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

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2009

OR

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

COMMISSION FILE NUMBER 000-49733
First Interstate BancSystem, Inc.
(Exact name of registrant as specified in its charter)

Montana	81-0331430
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

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

(Address of principal executive offices)	(Zip Code)

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

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

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 o	Accelerated filer o	Non-accelerated filer þ (Do not check if a Smaller Reporting Company)	Smaller reporting company o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of the Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.)
Yes o No o

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

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

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

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

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

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

See accompanying notes to unaudited consolidated financial statements.

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

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

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

See accompanying notes to unaudited consolidated financial statements.

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

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

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

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

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

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

	For the six months ended June 30, 2009	2008
Cash flows from financing activities:		
Net increase in deposits	$ 351,056	$ 72,161
Net increase (decrease) in federal funds purchased	(30,625)	108,410
Net decrease in repurchase agreements	(157,059)	(137,423)
Net increase (decrease) in other borrowed funds	(20,833)	117,319
Borrowings of long-term debt		112,500
Repayments of long-term debt	(4,504)	(28,800)
Proceeds from issuance of subordinated debentures held by subsidiary trusts		20,620
Net decrease (increase) in debt issuance costs	63	(471)
Preferred stock issuance costs		(38)
Proceeds from issuance of common stock	43	1,316
Excess tax benefits from stock-based compensation	678	801
Purchase and retirement of common stock	(7,606)	(18,312)
Dividends paid on common stock	(8,651)	(10,332)
Dividends paid on preferred stock	(1,697)	(1,622)
Net cash provided by financing activities	120,865	236,129
Net increase in cash and cash equivalents	237,877	15,220
Cash and cash equivalents at beginning of period	314,030	249,246
Cash and cash equivalents at end of period	$ 551,907	$ 264,466
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 42,615	$ 63,209
Income taxes	22,000	20,894

See accompanying notes to unaudited consolidated financial statements.

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

(1) Basis of Presentation

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

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

(2) Regulatory Capital

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

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

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

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

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

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

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

(3) <u>Investment Securities</u>

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

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

Held-to-Maturity *June 30, 2009*	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
State, county and municipal securities	$101,072	$854	$(924)	$101,002

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

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

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

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

There were no sales of investment securities during the six months ended June 30, 2009 or during 2008.
The following table shows the gross unrealized losses and fair values of investment securities, aggregated by investment category, and the length of time individual investment securities have been in a continuous unrealized loss position, as of June 30, 2009 and December 31, 2008.

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

State, county and municipal securities

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

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

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

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

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

(4) <u>Impaired Loans</u>

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

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

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

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

FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES
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(5) Allowance for Loan Losses

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

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

(6) Long-Term Debt

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

(7) Commitments

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

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

(8) Financial Instruments with Off-Balance Sheet Risk

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

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

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(9) Computation of Earnings per Common Share

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

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

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

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

(10) Non-Cash Investing and Financing Activities

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

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

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

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

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

(11) Fair Value Measurements

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

	Fair Value Measurements Using		
	Quoted Prices in	Significant Other	Significant

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

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

The following methods were used to estimate the fair value of each class of financial instrument above:
Investment Securities Available-for-Sale. The Company obtains fair value measurements for investment securities available-for-sale from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond s terms and conditions, among other things.
Mortgage Servicing Rights. Mortgage servicing rights are initially recorded at fair value based on comparable market quotes and are amortized in proportion to and over the period of estimated net servicing income. Mortgage servicing rights are evaluated quarterly for impairment using an independent valuation service. The valuation service utilizes discounted cash flow modeling techniques, which consider observable data that includes consensus prepayment speeds and the predominant risk characteristics of the underlying loans including loan type, note rate and loan term. Management believes the significant inputs utilized in the valuation model are observable in the market.
Additionally, from time to time, certain assets are measured at fair value on a non-recurring basis. These adjustments to fair value generally result from the application of lower-of-cost-or-market accounting or write-downs of individual assets due to impairment.
The following table presents information about the Company s assets and liabilities measured at fair value of a non-recurring basis during the six months ended June 30, 2009 and 2008:

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

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

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

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

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

Mortgage Loans Held for Sale. Mortgage loans held for sale are required to be measured at the lower of cost or fair value. The fair value of mortgage loans held for sale is based upon binding contracts or quotes or bids from third party investors. As of June 30, 2009 and December 31, 2008, all mortgage loans held for sale were recorded at cost.

The Company is required to disclose the fair value of financial instruments for which it is practical to estimate fair value. The methodologies for estimating the fair value of financial instruments that are measured at fair value on a recurring or non-recurring basis are discussed above. The methodologies for estimating the fair value of other financial instruments are discussed below. For financial instruments bearing a variable interest rate where no credit risk exists, it is presumed that recorded book values are reasonable estimates of fair value.

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

Financial Liabilities. The fair values of demand deposits, savings accounts, federal funds purchased, securities sold under repurchase agreements and accrued interest payable are the amount payable on demand at the reporting date. The fair values of fixed-maturity certificates of deposit are estimated using external market rates currently offered for deposits with similar remaining maturities. The carrying values of the interest bearing demand notes to the United States Treasury are deemed an approximation of fair values due to the frequent repayment and repricing at market rates. The revolving term loans, floating rate subordinated debentures, floating rate subordinated term loan and unsecured demand notes bear interest at floating market rates and, as such, carrying amounts are deemed to approximate fair values. The fair values of notes payable to the FHLB, fixed rate subordinated term debt and capital lease obligations are estimated by discounting future cash flows using current rates for advances with similar characteristics.

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

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

	As of June 30, 2009		As of December 31, 2008	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	$ 551,907	$ 551,907	$ 314,030	$ 314,030
Investment securities available-for-sale	953,977	953,977	961,914	961,914
Investment securities held-to-maturity	101,615	101,545	110,362	109,809
Net loans	4,567,155	4,575,096	4,685,497	4,696,287
Accrued interest receivable	38,272	38,272	38,694	38,694
Mortgage servicing rights, net	20,565	21,018	11,002	11,832
Total financial assets	$ 6,233,491	$ 6,241,815	$ 6,121,499	$ 6,132,566