|                                 |            | Quoted Prices<br>in Active<br>Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| <b>As of September 30, 2011</b> |            |  |   |  |
| Impaired loans                  | \$ 117,139 | \$   | \$  | \$ 117,139   |
| Other real estate owned         | 17,079     |  |   | 17,079   |
| <b>As of December 31, 2010</b>  |            |  |   |  |
| Impaired loans                  | \$ 97,574  | \$   | \$  | \$ 97,574  |
| Other real estate owned         | 23,727     |  |   | 23,727   |

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*Impaired Loans.* Collateralized impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from collateral. The impaired loans are reported at fair value through specific valuation allowance allocations. In addition, 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. Collateral values are estimated using independent appraisals and management estimates of current market conditions. Certain impaired loans with a carrying value of \$186,839 at September 30, 2011 were reduced by specific valuation allowance allocations of \$37,005 and partial loan charge-offs of \$32,696, resulting in a reported fair value of \$117,139.

**Table of Contents**

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

**Notes to Unaudited Consolidated Financial Statements**

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

*OREO.* The fair values of OREO are estimated using independent appraisals and management estimates of current market conditions. 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 OREO expense in the period in which they are identified. Write-downs of \$5,972 during the nine months ended September 30, 2011 included adjustments of \$3,521 directly related to receipt of updated appraisals and adjustments of \$2,451 based on management estimates of the current fair value of properties. Write-downs of \$5,564 during the nine months ended September 30, 2010 included adjustments of \$2,454 directly related to receipt of updated appraisals and adjustments of \$3,110 based on management estimates of the current fair value of properties.

*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. As of September 30, 2011 and December 31, 2010, the Company had one long-lived asset to be disposed of by sale carried at its cost of \$1,513.

In addition, 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 September 30, 2011 and December 31, 2010, 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 investment's terms and conditions, among other things. Fair values of fixed rate loans and variable rate loans that reprice on an infrequent basis are estimated by discounting future cash flows using current interest rates at which similar loans with similar terms would be made to borrowers of similar credit quality. Carrying values of variable rate loans that reprice frequently, and with no change in credit risk, approximate the fair values of these instruments.

*Financial Liabilities.* The fair values of demand deposits, savings accounts, securities sold under repurchase agreements and accrued interest payable are the amounts 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 fair value of the derivative liability contract was estimated by discounting cash flows using assumptions regarding the expected outcome of related litigation. The floating rate term notes, 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.

*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.

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

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

|   | September 30, 2011  |                      | December 31, 2010   |                      |
|---|---------------------|----------------------|---------------------|----------------------|
|   | Carrying Amount     | Estimated Fair Value | Carrying Amount     | Estimated Fair Value |
| <b>Financial assets:</b>                          |                     |                      |                     |                      |
| Cash and cash equivalents                         | \$ 504,227          | \$ 504,227           | \$ 685,618          | \$ 685,618           |
| Investment securities available-for-sale          | 1,896,385           | 1,896,385            | 1,786,335           | 1,786,335            |
| Investment securities held-to-maturity            | 149,411             | 157,639              | 147,068             | 146,508              |
| Net loans   | 4,155,414           | 4,155,441            | 4,247,429           | 4,222,984            |
| Accrued interest receivable                       | 34,994              | 34,994               | 33,628              | 33,628               |
| Mortgage servicing rights, net                    | 11,909              | 12,250               | 13,191              | 13,694               |
| <b>Total financial assets</b>                     | <b>\$ 6,752,340</b> | <b>\$ 6,760,936</b>  | <b>\$ 6,913,269</b> | <b>\$ 6,888,767</b>  |
| <b>Financial liabilities:</b>                     |                     |                      |                     |                      |
| Total deposits, excluding time deposits           | \$ 4,214,427        | \$ 4,214,427         | \$ 4,000,468        | \$ 4,000,468         |
| Time deposits                                     | 1,636,892           | 1,645,885            | 1,925,245           | 1,936,011            |
| Securities sold under repurchase agreements       | 475,522             | 475,522              | 620,154             | 620,154              |
| Derivative contract                               | 122                 | 122                  | 86                  | 86                   |
| Accrued interest payable                          | 8,786               | 8,786                | 13,178              | 13,178               |
| Other borrowed funds                              | 5,122               | 5,122                | 4,991               | 4,991                |
| Long-term debt                                    | 37,469              | 42,059               | 37,502              | 40,031               |
| Subordinated debentures held by subsidiary trusts | 123,715             | 129,810              | 123,715             | 128,954              |
| <b>Total financial liabilities</b>                | <b>\$ 6,502,055</b> | <b>\$ 6,521,733</b>  | <b>\$ 6,725,339</b> | <b>\$ 6,743,873</b>  |

**(13) Recent Authoritative Accounting Guidance**

**FASB ASC Topic 220, Comprehensive Income.** The Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2011-05 under Accounting Standards Codification ( ASC ) Topic 220, Comprehensive Income. ASU No. 2011-05 allows an entity the option to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in separate but consecutive statements. ASU No. 2011-05 is effective for the Company on January 1, 2012, and is to be applied retrospectively to all periods presented. Management does not expect the adoption of ASU No. 2011-05 will have a significant impact on the Company's consolidated financial statements, results of operations or liquidity.

**FASB ASC Topic 820, Fair Value Measurements and Disclosures.** New authoritative accounting guidance, ASU No. 2011-04, under ASC Topic 820 represents the converged guidance of the FASB and the International Accounting Standards Board (collectively, the Boards ) on fair value measurement. The collective efforts of the Boards and their staffs have resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term fair value. ASU No. 2011-04 is effective for the Company on January 1, 2012. Management does not expect the adoption of ASU No. 2011-04 will have a significant impact on the Company's consolidated financial statements, results of operations or liquidity.

**FASB ASC Topic 860, Transfers and Servicing.** New authoritative accounting guidance, ASU No. 2011-03, under ASC Topic 860, Transfers and Servicing, is intended to improve financial reporting or repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. ASU No. 2011-03 removes from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in

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the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. The amendments in ASU No. 2011-03 are effective for the Company on January 1, 2012. Management does not expect the adoption of ASU No. 2011-03 will have a significant impact on the Company's consolidated financial statements, results of operations or liquidity.

**Table of Contents**

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

**Notes to Unaudited Consolidated Financial Statements**

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

**FASB ASC Topic 310, Receivables.** New authoritative accounting guidance, ASU No. 2011-02, under ASC Topic 310, Receivables, requires significant new disclosures about the nature, extent and financial impact of troubled debt restructurings presented at the level of disaggregation that management uses when assessing and monitoring the portfolio's risk and performance. ASU No. 2011-02 also provides additional guidance to assist creditors in determining whether a restructuring of a receivable meets the criteria to be considered a troubled debt restructuring. ASU No. 2011-02 was effective for the Company on July 1, 2011, and has been applied retrospectively to restructurings occurring on or after the beginning of the fiscal year of adoption. The adoption of ASU 2011-02 did not have a significant impact on the Company's consolidated financial statements, results of operations or liquidity.

**FASB ASC Topic 350, Intangibles Goodwill and Other.** New authoritative accounting guidance under ASC Topic 350, Intangibles Goodwill and Other, amends prior guidance. Under this amended guidance, an entity is required to perform Step 2 of the goodwill impairment test if the reporting unit has a zero or negative carrying amount and if it is more likely than not that impairment exists. This guidance, which became effective for the Company on January 1, 2011, did not impact the Company's consolidated financial statements, results of operations or liquidity.

Additional new authoritative guidance, ASU No. 2011-08, under ASC Topic 350, Intangibles Goodwill and Other, permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill test. The more likely than not threshold is defined as having a likelihood of more than 50%. This guidance is effective for the Company January 1, 2012, with early adoption permitted. Management does not expect the adoption of ASU No. 2011-08 will have a significant impact on the Company's consolidated financial statements, results of operations or liquidity.

**(14) Subsequent Events**

Subsequent events have been evaluated for potential recognition and disclosure through the date financial statements were filed with the Securities and Exchange Commission. No events requiring disclosure were identified.

**Table of Contents**

**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, 2010, including the audited financial statements contained therein, filed with the SEC.

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.

**Cautionary Note Regarding Forward-Looking Statements and Factors that Could Affect Future Results**

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, (the Exchange Act) 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, could, might, may 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. The following factors, among others, may cause actual results to differ materially from current expectations in the forward-looking statements, including those set forth in this report:

The following factors, among others, may cause actual results to differ materially from current expectations in the forward-looking statements, including those set forth in this release:

credit losses;

concentrations of real estate loans;

economic and market developments, including inflation;

commercial loan risk;

adequacy of the allowance for loan losses;

impairment of goodwill;

changes in interest rates;

access to low-cost funding sources;



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increases in deposit insurance premiums;

inability to grow business;

adverse economic conditions affecting Montana, Wyoming and western South Dakota;

governmental regulation and changes in regulatory, tax and accounting rules and interpretations;

sweeping changes in regulation of financial institutions due to passage of the Dodd-Frank Act;

changes in or noncompliance with governmental regulations;

effects of recent legislative and regulatory efforts to stabilize financial markets;

dependence on the Company's management team;

ability to attract and retain qualified employees;

failure of technology;

reliance on external vendors;

disruption of vital infrastructure and other business interruptions;

illiquidity in the credit markets;

inability to meet liquidity requirements;

lack of acquisition candidates;

failure to manage growth;

competition;

inability to manage risks in turbulent and dynamic market conditions;

ineffective internal operational controls;

environmental remediation and other costs;

failure to effectively implement technology-driven products and services;

litigation pertaining to fiduciary responsibilities;

capital required to support the Company's bank subsidiary;

soundness of other financial institutions;

impact of Basel III capital standards and forthcoming new capital rules proposed for U.S. banks;

**Table of Contents**

inability of our bank subsidiary to pay dividends;

change in dividend policy;

lack of public market for our Class A common stock;

volatility of Class A common stock;

voting control of Class B stockholders;

decline in market price of Class A common stock;

dilution as a result of future equity issuances;

uninsured nature of any investment in Class A common stock;

anti-takeover provisions;

controlled company status; and

subordination of common stock to Company debt.

A more detailed discussion of each of the foregoing risks is included in our Annual Report on Form 10-K for the year ended December 31, 2010, filed February 28, 2011. These factors and other risk factors described in our periodic and current reports filed with the Securities and Exchange Commission from time to time, however, are not necessarily all of the factors that could cause our actual results, performance or achievements to differ materially from those expressed in or implied by any of our forward-looking statements. Other unknown or unpredictable factors also could harm our results.

All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements set forth above. Forward-looking statements speak only as of the date they are made and we do not undertake or assume any obligation to update publicly any of these statements to reflect actual results, new information or future events, changes in assumptions or changes in other factors affecting forward-looking statements, except to the extent required by applicable laws. If we update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements.

**Executive Overview**

We are a financial and bank holding company headquartered in Billings, Montana. As of September 30, 2011, we had consolidated assets of \$7,307 million, deposits of \$5,851 million, loans of \$4,276 million and total stockholders' equity of \$768 million. We currently operate 71 banking offices in 42 communities located in Montana, Wyoming and western South Dakota. Through our bank subsidiary, First Interstate Bank, or the Bank, we deliver a comprehensive range of banking products and services to individuals, businesses, municipalities and other entities throughout our market areas. Our customers participate in a wide variety of industries, including energy, healthcare and professional services, education and governmental services, construction, mining, agriculture, retail and wholesale trade.

*Our Business*

Our principal business activity is lending to and accepting deposits from individuals, businesses, municipalities and other entities. We derive our income principally from interest charged on loans and, to a lesser extent, from interest and dividends earned on investments. We also derive income from non-interest sources such as fees received in connection with various lending and deposit services; trust, employee benefit, investment and insurance services; mortgage loan originations, sales and servicing; merchant and electronic banking services; and from time to time, gains on sales of assets. Our principal expenses include interest expense on deposits and borrowings, operating expenses, provisions for loan losses and income tax expense.

Our loan portfolio consists of a mix of real estate, consumer, commercial, agricultural and other loans, including fixed and variable rate loans. Our real estate loans comprise commercial real estate, construction (including residential, commercial and land development loans), residential, agricultural and other real estate loans. Fluctuations in the loan portfolio are directly related to the economies of the communities we serve. While each loan originated generally must meet minimum underwriting standards established in our credit policies, lending officers are granted discretion within pre-approved limits in approving and pricing loans to assure that the banking offices are responsive to competitive issues and community needs in each market area. Our minimum underwriting standards include geographic limitations, identifying a legal purpose, repayment source verifications, loan maturity limitations, collateral requirements, loan concentration limitations, pricing limitations and set industry guidelines. Each underwriting standard must have adequate documentation as specified in our loan policy. Individual lending limits are established by the branch manager and regional managers. Lending limits are established at the individual, branch and market level. Individual lending limits are based on credit ability and experience of the individual officer. Branch and market lending limits are based on the loan portfolio size of the branch and market. Consideration in assigning lending limits also considers historical credit performance. These limits are presented and approved by the bank and the Director's Credit Committee, a committee which includes independent members of the Board of Directors. Aggregate lending relationships in excess of \$10 million must be approved by the bank's legal board after being reviewed by the Director's Credit Committee. We fund our loan portfolio primarily with the core deposits from our customers, generally without utilizing brokered deposits and with minimal reliance on wholesale funding sources.

## Table of Contents

### Recent Trends and Developments

On July 15, 2011, the Board of Governors of the Federal Reserve System, or FRB, and the Federal Deposit Insurance Corporation, or FDIC, issued separate final rules to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act, or Dodd-Frank Act, which mandated repeal of the prohibition against paying interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts beginning July 21, 2011. Management does not expect this change will have a significant impact on the Company's interest expense, consolidated financial statements, results of operations or liquidity.

On June 29, 2011, the FRB issued a final rule establishing standards for debit card interchange fees and prohibiting network exclusivity arrangements and routing restrictions. This rule, Regulation II Debit Card Interchange Fees and Routing, implements provisions of the Dodd-Frank Act. The rule, which became effective October 1, 2011, reduces the maximum allowable interchange fee per transaction for issuers with over \$10 billion in assets. Issuers with less than \$10 billion in assets, like us, are exempt from the debit card interchange fee limitations. Under this exemption, the Company does not anticipate any immediate, significant impact to interchange revenues. The Company recorded debit card interchange fees of \$3.0 million and \$8.7 million during the three and nine months ended September 30, 2011, respectively.

In February 2011, the FDIC issued a final rule that, among other things, modified the definition of an institution's deposit insurance assessment base and revised assessment rate schedules. The final rule changes the deposit insurance assessment base to an institution's average total assets less its average tangible equity, with adjustments for brokered deposits, unsecured debt and for custodial banks and banks that primarily provide services to other banks. These changes, which became effective April 1, 2011, resulted in a reduction in the Company's FDIC insurance premiums.

Our success is highly dependent on economic conditions and market interest rates. Because we operate in Montana, Wyoming and western South Dakota, the local economic conditions in each of these areas are particularly important. Our local economies entered the recession later than many areas of the United States and are now just beginning to show some signs of recovery. Although the continuing impact of the national recession and related real estate and financial market conditions is uncertain, these factors affect our business and could have a material negative effect on our cash flows, results of operations, financial condition and prospects.

### *Asset Quality*

Difficult economic conditions, depressed real estate values and limited sales activity have negatively impacted businesses and consumers in our market areas and have resulted in deterioration in the credit quality of our loan portfolio, which is reflected by year-over-year increases in non-performing and internally risk classified loans.

Unemployment rates in the three states in which we operate compare favorably to national averages. Unemployment rates increased in Montana and remained stable in South Dakota while decreasing 0.9% in Wyoming from September 2010 to September 2011. The table below presents average seasonally-adjusted unemployment rates in the three states in which we operate and nationally for the periods indicated.

|              | September<br>2011 | June<br>2011 | March<br>2011 | December<br>2010 | September<br>2010 |
|--------------|-------------------|--------------|---------------|------------------|-------------------|
| Montana      | 7.7%              | 7.5%         | 7.4%          | 7.4%             | 7.3%              |
| Wyoming      | 5.8%              | 5.9%         | 6.2%          | 6.4%             | 6.7%              |
| South Dakota | 4.6%              | 4.7%         | 4.9%          | 4.7%             | 4.6%              |
| National     | 9.1%              | 9.2%         | 8.8%          | 9.4%             | 9.6%              |

We monitor personal income growth nationally and in the three states in which we operate as an indicator of financial well-being in our market areas and in certain industries within our market areas. Per capita personal income increased 3.7% nationally in 2010, as compared to 2009. Montana, South Dakota and Wyoming saw increases in per capita personal income of 4.8%, 4.7% and 4.4%, respectively, during the same period. Additional increases in per capita income occurred during the first half of 2011 in all three states and nationally.

Individual bankruptcy filings in the three states in which we operate increased 12.7% to 6,366 in 2010 compared to 2009, as compared to an increase of 8.8% to 1,536,623 nationally. During the first six months of 2011, there was a decrease in individual bankruptcy filings in the three states in which we operate of 9.3% to 3,111, as compared to the same period in 2010. Nationally, individual bankruptcy filings decreased 7.7% to 721,288 during the first six months of 2011, as compared to the same period in 2010.



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## **Table of Contents**

The quarterly all-transaction housing price index in Montana and Wyoming declined during the second quarter of 2011, as compared to the same period in the prior year, with Montana and Wyoming decreasing 3.2%, as compared to a national decrease of 4.5%. The South Dakota all-transaction housing price index increased 0.2% during second quarter 2011, as compared to the same period in 2010.

Housing permits in the three states in which we operate showed a combined decrease of 10.0% to 4,603 during the eight months ended August 31, 2011, as compared to the same period in 2010, while nationally housing permits decreased 1.9% to 407,640 during the same period. Privately owned housing starts (1-unit structures) in the three states in which we operate showed a combined 7.3% decrease to 3,394 during the eight months ended August 31, 2011, as compared to the same period in 2010.

Most of our market areas have been experiencing a slow down in housing since 2008, with the most significant impact occurring in the Flathead area around Kalispell, Montana, the Gallatin Valley area around Bozeman, Montana and the Jackson, Wyoming market areas. Days on market and the level of lots available for sale in these three markets remain an area of concern.

Our non-performing assets increased to \$288 million, or 6.69% of total loans and OREO, as of September 30, 2011, from \$244 million, or 5.55% of total loans and OREO, as of December 31, 2010. Our non-performing assets decreased slightly to \$288 million as of September 30, 2011 from \$292 million, or 6.77% of total loans and OREO, as of second quarter 2011 as non-performing assets work through the credit cycle and we have a decrease in the volume of new additions. As of September 30, 2011, the Flathead, Gallatin Valley and Jackson market areas accounted for approximately 43% of our non-performing assets versus only 18% of the Company's total loans. Loan charge-offs, net of recoveries, totaled \$18 million during the third quarter of 2011, as compared to \$12 million during third quarter 2010. Approximately 48% of third quarter 2011 net charge-offs were attributable to the Flathead, Gallatin Valley and Jackson market areas. Net charge-offs are expected to remain elevated in future quarters as problem loans continue to work through the credit cycle. During third quarter 2011, we recorded provisions for loan losses of \$14.0 million, as compared to \$18.0 million during third quarter 2010. Management expects provisions for loan losses to decline as credit quality improves.

## **Primary Factors Used in Evaluating Our Business**

As a banking institution, we manage and evaluate various aspects of both our financial condition and our results of operations. We monitor our financial condition and performance on a monthly basis at our holding company, at the Bank and at each banking office. We evaluate the levels and trends of the line items included in our balance sheet and statements of income, as well as various financial ratios that are commonly used in our industry. We analyze these ratios and financial trends against both our own historical levels and the financial condition and performance of comparable banking institutions in our region and nationally.

### *Results of Operations*

Principal factors used in managing and evaluating our results of operations include net interest income, non-interest income, non-interest expense and net income.

*Net interest income.* Net interest income, the largest source of our operating income, is derived from interest, dividends and fees received on interest earning assets, less interest expense incurred on interest bearing liabilities. Interest earning assets primarily include loans and investment securities. Interest bearing liabilities include deposits and various forms of indebtedness. Net interest income is affected by the level of interest rates, changes in interest rates and changes in the composition of interest earning assets and interest bearing liabilities. The most significant impact on our net interest income between periods is derived from the interaction of changes in the rates earned or paid on interest earning assets and interest bearing liabilities, which we refer to as interest rate 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 interest rate spread, produces changes in our 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 interest rate spread. We seek to increase our net interest income over time, and we evaluate our net interest income on factors that include the yields on our loans and other earning assets, the costs of our deposits and other funding sources, the levels of our net interest spread and net interest margin and the provisions for loan losses required to maintain our allowance for loan losses at an adequate level.

*Non-interest income.* Our principal sources of non-interest income include (1) income from the origination and sale of loans, (2) other service charges, commissions and fees, (3) service charges on deposit accounts, (4) wealth management revenues and (5) other income. 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. Other service charges,





**Table of Contents**

commissions and fees primarily include debit and credit card interchange income, mortgage servicing fees, insurance and other commissions and ATM service charge revenues. Wealth management revenues principally comprise 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. Other income primarily includes company-owned life insurance revenues, check printing income, agency stock dividends and gains on sales of miscellaneous assets. We seek to increase our non-interest income over time, and we evaluate our non-interest income relative to the trends of the individual types of non-interest income in view of prevailing market conditions.

*Non-interest expense.* Non-interest expenses include (1) salaries, wages and employee benefits expense, (2) occupancy expense, (3) furniture and equipment expense, (4) FDIC insurance premiums, (5) outsourced technology services expense, (6) amortization and impairment of mortgage servicing rights, (7) OREO expense, net of income, (8) core deposit intangibles amortization and (9) other expenses, which primarily includes professional fees; advertising and public relations costs; office supply, postage, freight, telephone and travel expenses; donations expense; debit and credit card expenses; board of director fees; and other losses. OREO expense is recorded net of OREO income. Variations in net OREO expense between periods is primarily due to write-downs of the estimated fair value of OREO properties, fluctuations in gains and losses recorded on sales of OREO properties, and fluctuations in the carrying costs and/or operating expenses associated with OREO properties. We seek to manage our non-interest expenses in consideration of the growth of our business and our community banking model that emphasizes customer service and responsiveness. We evaluate our non-interest expense on factors that include our non-interest expense relative to our average assets, our efficiency ratio and the trends of the individual categories of non-interest expense.

*Net Income.* We seek to increase our net income and provide favorable stockholder returns over time, and we evaluate our net income relative to the performance of other banks and bank holding companies on factors that include return on average assets, return on average equity and consistency and rates of growth in our earnings.

*Financial Condition*

Principal areas of focus in managing and evaluating our financial condition include liquidity, the diversification and quality of our loans, the adequacy of our allowance for loan losses, the diversification and terms of our deposits and other funding sources, the re-pricing characteristics and maturities of our assets and liabilities, including potential interest rate exposure and the adequacy of our capital levels. We seek to maintain sufficient levels of cash and investment securities to meet potential payment and funding obligations, and we evaluate our liquidity on factors that include the levels of cash and highly liquid assets relative to our liabilities, the quality and maturities of our investment securities, our ratio of loans to deposits and our reliance on brokered certificates of deposit or other wholesale funding sources.

We seek to maintain a diverse and high quality loan portfolio. We evaluate our asset quality on factors that include the allocation of our loans among loan types, credit exposure to any single borrower or industry type, non-performing assets as a percentage of total loans and OREO, and loan charge-offs as a percentage of average loans. We seek to maintain our allowance for loan losses at a level adequate to absorb potential losses inherent in our loan portfolio at each balance sheet date, and we evaluate the level of our allowance for loan losses relative to our overall loan portfolio and the level of non-performing loans and potential charge-offs.

We seek to fund our assets primarily using core customer deposits spread among various deposit categories, and we evaluate our deposit and funding mix on factors that include the allocation of our deposits among deposit types, the level of our non-interest bearing deposits, the ratio of our core deposits (i.e. excluding time deposits above \$100,000) to our total deposits and our reliance on brokered deposits or other wholesale funding sources, such as borrowings from other banks or agencies. We seek to manage the mix, maturities and re-pricing characteristics of our assets and liabilities to maintain relative stability of our net interest rate margin in a changing interest rate environment, and we evaluate our asset-liability management using complex models to evaluate the changes to our net interest income under different interest rate scenarios.

Finally, we seek to maintain adequate capital levels to absorb unforeseen operating losses and to help support the growth of our balance sheet. We evaluate our capital adequacy using regulatory and financial capital ratios including leverage capital ratio, tier 1 risk-based capital ratio, total risk-based capital ratio, tangible common equity to tangible assets and tier 1 common capital to total risk-weighted assets.

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## **Table of Contents**

### **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. The most significant accounting policies we follow are presented in Note 1 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2010.

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 provision for loan losses creates an allowance for loan losses known and inherent in the loan portfolio at each balance sheet date. The allowance for loan losses represents management's estimate of probable credit losses inherent in the loan portfolio.

We perform a quarterly assessment of the risks inherent in our loan portfolio, as well as a detailed review of each significant loan 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. 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. 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, historical loan loss rates, changes in the nature of the loan portfolio, overall portfolio quality, industry concentrations, delinquency trends 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 possible and may have a material impact on our allowance, and therefore our consolidated financial statements, liquidity or results of operations. 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, and fluctuations in the provision for loan losses result from management's assessment of the adequacy of the allowance for loan losses. Management 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 the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2010 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 least annually and 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 net assets is estimated based on an analysis of our market value. Determining the fair value of goodwill is considered a critical accounting estimate because of its sensitivity to market-based trading of our Class A common stock. 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 allocate fair value are reasonably possible and may have a material impact on our consolidated financial statements, liquidity or results of operations. Note 1 of the Notes to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2010 describes our accounting policy with regard to goodwill.

Our annual goodwill impairment test on our single reporting unit is performed each year as of July 1<sup>st</sup>. Upon completion of this year's test, we passed Step 1 of the impairment test as the estimated fair value of net assets was greater than carrying value of the Company. We continue to monitor various qualitative and quantitative factors, including trading value of our Class A common stock, the values of stock of peer organizations, and other indications of value. Each quarter we assess whether these qualitative and quantitative factors are evidence of a prolonged downward trend rather than a short-term market dislocation or disruption. We currently see these factors as short-term dislocations or disruptions, but should they persist over the next quarter or two, an interim impairment test will be considered.

## **Table of Contents**

### *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 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 based on current industry expectations, costs to service and predominant risk characteristics of the underlying loans 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, liquidity or results of operations. Notes 1 and 8 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2010 describe the methodology we use to determine fair value of mortgage servicing rights.

### *Other Real Estate Owned*

Real estate acquired in satisfaction of loans is initially carried at current fair value less estimated selling costs. The carrying amount of the underlying loan is written down to the fair value of the real estate acquired by charge to the allowance for loan losses, if necessary. Subsequent declines in fair value less estimated selling costs are included in OREO expense. Subsequent increases in fair value less estimated selling costs are recorded as a reduction in OREO expense to the extent of recognized losses. Determining the fair value of OREO is considered a critical accounting estimate due to the assets' sensitivity to changes in estimates and assumptions used. Changes in these estimates and assumptions are reasonably possible and may have a material impact on our consolidated financial statements, liquidity or results of operations. Note 1 of the Notes to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2010 describes our accounting policy with regard to OREO.

## **Results of Operations**

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

*Net Interest Income.* During third quarter 2011, our net interest income on a fully taxable equivalent, or FTE, basis, decreased \$235 thousand, or less than 1%, to \$64.6 million, as compared to \$64.8 million during the same period in 2010, and our net FTE interest margin ratio decreased 5 basis points to 3.84%, as compared to 3.89% during the same period in 2010. For the nine months ended September 30, 2011, our net FTE interest income decreased \$771 thousand, or less than 1%, to \$191.2 million, as compared to \$192.0 million during the same period in 2010, and our net FTE interest margin ratio decreased 15 basis points to 3.80%, as compared to 3.95% during the same period in 2010. Although net FTE interest income remained stable, our net FTE interest margin ratio decreased during the three and nine months ended September 30, 2011, as compared to the same periods in the prior year. Compression in the net FTE interest margin ratio was primarily due to diminished loan demand combined with lower interest rates earned on loans and investment securities, the effects of which were partially offset by decreases in average time deposits outstanding, overall reductions in the cost of funds and increases in interest free funding sources as a percentage of the funding base.

**Table of Contents**

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**

|   | Three Months Ended September 30, |           |              |                 |           |              |
|---|----------------------------------|-----------|--------------|-----------------|-----------|--------------|
|   | 2011                             |           |              | 2010            |           |              |
| <i>(Dollars in thousands)</i>                                     | Average Balance                  | Interest  | Average Rate | Average Balance | Interest  | Average Rate |
| <i>Interest earning assets:</i>                                   |                                  |           |              |                 |           |              |
| Loans (1)(2)  | \$ 4,291,632                     | \$ 61,801 | 5.71%        | \$ 4,504,657    | \$ 67,473 | 5.94%        |
| Investment securities (2)   | 2,064,019                        | 12,594    | 2.42         | 1,720,925       | 12,333    | 2.84         |
| Interest bearing deposits in banks                                | 311,768                          | 200       | 0.25         | 392,149         | 252       | 0.25         |
| Federal funds sold  | 1,858                            | 2         | 0.43         | 2,299           | 3         | 0.52         |
| Total interest earning assets                                     | 6,669,277                        | 74,597    | 4.44%        | 6,620,030       | 80,061    | 4.80%        |
| Non earning assets  | 615,472                          |           |              | 658,680         |           |              |
| Total assets  | \$ 7,284,749                     |           |              | \$ 7,278,710    |           |              |
| <i>Interest bearing liabilities:</i>                              |                                  |           |              |                 |           |              |
| Demand deposits   | \$ 1,265,339                     | \$ 775    | 0.24%        | \$ 1,127,006    | \$ 842    | 0.30%        |
| Savings deposits  | 1,712,739                        | 1,478     | 0.34         | 1,555,510       | 2,199     | 0.56         |
| Time deposits   | 1,699,633                        | 5,652     | 1.32         | 2,119,083       | 9,931     | 1.86         |
| Repurchase agreements   | 477,612                          | 137       | 0.11         | 464,655         | 209       | 0.18         |
| Other borrowed funds  | 5,584                            |           |              | 5,256           | 1         | 0.08         |
| Long-term debt  | 37,473                           | 498       | 5.27         | 37,658          | 512       | 5.39         |
| Subordinated debentures held by subsidiary trusts                 | 123,715                          | 1,451     | 4.65         | 123,715         | 1,526     | 4.89         |
| Total interest bearing liabilities                                | 5,322,095                        | 9,991     | 0.74%        | 5,432,883       | 15,220    | 1.11%        |
| Non-interest bearing deposits                                     | 1,153,800                        |           |              | 1,046,112       |           |              |
| Other non-interest bearing liabilities                            | 47,412                           |           |              | 59,515          |           |              |
| Stockholders equity   | 761,442                          |           |              | 740,200         |           |              |
| Total liabilities and stockholders equity                         | \$ 7,284,749                     |           |              | \$ 7,278,710    |           |              |
| Net FTE interest income   |                                  | \$ 64,606 |              |                 | \$ 64,841 |              |
| Less FTE adjustments (2)  |                                  | (1,114)   |              |                 | (1,097)   |              |
| Net interest income from consolidated statements of income        |                                  | \$ 63,492 |              |                 | \$ 63,744 |              |
| Interest rate spread  |                                  |           | 3.70%        |                 |           | 3.69%        |
| Net FTE interest margin (3)                                       |                                  |           | 3.84%        |                 |           | 3.89%        |
| Cost of funds, including non-interest bearing demand deposits (4) |                                  |           | 0.61%        |                 |           | 0.93%        |

(1) Average loan balances include non-accrual loans. Interest income on loans includes amortization of deferred loan fees net of deferred loan costs, which is not material.

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- (2) Interest income and average rates for tax exempt loans and securities are presented on an FTE basis.
- (3) Net FTE interest margin during the period equals (i) the difference between interest income on interest earning assets and the interest expense on interest bearing liabilities, divided by (ii) average interest earning assets for the period.
- (4) Calculated by dividing total interest on total interest bearing liabilities by the sum of total interest bearing liabilities plus non-interest bearing deposits.

**Table of Contents****Average Balance Sheets, Yields and Rates**

|   | Nine Months Ended September 30, |            |              |                 |            |              |
|---|---------------------------------|------------|--------------|-----------------|------------|--------------|
|   | 2011                            |            |              | 2010            |            |              |
| <i>(Dollars in thousands)</i>                                     | Average Balance                 | Interest   | Average Rate | Average Balance | Interest   | Average Rate |
| <i>Interest earning assets:</i>                                   |                                 |            |              |                 |            |              |
| Loans (1)(2)  | \$ 4,288,237                    | \$ 186,564 | 5.82%        | \$ 4,509,206    | \$ 202,797 | 6.01%        |
| Investment securities (2)   | 2,010,966                       | 36,885     | 2.45         | 1,600,451       | 38,155     | 3.19         |
| Interest bearing deposits in banks                                | 418,661                         | 794        | 0.25         | 384,964         | 733        | 0.25         |
| Federal funds sold  | 2,656                           | 11         | 0.55         | 7,933           | 21         | 0.35         |
| Total interest earning assets                                     | 6,720,520                       | 224,254    | 4.46%        | 6,502,554       | 241,706    | 4.97%        |
| Non earning assets  | 618,367                         |            |              | 675,244         |            |              |
| Total assets  | \$ 7,338,887                    |            |              | \$ 7,177,798    |            |              |
| <i>Interest bearing liabilities:</i>                              |                                 |            |              |                 |            |              |
| Demand deposits   | \$ 1,259,421                    | \$ 2,456   | 0.26%        | \$ 1,118,951    | \$ 2,551   | 0.30%        |
| Savings deposits  | 1,722,782                       | 5,231      | 0.41         | 1,481,547       | 6,842      | 0.62         |
| Time deposits   | 1,784,256                       | 18,992     | 1.42         | 2,195,029       | 33,353     | 2.03         |
| Repurchase agreements   | 505,313                         | 545        | 0.14         | 461,652         | 632        | 0.18         |
| Other borrowed funds  | 5,579                           |            |              | 5,760           | 3          | 0.07         |
| Long-term debt  | 37,485                          | 1,482      | 5.29         | 48,895          | 1,940      | 5.30         |
| Subordinated debentures heldby subsidiary trusts                  | 123,715                         | 4,354      | 4.71         | 123,715         | 4,420      | 4.78         |
| Total interest bearing liabilities                                | 5,438,551                       | 33,060     | 0.81%        | 5,435,549       | 49,741     | 1.22%        |
| Non-interest bearing deposits                                     | 1,105,122                       |            |              | 996,290         |            |              |
| Other non-interest bearing liabilities                            | 48,726                          |            |              | 61,138          |            |              |
| Stockholders equity   | 746,488                         |            |              | 684,821         |            |              |
| Total liabilities and stockholders equity                         | \$ 7,338,887                    |            |              | \$ 7,177,798    |            |              |
| Net FTE interest income   |                                 | \$ 191,194 |              |                 | \$ 191,965 |              |
| Less FTE adjustments (2)  |                                 | (3,377)    |              |                 | (3,376)    |              |
| Net interest income from consolidatedstatements of income         |                                 | \$ 187,817 |              |                 | \$ 188,589 |              |
| Interest rate spread  |                                 |            | 3.65%        |                 |            | 3.75%        |
| Net FTE interest margin (3)                                       |                                 |            | 3.80%        |                 |            | 3.95%        |
| Cost of funds, including non-interest bearing demand deposits (4) |                                 |            | 0.68%        |                 |            | 1.03%        |

- (1) Average loan balances include non-accrual loans. Interest income on loans includes amortization of deferred loan fees net of deferred loan costs, which is not material.
- (2) Interest income and average rates for tax exempt loans and securities are presented on an FTE basis.
- (3) Net FTE interest margin during the period equals (i) the difference between interest income on interest earning assets and the interest expense on interest bearing liabilities, divided by (ii) average interest earning assets for the period.

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- (4) Calculated by dividing total interest on total interest bearing liabilities by the sum of total interest bearing liabilities plus non-interest bearing deposits.

**Table of Contents**

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**

| <i>(Dollars in thousands)</i>        | Three Months Ended September 30,<br>2011 Compared with 2010 |                |                | Nine Months Ended September 30,<br>2011 Compared with 2010 |                 |                 |
|--------------------------------------|---|----------------|----------------|--|-----------------|-----------------|
|                                      | Volume  | Rate           | Net            | Volume   | Rate            | Net             |
| <b>Interest earning assets:</b>      |   |                |                |  |                 |                 |
| Loans (1)                            | \$ (3,191)  | \$ (2,481)     | \$ (5,672)     | \$ (9,938)   | \$ (6,295)      | \$ (16,233)     |
| Investment securities (1)            | 2,459   | (2,198)        | 261            | 9,787  | (11,057)        | (1,270)         |
| Interest bearing deposits in banks   | (52)  |                | (52)           | 64   | (3)             | 61              |
| Federal funds sold                   | (1)   |                | (1)            | (14)   | 4               | (10)            |
| <b>Total change</b>                  | <b>(785)</b>  | <b>(4,679)</b> | <b>(5,464)</b> | <b>(101)</b>   | <b>(17,351)</b> | <b>(17,452)</b> |
| <b>Interest bearing liabilities:</b> |   |                |                |  |                 |                 |
| Demand deposits                      | 103   | (170)          | (67)           | 320  | (415)           | (95)            |
| Savings deposits                     | 222   | (943)          | (721)          | 1,114  | (2,725)         | (1,611)         |
| Time deposits                        | (1,966)   | (2,313)        | (4,279)        | (6,242)  | (8,119)         | (14,361)        |
| Repurchase agreements                | 6   | (78)           | (72)           | 60   | (147)           | (87)            |
| Other borrowed funds                 |   | (1)            | (1)            |  | (3)             | (3)             |
| Long-term debt                       | (3)   | (11)           | (14)           | (453)  | (5)             | (458)           |
| Subordinated debentures              |   | (75)           | (75)           |  | (66)            | (66)            |
| <b>Total change</b>                  | <b>(1,638)</b>  | <b>(3,591)</b> | <b>(5,229)</b> | <b>(5,201)</b>   | <b>(11,480)</b> | <b>(16,681)</b> |
| Increase in FTE net interest income  | \$ 853  | \$ (1,088)     | \$ (235)       | \$ 5,100   | \$ (5,871)      | \$ (771)        |

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

*Provision for Loan Losses.* The provision for loan losses decreased \$4.0 million, or 22.2%, to \$14.0 million for third quarter 2011, as compared to \$18.0 million for third quarter 2010. The provision for loan losses decreased \$5.0 million, or 10.1%, to \$44.4 million for the nine months ended September 30, 2011, compared to \$49.4 million for the same period in 2010. Fluctuations in provisions for loan losses reflect management's estimate of potential loan loss based on collateral of the underlying loan, loan loss trends and estimated effects of current economic conditions on our loan portfolio. Management expects quarterly provisions for loan losses to begin to decline as credit quality improves and non-performing loans level-off or begin to decline. For information regarding our 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, income from the origination and sale of loans, and revenues from wealth management. Non-interest income decreased \$1.7 million, or 7.0%, to \$23.1 million for the three months ended September 30, 2011, as compared to \$24.9 million for the same period in 2010. Non-interest income decreased \$525 thousand, or less than 1%, to \$64.9 million for the nine months ended September 30, 2011, as compared to \$65.4 million for the same period in 2010. Significant components of changes in non-interest income are discussed below.

Other service charges, commissions and fees primarily include debit and credit card interchange income, mortgage servicing fees, insurance and other commissions and ATM service charge revenues. Other service charges, commissions and fees increased \$658 thousand, or 8.4%, to \$8.5 million during the three months ended September 30, 2011, as compared to \$7.8 during the same period in 2010, and increased \$1.6 million, or 7.0%, to \$23.6 million for the nine months ended September 30, 2011, as compared to \$22.1 million for the same period in 2010. These increases were primarily attributable to higher service charge income from ATM transactions and higher interchange income resulting from higher volumes of debit and credit card transactions. During the three and nine months ended September 30, 2011, we recorded debit card



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interchange fee income of \$3.0 million and \$8.7 million, respectively, as compared to \$2.7 million and \$7.6 million, respectively, during the same periods in 2010. For additional information regarding recent regulations affecting future debit card interchange fee income, see Recent Trends and Developments included herein.

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**Table of Contents**

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. Income from the origination and sale of loans increased \$1.4 million, or 34.1%, to \$5.5 million during the third quarter of 2011, as compared to \$4.1 million during the second quarter of 2011, primarily due to increased purchased home and refinancing activity brought on by a reduction in residential mortgage interest rates. Income from the origination and sale of loans decreased \$1.8 million, or 25.1%, to \$5.5 million for the three months ended September 30, 2011, as compared to \$7.4 million for the same period in 2010 due to decrease refinancing activity that was partially offset by an increase in home purchases, and decreased \$1.8 million, or 12.0%, to \$13.1 million for the nine months ended September 30, 2011, as compared to \$14.8 million for the same period in 2010 due to decreases in both purchased home and refinancing activity.

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 \$281 thousand, or 8.1%, to \$3.2 million for the three months ended September 30, 2011, as compared to \$3.5 million for the three months ended June 30, 2011, primarily due to declines in market values of assets under trust management. Wealth management revenues increased \$111 thousand, or 3.6%, to \$3.2 million for the three months ended September 30, 2011, as compared to \$3.1 million for the same period in 2010, and \$676 thousand, or 7.3%, to \$10.0 million for the nine months ended September 30, 2011, as compared to \$9.3 million for the same period in 2010. These increases were primarily due to new business activity and increases in the market values of assets under trust management.

Other income decreased \$740 thousand, or 36.5%, to \$1.3 million for the three months ended September 30, 2011, compared to \$2.0 million for the same period in 2010, and decreased \$178 thousand, or 3.4%, to \$5.0 million for the nine months ended September 30, 2011, compared to \$5.2 million for the same period in 2010. Quarter and year-to-date decreases are primarily due to fluctuations of values of securities held under deferred compensation plans.

*Non-interest Expense.* Non-interest expense decreased \$3.0 million, or 5.1%, to \$55.0 million for the three months ended September 30, 2011, as compared to \$58.0 million for the same period in 2010, and decreased \$4.0 million, or 2.4%, to \$162.2 million for the nine months ended September 30, 2011, as compared to \$166.2 million for the same period in 2010. Significant components of the changes in non-interest expense are discussed below.

Salaries, wages and employee benefits decreased \$1.0 million, or 3.6% for the three months ended September 30, 2011, as compared to second quarter 2011, and decreased \$1.1 million, or 4.0%, as compared to the same period in the prior year. Salaries, wages and employee benefits decreased \$972 thousand, or 1.2% for the nine months ended September 30, 2011, as compared to the same period in the prior year. These decreases are largely due to reduction in FTEs and fluctuations of values of securities held under deferred compensation plans.

FDIC insurance premiums decreased \$706 thousand, or 30.2%, to \$1.6 million for the three months ended September 30, 2011, as compared to \$2.3 million for the same period in 2010, and \$1.7 million, or 23.2%, to \$5.7 million for the nine months ended September 30, 2011, as compared to \$7.5 million for the same period in 2010. In February 2011, the FDIC issued a final rule that, among other things, modified the definition of an institution's deposit insurance assessment base and revised assessment rate schedules. These changes, which became effective April 1, 2011, reduced the Company's FDIC insurance premiums. For additional information regarding FDIC insurance, see Recent Trends and Developments included herein.

OREO expense is recorded net of OREO income. Variations in net OREO expense between periods are primarily due to write-downs of the estimated fair value of OREO properties, fluctuations in gains and losses recorded on sales of OREO properties and fluctuations in the carrying costs and/or operating expenses associated with OREO properties. OREO expense increased \$270 thousand, or 10.4%, to \$2.9 million during third quarter 2011, as compared to \$2.6 million for the same period in 2010. OREO expenses increased \$502 thousand, or 8.2%, to \$6.6 million for the nine months ended September 30, 2011, as compared to \$6.1 million for the same period in 2010. Third quarter net OREO expenses included \$538 of net operating expenses, \$2.4 million of fair value write-downs and net gains of \$113 thousand on the sale of OREO properties.

Mortgage servicing rights are amortized in proportion to and over the period of estimated net servicing income. Changes in estimated servicing period and change 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 prepayment assumptions on the first day of each quarter. Mortgage servicing rights amortization decreased \$414 thousand, or 33.9%, to \$807 thousand for the three months ended September 30, 2011, as compared to \$1.2 million for the same period in 2010, and decreased \$1.2 million, or 34.1%, to \$2.3 million for the nine months ended September 30, 2011, as compared to \$3.5 million for the same period in 2010. These decreases were primarily due to the sale of mortgage servicing rights during fourth quarter 2010 and changes in the estimated duration of the loans underlying the Company's capitalized mortgage servicing rights.



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**Table of Contents**

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. Impairment adjustments are recorded through a valuation allowance. The valuation allowance is adjusted for changes in impairment through a charge to current period earnings. Fluctuations in the fair value of mortgage servicing rights are primarily due to changes in assumptions regarding prepayments of the underlying mortgage loans, which typically correspond with changes in market interest rates. During the third quarter of 2011 we recorded additional impairment of \$1.2 million, as compared to additional impairment of \$2.0 million during third quarter 2010. During the nine months ended September 30, 2011, we recorded additional impairment of \$848 thousand, as compared to recording additional impairment of \$2.2 million during the same period in 2010.

Other expenses primarily include professional fees; advertising and public relations costs; office supply, postage freight, telephone and travel expenses; donations expense; debit and credit card expenses; board of directors fees; and other losses. Other expenses increased \$204 thousand, or 1.7%, to \$11.9 million for the three months ended September 30, 2011, as compared to \$11.7 million for the three months ended September 30, 2010, and increased \$1.8 million, or 5.4%, to \$34.7 million for the nine months ended September 30, 2011, as compared to \$32.9 million during the same period in 2010. The increases were primarily due to fluctuations in the timing of expenses, most significantly professional fees, including legal, audit and other professional fees.

*Income Tax Expense.* Our effective federal income tax rate was 27.6% for the nine months ended September 30, 2011 and 26.7% for the nine months ended September 30, 2010. State income tax applies primarily to pretax earnings generated within Montana and South Dakota. Our effective state tax rate was 4.6% for the nine months ended September 30, 2011, and 4.3% for the nine months ended September 30, 2010. Changes in effective federal and state income tax rates are primarily fluctuations in tax exempt interest income as a percentage of total income.

**Financial Condition**

Total assets decreased \$194 million, or 2.6%, to \$7,307 million as of September 30, 2011, from \$7,501 million as of December 31, 2010.

*Loans.* Fluctuations in the loan portfolio are directly related to the economies of the communities we serve. Total loans decreased \$92 million, or 2.1%, to \$4,276 million as of September 30, 2011 from \$4,368 million as of December 31, 2010, with all major categories of loans showing decreases except residential real estate loans. Management attributes decreases in loans to a general decline in new home construction in our market areas, particularly in markets dependent upon resort and second home communities including the Flathead, Gallatin Valley and Jackson market areas, sluggish commercial and consumer growth amid economic uncertainty and the movement of lower quality loans out of the loan portfolio through charge-off, pay-off or foreclosure.

Residential real estate loans increased \$37 million, or 6.7%, to \$586 million as of September 30, 2011, from \$550 million as of December 31, 2010. Record low mortgage rates in third quarter 2011 resulted in increased residential real estate loans and mortgage loans held for sale. We typically sell a significant portion of our residential real estate loan production to secondary investors. In mid-2010, we began retaining more of our residential real estate loan production, which also contributed to the increase. Residential real estate loans retained are typically secured by first liens on the financed property and generally mature in less than fifteen years.

*Non-performing Assets.* Non-performing assets include non-accrual loans, loans contractually past due 90 days or more and still accruing interest, loans renegotiated in troubled debt restructurings and OREO.

Non-performing loans include non-accrual loans, loans contractually past due 90 days or more and still accruing interest and loans renegotiated in troubled debt restructurings. Impaired loans are a subset of non-performing loans and include all loans risk rated doubtful, loans placed on non-accrual status and loans renegotiated in troubled debt restructurings with the exception of consumer loans. We monitor and evaluate collateral values on impaired loans quarterly. Appraisals are required on all impaired loans every 18-24 months. We monitor real estate values by market for our larger market areas. Based on trends in real estate values, adjustments may be made to the appraised value based on time elapsed between the appraisal date and the impairment analysis or a new appraisal may be ordered. Appraised values in our smaller market areas may be adjusted based on trends identified through discussions with local realtors and appraisers. Appraisals are also adjusted for selling costs. The adjusted appraised value is then compared to the loan balance and any resulting shortfall is recorded in the allowance for loan losses as a specific valuation allowance. Overall increases in specific valuation allowances will result in higher provisions for loan losses. However, additional provisions resulting from overall increases in specific valuation allowances will also be impacted by changes in the historical or general valuation elements of the allowance for loan losses.



**Table of Contents**

Modifications of performing loans are made in the ordinary course of business and are completed on a case-by-case basis as negotiated with the borrower. Loan modifications typically include interest rate concessions, interest-only periods of less than twelve months, short-term payment deferrals and extension of amortization periods to provide payment relief. A loan modification is considered a troubled debt restructuring if the borrower is experiencing financial difficulties and we, for economic or legal reasons, grant a concession to the borrower that we would not otherwise consider. Those modifications deemed to be troubled debt restructurings are monitored centrally by specialized support staff who determine the loan has been properly classified as a troubled debt restructuring and if and/or when the loan may be placed on accrual status or removed from impaired loan status.

OREO consists of real property acquired through foreclosure on the collateral underlying defaulted loans. We initially record OREO at fair value less estimated costs to sell by a charge against the allowance for loan losses. Estimated losses that result from the ongoing periodic valuation of these properties are charged to earnings in the period in which they are identified. Fair values of OREO are estimated using appraisals and management estimates of current market conditions. OREO properties are appraised every 18-24 months unless deterioration in local market conditions indicates the need to obtain new appraisals sooner. OREO properties are evaluated by management quarterly to determine if additional write-downs are appropriate or necessary based on current market conditions. Quarterly evaluations include a review of the most recent appraisal of the property and reviews of recent appraisals and comparable sales data for similar properties in the same or adjacent market areas. Commercial and agricultural OREO properties are listed with unrelated third party professional real estate agents or brokers local to the areas where the marketed properties are located. Residential properties are typically listed with local realtors, after any redemption period has expired. We rely on these local real estate agents and/or brokers to list the properties on the local multiple listing system, to provide marketing materials and advertisements for the properties and to conduct open houses.

We generally place loans on non-accrual when they become 90 days past due, unless they are well secured and in the process of collection. When a loan is placed on non-accrual status, any interest previously accrued but not collected is reversed from income.

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

**Non-Performing Assets**

| <i>(Dollars in thousands)</i>                 | September 30,<br>2011 | June 30,<br>2011 | March 31,<br>2011 | December 31,<br>2010 | September 30,<br>2010 |
|---|-----------------------|------------------|-------------------|----------------------|-----------------------|
| <b>Non-performing loans:</b>                  |                       |                  |                   |                      |                       |
| Non-accrual loans                             | \$ 223,961            | 229,662          | 212,394           | \$ 195,342           | \$ 174,249            |
| Accruing loans past due 90 days or more       | 3,001                 | 2,194            | 4,140             | 1,852                | 1,129                 |
| Troubled debt restructurings                  | 35,616                | 31,611           | 33,344            | 13,490               | 26,630                |
| <b>Total non-performing loans</b>             | <b>262,578</b>        | <b>263,467</b>   | <b>249,878</b>    | <b>210,684</b>       | <b>202,008</b>        |
| OREO  | 25,080                | 28,323           | 31,995            | 33,632               | 35,296                |
| <b>Total non-performing assets</b>            | <b>\$ 287,658</b>     | <b>291,790</b>   | <b>281,873</b>    | <b>\$ 244,316</b>    | <b>\$ 237,304</b>     |
| Non-performing loans to total loans           | 6.14%                 | 6.15%            | 5.86%             | 4.82%                | 4.54%                 |
| Non-performing assets to total loans and OREO | 6.69%                 | 6.77%            | 6.56%             | 5.55%                | 5.29%                 |
| Non-performing assets to total assets         | 3.94%                 | 4.05%            | 3.79%             | 3.26%                | 3.24%                 |

Difficult economic conditions continued to negatively impact businesses and consumers in certain of our market areas during the first nine months of 2011. Non-performing assets increased \$43 million, or 17.7%, to \$288 million, or 6.69% of total loans and OREO, as of September 30, 2011, from \$244 million, or 5.55% of total loans and OREO, as of December 31, 2010. Our non-performing assets decreased slightly to \$288 million as of September 30, 2011 from \$292 million, or 6.77% of total loans and OREO, as of second quarter 2011 as non-performing assets work through the credit cycle and we have a decrease in the volume of new additions.

Total non-performing loans increased \$52 million, or 24.6%, to \$263 million as of September 30, 2011, from \$211 million as of December 31, 2010, primarily due to increases in troubled debt restructurings and non-accrual loans. Non-accrual loans increased \$29 million, or 14.7%, to \$224 million as of September 30, 2011, from \$195 million as of December 31, 2010. Non-accrual loans decreased \$6 million during third quarter 2011, as compared to the second quarter 2011. During third quarter, we charged-off loans of one commercial real estate and two land development borrowers aggregating \$15 million. The decrease from charge-offs, payoff and foreclosures were largely offset by two commercial

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and four real estate borrowers aggregating \$13 million that were placed on non-accrual during third quarter 2011. The remaining year-to-date increase was primarily due to nine large real estate and two large commercial borrowers aggregating \$50 million, added

**Table of Contents**

to non-accruals during the six months ended June 30, 2011, which were partially offset by one large pay-off of \$5 million and one large charge-off of \$6 million during the six months ended June 30, 2011. As of September 30, 2011, approximately 67% of our non-accrual loans were current with regard to principal.

Troubled debt restructurings increased \$22 million, or 164.0% to \$36 million as of September 30, 2011, from \$13 million as of December 31, 2010. Approximately 77% of the increase in troubled debt restructurings was due to the loans of one residential real estate and one commercial real estate borrower which were restructured during first quarter 2011, as well as one commercial real estate borrower restructured during third quarter 2011. As of September 30, 2011, approximately 92% of troubled debt restructurings were performing in accordance with their modified terms.

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. Estimated losses that result from the ongoing periodic valuation of these properties are charged to earnings in the period in which they are identified. OREO decreased \$9 million, or 25.4%, to \$25 million as of September 30, 2011, from \$34 million as of December 31, 2010. During the first nine months of 2011, the Company recorded additions to OREO of \$9 million, wrote down the fair value of OREO properties by \$6 million and sold OREO with a book value of \$12 million. As of September 30, 2011, approximately 68% of total OREO was comprised of properties located in the Flathead, Gallatin Valley and Jackson market areas.

The following table sets forth the allocation of our non-performing loans among our various loan categories as of the dates indicated:

**Non-Performing Loans by Loan Type**

| <i>(Dollars in thousands)</i>    | September 30,<br>2011 | Percent<br>of Total | December 31,<br>2010 | Percent<br>of Total |
|----------------------------------|-----------------------|---------------------|----------------------|---------------------|
| Real estate:                     |                       |                     |                      |                     |
| Commerical                       | \$ 91,329             | 34.8%               | \$ 73,449            | 34.9%               |
| Construction:                    |                       |                     |                      |                     |
| Land acquisition and development | 65,171                | 24.8%               | 44,546               | 21.1%               |
| Commercial                       | 21,189                | 8.1%                | 16,589               | 7.9%                |
| Residential                      | 15,030                | 5.7%                | 16,679               | 7.9%                |
| Total construction               | 101,390               | 38.6%               | 77,814               | 36.9%               |
| Residential                      | 23,752                | 9.0%                | 15,222               | 7.2%                |
| Agricultural                     | 8,943                 | 3.4%                | 3,476                | 1.6%                |
| Total real estate                | 225,414               | 85.8%               | 169,961              | 80.7%               |
| Consumer                         | 3,421                 | 1.3%                | 2,720                | 1.3%                |
| Commercial                       | 32,863                | 12.5%               | 36,906               | 17.5%               |
| Agricultural                     | 880                   | 0.4%                | 1,093                | 0.5%                |
| Other                            |                       | 0.0%                | 4                    | 0.0%                |
| Total non-performing loans       | \$ 262,578            | 100.0%              | \$ 210,684           | 100.0%              |

*Allowance for Loan Losses.* We perform a quarterly assessment of the adequacy of our allowance for loan losses in accordance with generally accepted accounting principals. The methodology used to assess the adequacy is consistently applied to our loan portfolio and takes into consideration the three elements that comprise the allowance for loan losses:



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- (1) Specific valuation allowances associated with impaired loans. Specific valuation allowances are determined based on assessment of the fair value of the collateral underlying the loans as determined through independent appraisals, the present value of future cash flows and observable market prices. No specific valuation allowances are recorded for impaired loans that are adequately secured.
- (2) Historical valuation allowances based on loan loss experience for similar loans with similar characteristics and trends.
- (3) General valuation allowances determined based on changes in the nature of the loan portfolio, overall portfolio quality, industry concentrations, delinquency trends, general economic conditions and other qualitative risk factors both internal and external to us. Based on the assessment of the adequacy of the allowance for loan losses, management records provisions for loan losses to maintain the allowance for loan losses at appropriate levels.

**Table of Contents**

Loans, or portions thereof, are charged-off against the allowance for loan losses when management believes that the collectability of the principal is unlikely, or, with respect to consumer installment loans, according to an established delinquency schedule. Generally, loans are charged-off when (1) there has been no material principal reduction within the previous 90 days and there is no pending sale of collateral or other assets, (2) there is no significant or pending event which will result in principal reduction within the upcoming 90 days, (3) it is clear that we will not be able to collect all or a portion of the loan, (4) payments on the loan are sporadic or if payments will result in an excessive amortization and are not consistent with the collateral held and (5) foreclosure or repossession actions are pending. Loan charge-offs do not directly correspond with the receipt of independent appraisals or the use of observable market data if the collateral value is determined to be sufficient to repay the principal balance of the loan.

If the impaired loan is adequately collateralized, a specific valuation allowance is not recorded. As such, significant changes in impaired and non-performing loans do not necessarily correspond proportionally with changes in the specific valuation component of the allowance for loan losses. Additionally, management expects the timing of charge-offs will vary between quarters and will not necessarily correspond proportionally to changes in the allowance for loan losses or changes in non-performing or impaired loans due to timing differences among the initial identification of an impaired loan, recording of a specific valuation allowance for the impaired loan and any resulting charge-off of uncollectible principal.

Based on declines in national, regional and local economies which began in 2008, we began to record additional general valuation allowances based on management's estimation of the probable impact that the declines would have on our loan portfolio. Accordingly, beginning in 2008, and continuing in 2009 and 2010, we recorded significantly higher provisions for loan losses to maintain the allowance for loan losses at appropriate levels. During 2008, 2009, 2010 and the first nine months of 2011, we experienced higher levels of impaired and non-performing loans as anticipated. Management expects that non-performing and impaired loans will start to decline as they make their way through the credit cycle and we have a decrease in the volume of new additions as the economy improves.

**Table of Contents**

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

**Allowance for Loan Losses**

| <i>(Dollars in thousands)</i>                            | Three Months Ended    |                  |                   |                      |                       |
|--|-----------------------|------------------|-------------------|----------------------|-----------------------|
|  | September 30,<br>2011 | June 30,<br>2011 | March 31,<br>2011 | December 31,<br>2010 | September 30,<br>2010 |
| Balance at beginning of period                           | \$ 124,579            | 124,446          | 120,480           | \$ 120,236           | \$ 114,328            |
| Provision charged to operating expense                   | 14,000                | 15,400           | 15,000            | 17,500               | 18,000                |
| <b>Charge offs:</b>                                      |                       |                  |                   |                      |                       |
| <b>Real estate</b>                                       |                       |                  |                   |                      |                       |
| Commercial   | 4,064                 | 5,005            | 1,186             | 2,835                | 2,082                 |
| Construction   | 7,997                 | 7,404            | 1,546             | 6,025                | 5,121                 |
| Residential  | 149                   | 748              | 1,499             | 2,269                | 788                   |
| Agricultural   |                       |                  |                   | 2,218                | 20                    |
| Consumer   | 1,682                 | 1,499            | 1,460             | 1,966                | 2,056                 |
| Commerical   | 6,498                 | 1,407            | 6,642             | 2,713                | 2,720                 |
| Agricultural   | 15                    | 39               | 6                 | 19                   | 2                     |
| <b>Total charge-offs</b>                                 | <b>20,405</b>         | <b>16,102</b>    | <b>12,339</b>     | <b>18,045</b>        | <b>12,789</b>         |
| <b>Recoveries:</b>                                       |                       |                  |                   |                      |                       |
| <b>Real estate</b>                                       |                       |                  |                   |                      |                       |
| Commercial   | 41                    | 11               | 125               | 20                   | 3                     |
| Construction   | 1,272                 | 50               | 92                | 18                   | 45                    |
| Residential  | 73                    | 48               | 28                | 105                  | 5                     |
| Agricultural   |                       |                  |                   |                      |                       |
| Consumer   | 453                   | 470              | 432               | 479                  | 505                   |
| Commerical   | 287                   | 253              | 621               | 153                  | 137                   |
| Agricultural   | 3                     | 3                | 7                 | 14                   | 2                     |
| <b>Total recoveries</b>                                  | <b>2,129</b>          | <b>835</b>       | <b>1,305</b>      | <b>789</b>           | <b>697</b>            |
| <b>Net charge-offs</b>                                   | <b>18,276</b>         | <b>15,267</b>    | <b>11,034</b>     | <b>17,256</b>        | <b>12,092</b>         |
| <b>Balance at end of period</b>                          | <b>\$ 120,303</b>     | <b>124,579</b>   | <b>124,446</b>    | <b>\$ 120,480</b>    | <b>120,236</b>        |
| <b>Period end loans</b>                                  | <b>\$ 4,275,717</b>   | <b>4,281,260</b> | <b>4,263,764</b>  | <b>\$ 4,367,909</b>  | <b>4,452,387</b>      |
| <b>Average loans</b>                                     | <b>4,291,632</b>      | <b>4,269,637</b> | <b>4,303,575</b>  | <b>4,402,141</b>     | <b>4,504,657</b>      |
| <b>Annualized net loans charged off to average loans</b> | <b>1.69%</b>          | <b>1.43%</b>     | <b>1.04%</b>      | <b>1.56%</b>         | <b>1.06%</b>          |
| <b>Allowance to period end loans</b>                     | <b>2.81%</b>          | <b>2.91%</b>     | <b>2.92%</b>      | <b>2.76%</b>         | <b>2.70%</b>          |

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. If the economy declines or asset quality deteriorates, material additional provisions could be required.

*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 increased \$112 million, or 5.8%, to \$2,046 million, or 28.0% of total assets, as of September 30, 2011, from \$1,933 million, or 25.8% of total assets, as of December 31, 2010. During the first nine months of 2011, excess liquidity was primarily used to purchase available-for-sale U.S. government agency investment securities.

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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 September 30, 2011, we had investment securities with fair values of \$4 million that had been in a continuous loss position more than twelve months. Gross unrealized losses on these securities totaled \$49 thousand as of September 30, 2011, and were primarily attributable to changes in interest rates. No impairment losses were recorded during the three or nine months ended September 30, 2011 or 2010.

**Table of Contents**

*Deposits.* Our deposits consist of non-interest bearing and interest bearing demand, savings, individual retirement and time deposit accounts. Total deposits decreased \$74 million, or 1.3%, to \$5,851 million as of September 30, 2011, from \$5,926 million as of December 31, 2010, with a shift in the mix of deposits away from higher-costing time deposits to lower-costing savings, interest bearing demand and non-interest bearing demand deposits. The following table summarizes our deposits as of the dates indicated:

**Deposits**

| <i>(Dollars in thousands)</i> | September 30,<br>2011 | Percent<br>of Total | December 31,<br>2010 | Percent<br>of Total |
|-------------------------------|-----------------------|---------------------|----------------------|---------------------|
| Non-interest bearing demand   | \$ 1,243,703          | 21.3%               | \$ 1,063,869         | 18.0%               |
| Interest bearing:             |                       |                     |                      |                     |
| Demand                        | 1,308,122             | 22.4                | 1,218,078            | 20.6                |
| Savings                       | 1,662,602             | 28.4                | 1,718,521            | 28.9                |
| Time, \$100 and over          | 704,518               | 12.0                | 908,044              | 15.3                |
| Time, other (1)               | 932,374               | 15.9                | 1,017,201            | 17.2                |
| <b>Total interest bearing</b> | <b>4,607,616</b>      | <b>78.7</b>         | <b>4,861,844</b>     | <b>82.0</b>         |
| <b>Total deposits</b>         | <b>\$ 5,851,319</b>   | <b>100.0%</b>       | <b>\$ 5,925,713</b>  | <b>100.0%</b>       |

(1) Included in Time, other are Certificate of Deposit Account Registry Service, or CDAR, deposits of \$133 million as of September 30, 2011 and \$139 million as of December 31, 2010.

*Repurchase Agreements.* In addition to deposits, repurchase agreements with commercial depositors, which include municipalities, provide an additional source of funds. Under repurchase agreements, deposit balances are invested in short-term U.S. government agency residential securities overnight and are then repurchased the following day. All outstanding repurchase agreements are due in one day. Repurchase agreements decreased \$145 million, or 23.3%, to \$476 million as of September 30, 2011, from \$620 million as of December 31, 2010, due to fluctuations in the liquidity of our customers.

**Capital Resources and Liquidity Management**

Stockholders' equity is influenced primarily by earnings, dividends, changes in the unrealized holding gains or losses, net of taxes, on available-for-sale investment securities and sales and redemptions of common stock. Stockholders' equity increased \$31 million, or 4.2% to \$768 million as of September 30, 2011, from \$737 million as of December 31, 2010, primarily due to increases in unrealized holding gains on available-for-sale investment securities and the retention of earnings.

On September 23, 2011, we declared a quarterly dividend to common stockholders of \$0.1125 per share to be paid on October 17, 2011 to shareholders of record as of October 3, 2011. During the first nine months of 2011, we paid aggregate cash dividends of \$14.4 million, or \$0.3375 per share, to common stockholders, as compared to aggregate cash dividends of \$13.1 million, or \$0.3375 per share, to common shareholders during the same period in 2010. In addition, we paid dividends of \$2.6 million to preferred stockholders during each of the nine month periods ended September 30, 2011 and 2010.

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. As of September 30, 2011 and December 31, 2010, the Bank had capital levels that, in all cases, exceeded the well-capitalized guidelines. As of September 30, 2011, we had consolidated leverage, tier 1 and total risk-based capital ratios of 9.77%, 14.28% and 16.26%, respectively, as compared to 9.27%, 13.53% and 15.50%, respectively, as of December 31, 2010.

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*Liquidity.* Liquidity measures 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 and access to alternative sources of funds. 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. Other sources of liquidity 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.

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. For additional information regarding our operating, investing and financing cash flows, see the unaudited Consolidated Statements of Cash Flows, included in Part I, Item 1.

## **Table of Contents**

As a holding company, we are a corporation separate and apart from the Bank and, therefore, we provide for our own liquidity. Our main sources of funding include management fees and dividends declared and paid by the Bank and access to capital markets. There are statutory, regulatory and debt covenant limitations that affect the ability of our subsidiary bank to pay dividends to us. Management believes that such limitations will not impact our ability to meet our ongoing short-term cash obligations.

Management continuously monitors our liquidity position and adjustments are made to the balance between sources and uses of funds as deemed appropriate. Our management is not aware of any events that are reasonably likely to have a material adverse effect on our liquidity, capital resources or operations. In addition, our management is not aware of any regulatory recommendations regarding liquidity, which if implemented, would have a material adverse effect on us.

## **Recent Accounting Pronouncements**

See Note 13 **Authoritative Accounting Guidance** 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 September 30, 2011, 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, 2010.

### **Item 4.**

## **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 September 30, 2011, 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 September 30, 2011, 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, and is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

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

There were no changes in our internal control over financial reporting for the quarter ended September 30, 2011, that have materially affected, or are reasonably likely to materially affect, such control.

### **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**



**Table of Contents****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, 2010.

**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, 2010.

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

(a) There were no unregistered sales of equity securities during the nine months ended September 30, 2011.

(b) Not applicable.

(c) The following table provides information with respect to purchases made by or on behalf of us or any affiliated purchasers (as defined in Rule 10b-18(a)(3) under the Exchange Act), of our common stock during the three months ended September 30, 2011.

| Period         | Total Number of Shares Purchased (1) | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|----------------|--------------------------------------|------------------------------|--|--|
| July 2011      |                                      | \$                           | 0  | Not Applicable   |
| August 2011    | 352                                  | 10.39                        | 0  | Not Applicable   |
| September 2011 |                                      |                              | 0  | Not Applicable   |
| Total          | 352                                  | \$ 10.39                     | 0  | Not Applicable   |

(1) Represents shares purchased by the Company in satisfaction of minimum required income tax withholding requirements pursuant to the vesting of restricted stock.

**Item 3. Defaults upon Senior Securities**

None.

**Item 4. (Removed and Reserved)****Item 5. Other Information**

Not applicable or required.

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### Item 6. Exhibits

- 2.1 Stock Purchase Agreement dated as of September 18, 2007, by and between First Interstate BancSystem, Inc. and First Western Bancorp, Inc. (incorporated herein by reference to Exhibit 2.1 of the Company's Current Report on Form 8-K filed on September 19, 2007)
- 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. (incorporated herein by reference to Exhibit 10.20 of the Company's Current Report on Form 8-K filed on January 16, 2008)
- 3.1 Amended and Restated Articles of Incorporation dated March 5, 2010 (incorporated herein by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K/A filed on March 10, 2010)
- 3.2 Second Amended and Restated Bylaws dated January 27, 2011 (incorporated herein by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K/A filed on February 3, 2011)
- 4.1 Specimen of Series A preferred stock certificate of First Interstate BancSystem, Inc. (incorporated herein by reference to Exhibit 4.2 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007)
- 10.1 Credit Agreement Re: Subordinated Term Note dated as of January 10, 2008, between First Interstate BancSystem, Inc. and First Midwest Bank (incorporated herein by reference to Exhibit 10.24 of the Company's Current Report on Form 8-K filed on January 16, 2008)

**Table of Contents**

|       |   |
|-------|---|
| 10.2  | Lease Agreement between Billings 401 Joint Venture and First Interstate Bank Montana dated September 20, 1985 and addendum thereto (incorporated herein by reference to Exhibit 10.4 of the Company's Post-Effective Amendment No. 3 to Registration Statement on Form S-1, No. 033-84540, filed on September 29, 1994) |
| 10.3  | First Interstate BancSystem's Deferred Compensation Plan dated December 1, 2006 (incorporated herein by reference to Exhibit 10.9 of the Company's Pre-Effective Amendment No. 3 to Registration Statement on Form S-1, No. 333-164380, filed on March 23, 2010)  |
| 10.4  | First Amendment to the First Interstate BancSystem's Deferred Compensation Plan dated October 24, 2008 (incorporated herein by reference to Exhibit 10.10 of the Company's Pre-Effective Amendment No. 3 to Registration Statement on Form S-1, No. 333-164380, filed on March 23, 2010)                                |
| 10.5  | 2001 Stock Option Plan (incorporated herein by reference to Exhibit 4.12 of the Company's Registration Statement on Form S-8, No. 333-106495, filed on June 25, 2003)   |
| 10.6  | Second Amendment to 2001 Stock Option Plan (incorporated herein by reference to Exhibit 10.6 of the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2010)   |
| 10.7  | First Interstate BancSystem, Inc. 2006 Equity Compensation Plan (incorporated herein by reference to Appendix A of the Company's 2006 Definitive Proxy Statement of Schedule 14A)   |
| 10.8  | Amendment to First Interstate BancSystem, Inc. 2006 Equity Compensation Plan (incorporated herein by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed on March 22, 2010)   |
| 10.9  | Second Amendment to First Interstate BancSystem, Inc. 2006 Equity Compensation Plan (incorporated herein by reference to Exhibit 10.9 of the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2010)  |
| 10.10 | Form of First Interstate BancSystem, Inc. 2006 Equity Compensation Plan Restricted Stock Agreement (Time) for Certain Executive Officers (incorporated herein by reference to Exhibit 10.13 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008)                                    |
| 10.11 | Form of First Interstate BancSystem, Inc. 2006 Equity Compensation Plan Restricted Stock Agreement (Performance) for Certain Executive Officers (incorporated herein by reference to Exhibit 10.14 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008)                             |
| 10.12 | Trademark License Agreements between Wells Fargo & Company and First Interstate BancSystem, Inc. (incorporated herein by reference to Exhibit 10.11 of the Company's Registration Statement on Form S-1, No. 333-25633 filed on April 22, 1997)   |
| 31.1* | Certification of Quarterly Report on Form 10-Q pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 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 by Chief Financial Officer   |
| 32*   | Certification of Quarterly Report on Form 10-Q pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 101** | Interactive data file   |

Management contract or compensatory arrangement.

\* Filed herewith.

\*\* As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

**Table of Contents**

**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 November 9, 2011

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

Date November 9, 2011

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