CVS CAREMARK CORP
Form PRE 14A
March 18, 2013
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SCHEDULE 14A

(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a)

of the Securities Exchange Act of 1934

(Amendment No.)

Filed by the Registrant x

Filed by a Party other than the Registrant ¨

Check the appropriate box:

x	Preliminary Proxy Statement		
¨	Definitive Proxy Statement	¨	**Confidential, For Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
¨	Definitive Additional Materials		
¨	Soliciting Material Pursuant to Rule 14a-11(c) or Rule 14a-12		

CVS CAREMARK CORPORATION

(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing fee (Check the appropriate box):

x No fee required.

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

¨ Fee paid previously with preliminary materials:

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.

(1) Amount previously paid:

Not Applicable

(2) Form, Schedule or Registration Statement No.:

Not Applicable

(3) Filing Party:

Not Applicable

(4) Date Filed:

Not Applicable

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CVS Caremark Corporation

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

MAY 9, 2013

9:00 A.M.

CVS Caremark Corporation

One CVS Drive

Woonsocket, Rhode Island 02895

To our stockholders:

We are pleased to invite you to attend our 2013 annual meeting of stockholders to:

- Elect 8 directors named in the accompanying proxy statement;
- Ratify the appointment of Ernst & Young LLP as the Company s independent registered public accounting firm for fiscal 2013;
- Act, by non-binding vote, to approve the Company s executive compensation as disclosed in this proxy statement;
- Amend the Company s 2007 Employee Stock Purchase Plan to add shares to the Plan;
- Act on a proposal by the Company to amend the Company s charter to reduce the threshold for stockholder approval of certain related person business combination transactions under the Charter s fair price provision from 2/3 of shares outstanding to a majority of shares outstanding;
- Act on three stockholder proposals to be presented; and
- Conduct other business properly brought before the meeting.

Stockholders of record at the close of business on March 13, 2013 may vote at the meeting.

Your vote is important. Whether or not you plan to attend the meeting, please vote your shares. In addition to voting in person or by mail, stockholders of record have the option of voting by telephone or via the Internet. If your shares are held in the name of a bank, broker or other holder of record (i.e., in street name), please read your voting instructions to see which of these options are available to you. Even if you are attending the meeting in person, we encourage you to vote in advance by mail, phone or Internet.

By Order of the Board of Directors,

David W. Dorman

Chairman of the Board

Important Notice Regarding the Availability of Proxy Materials for the Stockholder Meeting to Be Held on May 9, 2013.

The proxy statement and annual report to security holders are available at

http://info.cvscaremark.com/investors and at www.envisionreports.com/cvs.

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INFORMATION ABOUT THE ANNUAL MEETING AND VOTING

The Board of Directors of CVS Caremark Corporation (the Company or CVS Caremark) is soliciting your proxy to vote at our 2013 annual meeting of stockholders (or at any adjournment of the meeting; the Meeting or Annual Meeting). This proxy statement summarizes the information you need to know to vote at the Meeting.

We began mailing this proxy statement and the enclosed proxy card on or about April [ ], 2013 to all stockholders entitled to vote. The Company s 2012 Annual Report, which includes our financial statements, is being sent with this proxy statement.

Date, Time and Place of the Annual Meeting

Date:	May 9, 2013
Time:	9:00 a.m. Eastern Time
Place:	CVS Caremark Customer Support Center (Company Headquarters) One CVS Drive Woonsocket, Rhode Island 02895

Stockholders must present a form of personal photo identification in order to be admitted to the Annual Meeting. No cell phones, cameras, recording equipment, electronic devices, large bags, briefcases or packages will be permitted in the Meeting.

Shares Entitled to Vote

Stockholders entitled to vote are those who owned CVS Caremark common stock at the close of business on the record date, March 13, 2013. As of the record date, there were 1,241,647,389 shares of common stock outstanding. Each share of CVS Caremark common stock that you own entitles you to one vote.

The Bank of New York Mellon presently holds shares of common stock as Trustee under the 401(k) Plan and the Employee Stock Ownership Plan of CVS Caremark Corporation and Affiliated Companies (the ESOP). Each participant in the ESOP instructs the Trustee of the ESOP how to vote his or her shares. As to shares with respect to which the Trustee receives no timely voting instructions, the Trustee, pursuant to the ESOP Trust Agreement, votes these shares in the same proportion as it votes all the shares as to which it has received timely voting instructions. The results of the voting will be held in strict confidence by the Trustee. Please note that the cut-off date by which participants of the ESOP must submit their vote to the tabulator in order to be counted is 5:00 P.M. Eastern Time on May 6, 2013.

Voting

Whether or not you plan to attend the Annual Meeting, we urge you to vote. You may vote by calling a toll-free telephone number, by using the Internet or by mailing your signed proxy card in the postage-paid envelope provided. If you vote by telephone or the Internet, you do NOT need to return your proxy card. Returning the proxy card by mail or voting by telephone or Internet will not affect your right to attend the Annual Meeting and change your vote, if desired.

If your shares are held in the name of a bank, broker or other holder of record (a nominee), you will receive instructions from the nominee that you must follow in order for your shares to be voted. Certain of these institutions offer telephone and Internet voting.

The enclosed proxy card indicates the number of shares that you own as of the record date.

Voting instructions are included on your proxy card. If you properly fill in your proxy card and send it to us in time to vote, or vote by telephone or the Internet, one of the individuals named on your proxy card

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(your proxy) will vote your shares as you have directed. If you sign the proxy card but do not make specific choices, your proxy will follow the Board s recommendations and vote your shares:

- FOR the election of all 8 nominees for director (as described beginning on page 55);
- FOR the ratification of the appointment of Ernst & Young LLP as the Company s independent registered public accounting firm for fiscal 2013 (as described on page 58);
- FOR approval of the Company s executive compensation as disclosed in this proxy statement (as described beginning on page 59);
- FOR approval of a proposal to amend of the Company s 2007 Employee Stock Purchase Plan to add shares to the Plan (as described beginning on page 61);
- FOR the adoption of a proposal by the Company to amend the Company s charter to reduce the voting thresholds in the fair price provision (as described on page 65); and
- AGAINST each of the stockholder proposals to be presented (as described beginning on page 66).

The Board of Directors and the Company s management have not received notice of, and are not aware of, any business to come before the Meeting other than the agenda items referred to in this proxy statement.

Revoking your proxy card

You may revoke your proxy card by:

- sending in another signed proxy card with a later date;
- providing subsequent telephone or Internet voting instructions;
- notifying our Corporate Secretary in writing before the Annual Meeting that you have revoked your proxy card; or
- voting in person at the Annual Meeting.

Voting in person

If you plan to attend the Annual Meeting and vote in person, we will give you a ballot when you arrive. However, if your shares are held in the name of a nominee, you must bring an account statement or letter from the nominee indicating that you were the beneficial owner of the shares on March 13, 2013, the record date for voting.

Appointing your own proxy

If you want to give your proxy to someone other than the individuals named as proxies on the proxy card, you may cross out the names of those individuals and insert the name of the individual you are authorizing to vote. Either you or that authorized individual must present the proxy card at the Annual Meeting to vote.

Proxy solicitation

We are soliciting this proxy on behalf of our Board of Directors and will bear the solicitation expenses. We are making this solicitation by mail but we may also solicit by telephone, e-mail or in person. We have hired Morrow & Co., LLC, 470 West Avenue, Stamford, CT 06902, for a fee of $25,000, plus out-of-pocket expenses, to provide customary assistance to us in the solicitation. We will reimburse banks, brokerage houses and other institutions, nominees and fiduciaries, if they so request, for their expenses in forwarding proxy materials to beneficial owners.

Householding

Under U.S. Securities and Exchange Commission (SEC) rules, a single set of annual reports and proxy statements may be sent to any household at which two or more Company stockholders reside if they appear to be members of the same family. Each stockholder continues to receive a separate proxy card. This procedure, referred to as householding, reduces the volume of duplicate information stockholders receive and reduces mailing and printing expenses for the Company. Brokers with accountholders who are Company stockholders may be householding our proxy materials. As indicated in the notice previously provided by these brokers to our stockholders, a single annual report and proxy statement will be delivered to multiple stockholders sharing an address unless contrary instructions have been received from an affected stockholder. Once you have received notice from your broker that it will be householding communications to your address, householding will continue until you are notified otherwise or until you revoke your consent. If, at any time, you no longer wish to participate in householding and would prefer to receive a separate annual report and proxy statement, please notify your broker so that separate copies may be delivered to you. Stockholders who currently receive multiple copies of the annual report and proxy statement at their address who would prefer that their communications be householded should contact their broker.

Quorum Requirement

A quorum of stockholders is necessary to hold a valid meeting. The presence in person or by proxy at the Annual Meeting of holders of shares representing a majority of shares entitled to vote constitutes a quorum. Abstentions and broker non-votes are counted as present for establishing a quorum. A broker non-vote occurs on an item when a broker is not permitted to vote on that item absent instruction from the beneficial owner of the shares and no instruction is given.

Vote Necessary to Approve Proposals

- n *Item 1, election of directors*. Each director is elected by a majority of the votes cast with respect to that director s election (at a meeting for the election of directors at which a quorum is present) by the holders of shares of common stock present in person or by proxy at the meeting and entitled to vote.

A majority of votes cast means that the number of votes for a director s election must exceed 50% of the votes cast with respect to that director s election. Votes against a director s election will count as a vote cast, but abstentions and broker non-votes will not count as a vote cast with respect to that director s election and will have no effect.

- n *Item 5, Amendment of the Company s Charter to reduce the threshold for stockholder approval of certain related person business combination transactions under the Charter s fair price provision from 2/3 of shares outstanding to a majority of shares outstanding*. Approval is by an affirmative vote (at a meeting at which a quorum is present) of the holders of two-thirds (2/3) of the shares of common stock outstanding. Abstentions are counted as shares present or represented and voting and have the effect of a vote against. Broker non-votes are not counted as shares present or represented and voting and have the effect of a vote against.

- n *All other items*. For Items 2, 3, 4, 6, 7 and 8, approval is by affirmative vote (at a meeting at which a quorum is present) of a majority of the votes represented by the shares of common stock present at the meeting in person or by proxy and entitled to vote. Abstentions are counted as shares present or represented and voting and have the effect of a vote against. Broker non-votes are not counted as shares present or represented and voting and have no effect on the vote.

- n *Broker voting*. Under current New York Stock Exchange (NYSE) rules, if the record holder of your shares (usually a bank, broker or other nominee) holds your shares in its name, your record holder is permitted to vote your shares on Item 2, Ratification of Auditors, in its discretion, even if it does not receive voting instructions from you. On all other Items, your record holder is not permitted to vote your shares without your instructions and such uninstructed shares are considered broker non-votes.

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CORPORATE GOVERNANCE AND RELATED MATTERS

Corporate Governance Guidelines

The Company s Board of Directors acts as the ultimate decision-making body of the Company and advises and oversees management, who are responsible for the day-to-day operations and management of the Company. In carrying out its responsibilities, the Board reviews and assesses the Company s long-term strategy and its strategic, competitive and financial performance. The Board has adopted Corporate Governance Guidelines, which are available on our investor relations website at http://info.cvscaremark.com/ investors and are also available to stockholders at no charge upon request to the Company s Corporate Secretary. These Guidelines meet or exceed the listing standards adopted by the NYSE, on which the Company s common stock is listed.

Meetings of the Board

During 2012, there were eight meetings of the Board of Directors. Directors are expected to make every effort to attend the Annual Meeting, all Board meetings and the meetings of the Committees on which they serve. All but one of our directors at the time of the Company s 2012 annual meeting of stockholders attended that annual meeting. In 2012, each director attended at least 75% of the meetings of the Board and of the Committees of which he or she was a member.

One Board meeting was our annual meeting of independent directors. The independent directors also regularly hold executive sessions during which the Company s management does not participate.

The Board s Leadership Structure

Mr. David W. Dorman is our independent Chairman of the Board. The independent Chairman presides at all meetings of the Board, and works with the Company s Chief Executive Officer (CEO) to set Board meeting agendas and the schedule of Board meetings. In addition, the independent Chairman has the following duties and responsibilities: the authority to call, and to lead, independent director sessions; the ability to retain independent legal, accounting or other advisors in connection with these sessions; facilitation of communication and service as a liaison between the CEO and the other independent directors; and the duty to advise the CEO of the informational needs of the Board.

The Board believes that Board independence and oversight of management will be effectively maintained through the independent Chairman, the Board s composition and its Committee system. Consistent with past practice, if in the future the Board decides that a non-independent Chairman should lead, then it will appoint an independent Lead Director. The Board also believes that it is not necessary to adopt a rigid policy restricting its discretion in selecting the Chairman of the Board (as well as restricting the ability to combine the positions of Chairman and CEO if future circumstances warrant), because this would deprive the Board of the ability to select the most qualified and appropriate individual to lead the Board as Chairman at any particular point in time.

The Board s Role in Risk Oversight

The Board of Directors role in risk oversight involves both the full Board of Directors and its Committees. The Audit Committee is charged with the primary role in carrying out risk oversight responsibilities on behalf of the Board. Pursuant to its charter, the Audit Committee annually reviews the Company s policies and practices with respect to risk assessment and risk management, including discussing with management the Company s major risk exposures and the steps that have been taken to monitor and mitigate such exposures. As part of CVS Caremark s ongoing Enterprise Risk Management process, each of the Company s major business units is responsible for identifying risks that could affect achievement of business goals and strategies, assessing the likelihood and potential impact of significant risks, prioritizing risks and actions to be taken in mitigation and/or response, and reporting to management s Executive Risk Steering Committee on actions to monitor, manage and mitigate significant risks. Additionally, the Chief Financial Officer (CFO), Chief Compliance Officer (CCO) and General

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Counsel (GC) periodically report on the Company s risk management policies and practices to relevant Board Committees and to the full Board. The Audit Committee reviews CVS Caremark s major financial risk exposures as well as major operational, compliance, reputational and strategic risks, including steps to monitor, manage and mitigate those risks. In addition, each of the other Board Committees is responsible for oversight of risk management practices for categories of risks relevant to their functions. For example, the Management Planning and Development Committee has oversight responsibility for the Company s overall compensation structure, including review of its compensation practices, with a view to assessing associated risk. See Executive Compensation and Related Matters Compensation Discussion and Analysis Risk Assessment. The Board as a group is regularly updated on specific risks in the course of its review of corporate strategy, business plans and reports to the Board by its respective Committees.

The Board considers its role in risk oversight when evaluating the Company s Corporate Governance Guidelines and its leadership structure. Both the Corporate Governance Guidelines and the Board s leadership structure facilitate the Board s oversight of risk and communication with management. Our Chairman and our CEO are focused on the Company s risk management efforts and ensure that risk matters are appropriately brought to the Board and/or its Committees for their review.

Director Nominations

Under the Company s Corporate Governance Guidelines, the Nominating and Corporate Governance Committee recommends to the Board criteria for Board membership and recommends individuals for membership on the Company s Board of Directors. Director Qualification Criteria used by the Committee in nominating directors are found in the Committee s charter and are attached to this proxy statement as Exhibit A. Although there is no specific policy on diversity, the Committee values diversity, which it broadly views in terms of, among other things, gender, race, background and experience, as a factor in selecting members to serve on the Board, and believes that the diversity of the Board s current composition provides significant benefits to the Company. When considering current directors for re-nomination to the Board, the Committee takes into account the performance of each director. The Committee also reviews the composition of the Board in light of the current challenges and needs of the Board and the Company, and determines whether it may be appropriate to add or remove individuals after considering, among other things, the need for audit committee expertise and issues of independence, judgment, age, skills, background and experience. As desired, the Committee may confer with the Chairman and other directors as to the foregoing matters.

The Nominating and Corporate Governance Committee will consider any director candidates recommended by stockholders who submit a written request to the Corporate Secretary of the Company. The candidates should meet the Director Qualification Criteria noted above. The Committee evaluates all director candidates and nominees in the same manner regardless of the source. If a stockholder would like to nominate a person for election or re-election to the Board, he or she must provide notice to the Company as provided in our by-laws. Such notice must be addressed to the Corporate Secretary and must arrive at the Company in a timely manner, between 90 and 120 days prior to the anniversary of our last annual meeting of stockholders. The notice must include (i) the name and address, as they appear in the Company s books, of the stockholder giving the notice, (ii) the class and number of shares of the Company that are beneficially owned by the stockholder (including information concerning derivative ownership and other arrangements concerning our stock as described in our by-laws), (iii) a written consent indicating that the candidate is willing to be named in the proxy statement as a nominee and to serve as a director if elected, and (iv) any other information that the SEC would require to be included in a proxy statement when a stockholder submits a proposal. See Other Matters Stockholder Proposals and Other Business for our Annual Meeting in 2014 for additional information related to our 2014 annual meeting.

The retirement age for CVS Caremark directors is 72. The Company s Corporate Governance Guidelines provide that no director who is or would be over the age of 72 at the expiration of his or her current term may be nominated to a new term, unless the Board waives the retirement age for a specific director in exceptional circumstances.

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Independence Determinations for Directors

Under the Company s Corporate Governance Guidelines, a majority of our Board must be comprised of directors who meet the director independence requirements set forth in the Corporate Governance Rules of the NYSE applicable to listed companies. Under the NYSE Corporate Governance Rules, no director qualifies as independent unless the Board affirmatively determines that the director has no material relationship with the Company (either directly or as a partner, stockholder or officer of an organization that has a relationship with the Company). The basis for a Board s determination that a relationship is not material must be disclosed in the Company s annual proxy statement. In this regard, the Board has adopted categorical standards to assist it in making determinations of independence, which are attached to this proxy statement as Exhibit B.

The Nominating and Corporate Governance Committee of the Board undertook its annual review of director independence in March 2013, and determined that each of C. David Brown II, David W. Dorman, Anne M. Finucane, Kristen Gibney Williams, Jean-Pierre Millon, Richard W. Swift and Tony L. White, is independent. Ms. Heard and Mr. Piccolo, each of whom is retiring at the time of the Annual Meeting, also were determined to be independent during their 2012-13 Board year service. Mr. Merlo is considered an inside director because of his current employment as President and CEO of the Company.

In the course of its review as to the independence of each director, the Committee considered transactions and relationships, if any, between each director or any member of his or her immediate family, on the one hand, and the Company and its subsidiaries, on the other.

Contact with the Board, the Chairman and Other Independent Directors

Stockholders and other parties interested in communicating directly with the Board, the independent Chairman of the Board or with the independent directors as a group may do so by writing to them care of CVS Caremark Corporation, One CVS Drive, Woonsocket, RI 02895. The Nominating and Corporate Governance Committee has approved a process for handling letters received by the Company and addressed to the Board, the Chairman of the Board or to independent members of the Board. Under that process, the Corporate Secretary of the Company reviews all such correspondence and regularly forwards to the Board a summary of all such correspondence and copies of all correspondence that, in the opinion of the Corporate Secretary, deals with the functions of the Board or Committees thereof or that he otherwise determines requires their attention. Directors shall from time to time review a log of all correspondence received by the Company that is addressed to members of the Board and may request copies of any such correspondence. Concerns relating to accounting, internal accounting controls or auditing matters will be promptly brought to the attention of the Company s internal audit department and handled in accordance with procedures established by the Audit Committee with respect to such matters.

Code of Conduct

The Company has adopted a Code of Conduct that applies to all of our directors, officers and employees, including our CEO, CFO and Chief Accounting Officer. The Company s Code of Conduct is available on the Company s website at http://info.cvscaremark.com/investors, and will be provided to stockholders without charge upon request to the Company s Corporate Secretary. The Company intends to post amendments to or waivers from its Code of Conduct (to the extent applicable to the Company s executive officers or directors) at that location on its website within the timeframe required by SEC rules.

Committees of the Board

Audit Committee

Richard J. Swift, Chair

Kristen Gibney Williams

Jean-Pierre Millon

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The Audit Committee met nine times during 2012. Mr. Edwin M. Banks was a member of the Committee until his retirement from the Board and the Committee at the time of our 2012 Annual Meeting of Stockholders. Each member of the Committee is financially literate and independent of the Company and management under the standards set forth in applicable SEC rules and the Corporate Governance Rules of the NYSE. The Board has designated each of Mr. Swift and Mr. Millon as an audit committee financial expert, as defined under applicable SEC rules. The Board has approved a charter for the Committee, a copy of which can be viewed on the Company s website at http://info.cvscaremark.com/investors, and also is available to stockholders without charge upon request to the Company s Corporate Secretary. Pursuant to its charter, the Committee assists the Board in its oversight of: (i) the integrity of the financial statements of the Company; (ii) the qualifications, independence and performance of the Company s independent registered public accounting firm, for whose appointment the Committee bears principal responsibility; (iii) the performance of the Company s internal audit function; (iv) the Company s policies and practices with respect to risk assessment and risk management, including discussing with management the Company s major financial risk exposures and the steps that have been taken to monitor and control such exposures; (v) compliance with the Company s Code of Conduct; (vi) the review of the Company s information governance framework, including its privacy and information security programs, as well as the cybersecurity aspects of the information security program; (vii) review and ratification of any related person transactions pursuant to the Company s policy on such matters; and (viii) compliance by the Company with legal and regulatory requirements. The Committee also approved the Audit Committee Report that is found on page 13 of this proxy statement.

Nominating and Corporate Governance Committee

David W. Dorman, Chair

C. David Brown II

Anne M. Finucane

Marian L. Heard

C.A. Lance Piccolo

The Nominating and Corporate Governance Committee met five times during 2012. Each member of the Committee is independent of the Company and management under the standards set forth in the Corporate Governance Rules of the NYSE. The Board has approved a charter for the Committee, a copy of which can be viewed on the Company s website at http://info.cvscaremark.com/investors, and also is available to stockholders without charge upon request to the Company s Corporate Secretary. Pursuant to its charter, the Committee has responsibility for: (i) identifying individuals qualified to become Board members; (ii) recommending to the Board director nominees for election at the next annual or special meeting of stockholders at which directors are to be elected or to fill any vacancies or newly-created directorships that may occur between such meetings; (iii) recommending directors for appointment to Board Committees; (iv) making recommendations to the Board as to determinations of director independence; (v) evaluating Board and Committee performance; and (vi) reviewing and assessing the Company s Corporate Governance Guidelines and overseeing compliance with such Guidelines.

Management Planning and Development Committee

C. David Brown II, Chair

David W. Dorman

Marian L. Heard

Tony L. White

The Management Planning and Development Committee met five times during 2012. Mr. Terrence Murray was a member of the Committee until his retirement from the Board and the Committee at the time of our 2012 Annual Meeting of Stockholders. Each member of the Committee is independent of the Company and management under the standards set forth in the Corporate Governance Rules of the NYSE. No Committee member participates in any of the Company s employee compensation programs and none is

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a current or former officer or employee of CVS Caremark or its subsidiaries. At its meetings, non-members, such as the CEO, the CFO, the Chief Human Resources Officer, the GC, other senior human resources and legal officers, or external consultants, may be invited to provide information, respond to questions and provide general staff support. However, no CVS Caremark executive officer is permitted to be present during any discussion of his or her compensation or performance, and the Committee may exercise its prerogative to meet in executive session without non-members.

The Committee s responsibilities are specified in its charter. The charter, as approved by the Board, may be viewed on the Company s website at http://info.cvscaremark.com/investors, and also is available to stockholders without charge upon request to the Company s Corporate Secretary. These responsibilities fall into six broad categories. Pursuant to its charter, the Committee: (i) oversees the Company s compensation and benefits policies and programs generally; (ii) evaluates the performance of designated senior executives, including the CEO, and reviews the Company s management succession plan; (iii) in consultation with the other independent directors of the Company, oversees and sets compensation for the CEO; (iv) oversees and sets compensation for the Company s designated senior executives; (v) reviews and recommends to the Board compensation (including cash and equity-based compensation) for the Company s directors; and (vi) prepares and recommends to the full Board the inclusion of Management Planning and Development Committee Report found on page 39 of this proxy statement. The Committee may delegate its authority relating to employees other than executive officers and directors as it deems appropriate and may also delegate its authority relating to ministerial matters.

In addition to the responsibilities defined above, the Committee is also responsible for reviewing and assessing any potential risk arising from the Company s compensation policies and practices for its employees. During 2012, the Committee oversaw a risk assessment of the Company s compensation policies and practices with specific focus on incentive programs across the organization to ascertain any potential material risks that may be created by the compensation programs. The Committee considered the findings of the assessment and concluded that the Company s compensation programs are designed and administered with the appropriate balance of risk and reward in relation to its overall business strategy, do not encourage employees or officers to take unnecessary or excessive risks and any level of risk is not reasonably likely to have a material adverse impact on the Company. For non-executives, incentives represent a small percentage of total compensation so participants would not be rewarded for excessive risk-taking. The exception would be in sales where commission income can represent a significant portion of total compensation. In that case, our assessment looked at the goal setting process. No sales plan participants establish sales goals; sales goals are established by members of management who do not participate in the sales commission plans. The assessment also looked at the cost of non-executive incentive plans across the organization and determined it is not material to the Company s financial performance.

A discussion of risk assessment with respect to the executive compensation programs is included in the Compensation Discussion and Analysis section of this proxy statement, which begins on page 16.

As provided in its charter, the Committee has the sole authority to retain an external compensation consultant, determine the scope of the compensation consultant s services and terminate the engagement at any time. The external compensation consultant reports to the Committee Chair. Exequity LLP is the Committee s independent compensation consultant. Pursuant to the Company s policy, Exequity provides no other services to the Company other than consulting services provided to the Committee related to the Company s executive compensation programs. Exequity s fees for executive compensation consulting to the Committee for fiscal year 2012 were $216,429. During fiscal 2012, Exequity:

- n Collected, organized and presented quantitative competitive market data for a relevant competitive peer group with respect to executive officers target, annual and long-term compensation levels;
- n Developed and delivered an annual Committee briefing on executive compensation legislative and regulatory developments and trends and their implications for CVS Caremark; and
- n Collected market data and provided recommendations for non-employee director compensation to the Committee for approval by the Board.

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The Committee believes that the advice it receives from Exequity is objective and not influenced by any other business relationship. The Committee and Exequity have policies and procedures in place to preserve the objectivity and integrity of the executive compensation consulting advice, including:

- The Committee has the sole authority to retain and terminate the executive compensation consultant;
- The consultant has direct access to the Committee without management involvement;
- While it is necessary for the consultant to interact with management to gather information, the Committee determines if and how the consultant s advice can be shared with management; and
- The Committee may choose to meet with the consultant in executive session, without management present, to discuss recommendations.

The Committee conducts an annual review of the independence of its compensation consultant, taking into account the standards above and applicable rules and regulations, and has determined that its consultant s work does not raise any conflicts.

Executive Committee

C. David Brown II

David W. Dorman

Larry J. Merlo

Richard W. Swift

The Executive Committee did not meet in 2012. At all times when the Board is not in session, the Executive Committee may exercise most of the powers of the Board, as permitted by applicable law.

Director Compensation

The Company s approach to compensating outside directors for Board service is to provide directors with an annual retainer mix comprised of a mandatory 75% paid in shares of Company common stock, and 25% paid in cash (or 100% stock at the director s election). The payment of a significant portion of annual retainers, and additional chairperson retainers as outlined below, in Company common stock is consistent with our policy of using equity compensation to better align directors interests with stockholders and enhances the directors ability to meet and continue to comply with the stock ownership guidelines described below.

Each non-employee director receives shares of the Company s stock valued at $195,000 (the mandatory annual stock retainer) and a cash payment of $65,000 (unless the director elects to receive 100% of the annual retainer in shares of Company stock). The total annual retainer for outside directors is $260,000 annually.

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The Management Planning and Development Committee and the Board believe that this approach reflects the ongoing accountability of directors. Service on the Board requires directors to commit significant amounts of time to Company matters year-round, not only at meetings. This approach also facilitates administration of the directors compensation program, and aligns with the manner in which director compensation is paid in our peer group, where it is common to pay directors with an annual cash retainer and an annual equity award.

Additional chairperson retainers are paid as follows: Chairs of the Nominating and Corporate Governance and Management Planning and Development Committees, $10,000 each; Chair of the Audit Committee, $20,000; and independent Chairman of the Board, $190,000. Each of these additional chairperson retainers is paid semi-annually; at least 75% of each retainer must be paid in shares of Company common stock, with the remaining 25% paid in either shares or cash at the directors election. Directors may elect to defer receipt of shares for the annual retainer and additional chairperson retainers; deferred shares will be credited with dividend equivalents.

Director Stock Ownership Requirements

All non-employee directors must own a minimum of 10,000 shares of CVS Caremark common stock, which is worth approximately $480,000 based on the December 31, 2012 stock price of $48.35, or approximately seven times the amount of the annual cash retainer ($65,000). Directors must attain this minimum ownership level within five years of being elected to the Board and must retain this minimum ownership level for at least six months after leaving the Board. The current level of mandatory stock provided in the director s mix of annual compensation enhances the director s ability to meet the ownership level within this timeframe. Each of our directors has attained the minimum ownership level.

All Other Compensation and Benefits

Directors are eligible to receive stock options, but typically do not receive them and did not receive them in 2012. They do not participate in a pension plan or nonqualified deferred compensation plan with above market earnings. Directors are eligible to participate in the employee discount program and are subject to the same terms of the program as Company employees. Directors are generally reimbursed for business expenses incurred directly in connection with their roles and duties on the CVS Caremark Board, such as services provided by an executive assistant, travel, meals and lodging. The Company has extended to all directors the option to enroll themselves and their eligible dependents in the Company s prescription drug benefit program, paying the same premium rates as employees. If a director retires from the Board with at least five years of service, the Company will allow continued participation in the prescription drug benefit plan, but the director must bear the full cost of the premium.

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The following chart shows amounts paid to each of our non-employee directors in fiscal 2012.

Non-Employee Director Compensation Fiscal Year 2012

Name	Fees Earned and Paid in Cash [(1)] ($)	Cash Fees Elected to be Paid in Stock [(2)] ($)	Stock Awards [(2)] ($)	All Other Compen-sation [(3)] ($)	Total ($)
C. David Brown II	60	67,440	202,500	1,658	271,658
David W. Dorman	44	114,956	345,000		460,000
Anne M. Finucane	65,087		194,913	1,982	261,982
Kristen Gibney Williams	65,087		194,913	1,498	261,498
Marian L. Heard	65,000		195,000	1,658	261,658
Jean-Pierre Millon	65,087		194,913	1,658	261,658
C. A. Lance Piccolo	65,087		194,913	5,935	265,935
Richard J. Swift	70,000		210,000	1,658	281,658
Tony L. White	65,087		194,913	789	260,789

(1) The amounts shown include cash payments made in lieu of fractional shares to Mmes. Finucane and Gibney Williams and Messrs. Brown, Dorman, Millon, Piccolo and White.

(2) These awards are fully vested at grant and the amounts shown represent both the fair market value and the full fair value at grant. During 2012, each director received 4,219 shares of stock with a total value of $195,000 (the mandatory annual stock retainer) on the date of grant; each director electing to receive the remaining annual retainer in stock also received 1,406 shares valued at $65,000 on the date of grant. Some directors elected to receive their additional chairperson retainers in stock in lieu of cash. As of December 31, 2012, our directors had deferred receipt of shares of Company common stock as follows: Mr. Brown, 30,893; Mr. Dorman, 15,159; Ms. Heard, 85,113; and Mr. Swift, 40,212.

(3) Represents Company contributions for director health and prescription benefits. Amount also includes split dollar life insurance for Mr. Piccolo in the amount of $4,277 and Ms. Gibney Williams in the amount of $709.

Certain Transactions with Directors and Officers

In accordance with SEC rules, the Board has adopted a written Related Person Transaction Policy (the Policy). The Audit Committee of the Board has been designated as the Committee responsible for reviewing, approving or ratifying any related person transactions under the Policy.

Pursuant to the Policy, all executive officers, directors and director nominees are required to notify the Company s GC or Corporate Secretary of any financial transaction, arrangement or relationship, or series of similar transactions, arrangements or relationships, involving the Company in which an executive officer, director, director nominee, 5% beneficial owner or any immediate family member of such a person has a direct or indirect material interest. Such officers, directors, nominees, 5% beneficial owners and their immediate family members are considered related persons under the Policy.

For the above purposes, immediate family member includes a person s spouse, parents, siblings, children, in-laws, step-relatives and any other person sharing the household (other than a tenant or household employee).

The GC or the Corporate Secretary will present any reported new related person transactions, and proposed transactions involving related persons, to the Audit Committee at its next regular meeting, or earlier if appropriate. The Committee shall review transactions to determine whether the related person involved has a direct or indirect material interest in the transaction. The Committee may conclude, upon review of all relevant information, that the transaction does not constitute a related person transaction, and thus that no further review is required under the Policy. On an annual basis, the Committee shall review previously approved related person transactions, under the standards described below, to determine whether such transactions should continue.

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In reviewing the transaction or proposed transaction, the Committee shall consider all relevant facts and circumstances, including without limitation the commercial reasonableness of the terms, the benefit and perceived benefit, or lack thereof, to the Company, the availability and/or opportunity costs of alternate transactions, the materiality and character of the related person s direct or indirect interest, and the actual or apparent conflict of interest of the related person. The Committee will not approve or ratify a related person transaction unless it shall have determined that, upon consideration of all relevant information, the transaction is in, or not inconsistent with, the best interests of the Company and its stockholders.

If after the review described above, the Committee determines not to approve or ratify a related person transaction (whether such transaction is being reviewed for the first time or has previously been approved and is being re-reviewed), the transaction will not be entered into or continued, as the Committee shall direct.

Notwithstanding the foregoing, the following types of transactions are deemed not to create or involve a material interest on the part of the related person and will not be reviewed, nor will they require approval or ratification, under the Policy:

(i) Transactions involving the purchase or sale of products or services in the ordinary course of business, not exceeding $120,000.

(ii) Transactions in which the related person s interest derives solely from his or her service as a director of another corporation or organization that is a party to the transaction.

(iii) Transactions in which the related person s interest derives solely from his or her ownership of less than 10% of the equity interest in another entity (other than a general partnership interest) which is a party to the transaction.

(iv) Transactions in which the related person s interest derives solely from his or her ownership of a class of equity securities of the Company and all holders of that class of equity securities received the same benefit on a pro rata basis.

(v) Transactions in which the related person s interest derives solely from his or her service as a director, trustee or officer (or similar position) of a not-for-profit organization or charity that receives donations from the Company, which donations are made in accordance with the Company s matching program that is available on the same terms to all employees of the Company.

(vi) Compensation arrangements of any executive officer, other than an individual who is an immediate family member of a related person, if such arrangements have been approved by the Management Planning and Development Committee.

(vii) Director compensation arrangements, if such arrangements have been approved by the Board.

(viii) Indemnification payments and payments made under directors and officers indemnification insurance policies or made pursuant to the charter or by-laws of the Company or any of its subsidiaries or pursuant to any policy, agreement or instrument.

The Board reviews the Policy on an annual basis and will make changes as appropriate.

Additionally, under the Company s Corporate Governance Guidelines and its Code of Conduct, with respect to any transaction in which a director or executive officer has a personal interest, such that a potential conflict of interest could arise, the director or executive officer must report the matter immediately to the Company s GC or the CCO who will, where appropriate, report the matter to the Nominating and Corporate Governance Committee for evaluation and appropriate resolution.

If a director has a personal interest in a matter before the Board, the director must disclose the interest to the full Board, will recuse himself or herself from participation in the discussion and will not vote on the matter.

Furthermore, proposed charitable contributions by the Company within any given fiscal year in an aggregate amount exceeding $120,000, to an entity for which a director or a member of his or her immediate family serves as a director, officer, or member of such entity s fund-raising organization or committee, will be subject to prior review and approval by the Audit Committee (with notification to the Nominating and Corporate Governance Committee).

In addition, under the Nominating and Corporate Governance Committee s charter, such Committee shall evaluate the possibility that a director s independence may be compromised or impaired for Board or Committee purposes if director compensation exceeds customary levels, if the Company makes substantial charitable contributions to an organization with which a director is affiliated, or if the Company enters into consulting contracts with (or provides other indirect forms of compensation to) a director (which consulting contracts or other indirect forms of compensation are expressly prohibited for Audit Committee members).

During 2012 there were no reportable transactions between the Company and any of its directors, executive officers, director nominees, 5% stockholders or immediate family members of any of such persons.

Audit Committee Report

The Audit Committee of the Board of Directors (for purposes of this report, the Committee) is composed of three independent directors. Set forth below is the report of the Committee on its activities with respect to CVS Caremark s audited financial statements for the fiscal year ended December 31, 2012 (the audited financial statements).

- n The Committee has reviewed and discussed the audited financial statements with management;

- n The Committee has discussed with Ernst & Young LLP (Ernst & Young), the Company s independent registered public accounting firm, the matters required to be discussed by Statement on Auditing Standards No. 61, as amended and as adopted by the Public Company Accounting Oversight Board (PCAOB) in Rule 3200T;

- n The Committee has received the written disclosures and the letter from Ernst & Young pursuant to applicable requirements of the PCAOB regarding Ernst & Young s communications with the Committee concerning independence, and has discussed with Ernst & Young its independence from the Company; and

- n Based on the review and discussions referred to above and relying thereon, the Committee recommended to the Board of Directors that the audited financial statements be included in CVS Caremark s Annual Report on Form 10-K for the fiscal year ended December 31, 2012, for filing with the SEC.

Richard J. Swift, Chair

Kristen Gibney Williams

Jean-Pierre Millon

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Share Ownership of Directors and Certain Executive Officers

The following table shows the share ownership, as of March 7, 2013, of each director, each executive officer appearing in the Summary Compensation Table found on page 40 and all directors and executive officers as a group, based on information provided by these individuals. Each individual beneficially owns less than 1% of our common stock and, except as described in the footnotes to the table, each person has sole investment and voting power over the shares. None of the shares listed below has been pledged as collateral.

	Ownership of Common Stock [(1)]	
Name	**Number**	**Percent**
C. David Brown II	172,281 [(6)]	*
Mark S. Cosby	183,722 [(1)(2)]	*
David M. Denton	403,015 [(1)(2)(4)]	*
David W. Dorman	61,351 [(6)]	*
Anne M. Finucane	11,783 [(7)]	*
Kristen Gibney Williams	71,623 [(8)]	*
Marian L. Heard	96,842 [(6)]	*
Per G.H. Lofberg	1,231,142 [(1)(3)(9)]	*
Larry J. Merlo	1,885,682 [(1)(2)(3)(4)(5)]	*
Jean-Pierre Millon	75,511 [(10)]	*
C.A. Lance Piccolo	181,461	*
Jonathan C. Roberts	514,983 [(1)(2)(3)(4)(5)]	*
Richard J. Swift	44,799 [(6)]	*
Tony L. White	11,504 [(11)]	*
All directors and executive officers as a group (22 persons)	6,213,371 [(1)(2)(3)(4)(5)(6)(7)(8)(9)(10)(11)]	0.50%

*Less than 1%.

(1) Includes the following shares of common stock not currently owned, but subject to options which were outstanding on March 7, 2013 and were exercisable within 60 days thereafter: Mr. Cosby, 74,140; Mr. Denton, 278,456; Mr. Lofberg, 790,888; Mr. Merlo, 822,551; Mr. Roberts, 372,155; and all executive officers as a group, 3,214,440.

(2) Includes the following shares of common stock granted under the Company s 1997 Incentive Compensation Plan and/or 2010 Incentive Compensation Plan (together, the ICPs) that remain subject to certain restrictions regarding employment and transfer as provided in the ICPs: Mr. Cosby, 58,564; Mr. Denton, 68,970; Mr. Merlo, 288,004; Mr. Roberts, 78,201; and all executive officers as a group, 734,915.

(3) Includes the following shares of common stock that were receivable upon the lapse of restrictions on restricted stock units or the exercise of options, but the actual receipt of which was deferred pursuant to the Company s Deferred Stock Compensation Plan, and which do not have current voting rights: Mr. Lofberg, 217,454; Mr. Merlo, 308,483; Mr. Roberts, 34,385; and all executive officers as a group, 591,843.

(4) Includes shares of common stock held by the Trustee of the ESOP that are allocated to the executive officers as follows: Mr. Denton, 1,604; Mr. Merlo, 6,309; Mr. Roberts, 5,053; and all executive officers as a group, 17,381.

(5) Includes the following hypothetical shares of common stock held in notional accounts in the Company s unfunded Deferred Compensation Plan, which do not have current voting rights: Mr. Merlo, 5,189; Mr. Roberts, 1,433 and all executive officers as a group, 7,094.

(6) Includes the following shares of common stock constituting deferred non-employee director compensation, which do not have current voting rights: Mr. Brown, 31,029; Mr. Dorman, 15,226; Ms. Heard, 85,489; Mr. Swift, 40,390; and all non-employee directors as a group, 172,134.

(7) Includes 11,783 shares held in a family trust.

(8) Includes 71,623 shares held in a family trust.

(9) Includes 162,000 shares held in a family partnership and 14,400 held by trusts. Mr. Lofberg disclaims beneficial ownership of these securities.

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(10) Includes 75,511 shares held in a family trust.

(11) Includes 7 shares held by Mr. White s wife.

Share Ownership of Principal Stockholders

We have been notified by the entity in the following table that it is the beneficial owner (as defined by the rules of the SEC) of more than five percent (5%) of our common stock. According to the most recent Schedule 13G filed by the beneficial owner with the SEC, these shares were acquired in the ordinary course of business, and were not acquired for the purpose of, and do not have the effect of, changing or influencing control over us.

Title of Class	Name and Address of Beneficial Owner	No. of Shares Beneficially Owned [(1)]	Percent of Class Owned [(1)]
Common Stock	BlackRock, Inc.[(1)] 40 East 52nd Street New York, NY 10022	76,766,294	6.2%

(1) Information based on a Schedule 13G filed January 30, 2013. BlackRock, Inc. (BlackRock) is the parent holding company of a number of subsidiaries that hold CVS Caremark common stock for the benefit of various investors. BlackRock has sole voting power and sole dispositive power with respect to all of these shares.

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EXECUTIVE COMPENSATION AND RELATED MATTERS

COMPENSATION DISCUSSION AND ANALYSIS

Executive Summary

At CVS Caremark, our executive compensation philosophy and practice reflects our strong commitment to paying for performance both short- and long-term. Performance is defined as the achievement of results against our challenging internal financial targets, which take into account relative financial measures of our external peer group as well as industry and market conditions. We believe that our multi-faceted executive compensation plans, with their integrated focus on short- and long-term metrics, provide an effective framework by which progress against our strategic goals may be appropriately measured and rewarded.

2012 was a very strong performance year for the Company with record net revenues of $123.1 billion and healthy profitable growth in all of the businesses. The Company believes its efforts during the past three years set the stage for our 2012 results and continued strong performance in the future. CVS Caremark performed favorably against its peer group on several critical measures including revenue, operating income and EPS growth along with a total shareholder return of 20.3%. The positive results of 2012 are reflected in the 2012 Management Incentive Plan payouts to our named executive officers (Named Executive Officers or NEOs). However, the performance challenges in 2010 through 2011 are reflected in the three year long-term incentive plan performance results. Consistent with our pay-for-performance philosophy and the terms of our incentive plans, incentive compensation paid to our NEOs under the three-year Long-Term Incentive Plan (LTIP) reflects the below-target performance results.

Throughout this Compensation Discussion and Analysis, we refer to EPS, EBIT (or Operating Profit), free cash flow and RoNA (or return on net assets). When we use these terms, unless we specifically refer to them as GAAP (which stands for U.S. Generally Accepted Accounting Principles), we are referring to non-GAAP financial measures. Exhibit C to this proxy statement contains an explanation of how we calculate these measures.

In 2012 CVS Caremark had its second-non-binding stockholder vote on our executive pay programs for our Named Executive Officers (say-on-pay). The vote was overwhelmingly positive, with 94.7% of the stockholders voting in support of our executive pay programs. Although the stockholder vote on our executive pay was very positive, the Management Planning and Development Committee of the Board (the Committee) continually assesses our programs and several significant changes were made in 2012 to our executive compensation programs and practices to increase alignment with stockholders. These changes discussed in greater detail in other sections of this report include the following:

- Amended the existing employment contract with Mr. Larry J. Merlo, President and Chief Executive Officer (CEO), to eliminate the excise tax gross-up in the event of a change in control, with no additional compensation provided to Mr. Merlo in connection with the amendment of his agreement.

- Amended the existing change in control agreements with Mr. David M. Denton, Executive Vice President and Chief Financial Officer (CFO), and Mr. Jonathan C. Roberts, Executive Vice President and President CVS Caremark Pharmacy Services, to eliminate the excise tax gross-ups in the event of a change in control, with no additional compensation provided to either executive in connection with the amendment of his agreement.

- Converted the provisions in the 2010 Incentive Compensation Plan (2010 ICP) that allowed for the immediate vesting of equity awards in connection with a change in control from a single to a double trigger .

- Eliminated the share recycling provisions of the 2010 ICP.

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- n Added an additional measure total shareholder return to our LTIP to complement the return on net assets measure and to demonstrate our commitment to linking pay and performance. We continue to believe that return on net assets is an important and appropriate focus, as successful management of our working capital in the near to medium-term is expected to help drive sustained stockholder value. In addition, we believe including total shareholder return as a measure will result in executive awards that reflect the market s view of our achievements and further align executive pay with satisfaction of stockholder objectives.

Business Highlights and Performance Success

We continue to believe that the combination of our industry-leading assets in retail pharmacy, pharmacy benefits management and retail health clinics is an optimal, unmatched and winning strategy.

Each of our best-in-class business units achieved healthy top and bottom line growth and the Company is capitalizing on the power of the combined entity and integrated offerings to drive superior long-term growth, as demonstrated by the following accomplishments:

- n Executed a disciplined capital allocation strategy and returned more than $5.1 billion to stockholders, reflecting our continued commitment to using our free cash flow to enhance total returns to stockholders through a combination of high-return investments, dividend increases and value-enhancing share repurchases, as evidenced by:

  - n Announcing an increase of our quarterly dividend by 38% starting in the first quarter of 2013 our tenth consecutive year of dividend increases; and

113,470

SBA Pools
18,595

—

—

(147
)

18,448

Mortgage-backed securities - Non Agency CMO's (investment grade)
5,590

—

368

—

5,958

Mortgage-backed securities - Non Agency CMO's (below investment grade)
10,003

(1,747
)

444

(539
)

8,161

$
260,907

$
(1,747
)

$
6,478

$
(1,325
)

$
264,313

December 31, 2011

U.S. treasury securities and obligations of U.S. government agencies
$

21

$
—

$
—

$
—

$
21

State and municipal securities
35,352

—

1,791

(8
)

37,135

Mortgage-backed securities - Agency Pass Throughs
59,436

—

2,252

(126
)

61,562

Mortgage-backed securities - Agency CMO's
103,349

—

2,526

(328
)

105,547

Mortgage-backed securities - Non Agency CMO's (investment grade)
5,934

—

389

—

6,323

Mortgage-backed securities - Non Agency CMO's (below investment grade)
10,489

(2,011
)

435

(462
)

8,451

$
214,581

$
(2,011
)

$
7,393

$
(924
)

$
219,039

Held-to-Maturity

Carrying Value / Amortized Cost

Cumulative Non-Credit
OTTI (Losses)
Recognized
in OCI

Gross Unrealized Gains

Gross Unrealized Losses

Fair Value
March 31, 2012

State and municipal securities
$
15,024

$
—

$
1,374

$
—

$
16,398

December 31, 2011

State and municipal securities
$
16,143

$
—

$
1,328

$
—

$
17,471

The following table summarizes the duration of Intermountain's unrealized losses on available-for-sale and held-to-maturity securities as of the dates indicated (in thousands).

	Less Than 12 Months		12 Months or Longer		Total	
March 31, 2012	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Residential mortgage-back securities	$72,633	$(623)	$3,772	$(552)	$76,405	$(1,175)
SBA Pools	18,336	(147)	—	—	18,336	(147)
State and municipal securities	3,496	(3)	—	—	3,496	(3)
Total	$94,465	$(773)	$3,772	$(552)	$98,237	$(1,325)

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December 31, 2011	Less Than 12 Months Fair Value	Unrealized Losses	12 Months or Longer Fair Value	Unrealized Losses	Total Fair Value	Unrealized Losses
State and municipal securities	$1,659	$(8)	$—	$—	$1,659	$(8)
Mortgage-backed securities & CMO's	39,905	(433)	3,993	(483)	43,898	(916)
Total	$41,564	$(441)	$3,993	$(483)	$45,557	$(924)

At March 31, 2012, the amortized cost and fair value of available-for-sale and held-to-maturity debt securities, by contractual maturity, are as follows (in thousands):

	Available-for-Sale Amortized Cost	Fair Value	Held-to-Maturity Amortized Cost	Fair Value
One year or less	$—	$—	$130	$130
After one year through five years	2,009	2,124	2,367	2,531
After five years through ten years	—	—	7,779	8,457
After ten years	37,652	39,285	4,748	5,280
Subtotal	39,661	41,409	15,024	16,398
Mortgage-backed securities	202,651	204,456	—	—
SBA Pools	18,595	18,448	—	—
Total Securities	$260,907	$264,313	$15,024	$16,398

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Intermountain's investment portfolios are managed to provide and maintain liquidity; to maintain a balance of high quality, diversified investments to minimize risk; to offset other asset portfolio elements in managing interest rate risk; to provide collateral for pledging; and to maximize returns. At March 31, 2012, the Company does not intend to sell any of its available-for-sale securities that have a loss position and it is not likely that it will be required to sell the available-for-sale securities before the anticipated recovery of their remaining amortized cost or maturity date. The unrealized losses on residential mortgage-backed securities without other-than-temporary impairment ("OTTI") were considered by management to be temporary in nature.

The following table presents the OTTI losses for the three months ended March 31, 2012 and March 31, 2011:

	2012 Held To Maturity	Available For Sale	2011 Held To Maturity	Available For Sale
Total other-than-temporary impairment losses	$—	$7	$—	$—
Portion of other-than-temporary impairment losses transferred from (recognized in) other comprehensive income (1)	—	264	—	—
Net impairment losses recognized in earnings (2)	$—	$271	$—	$—

(1) Represents other-than-temporary impairment losses related to all other factors.
(2) Represents other-than-temporary impairment losses related to credit losses.

The OTTI recognized on investment securities available for sale relates to two non-agency collateralized mortgage obligations. Each of these securities holds various levels of credit subordination. These securities were valued by third-party pricing services using matrix or model pricing methodologies and were corroborated by broker indicative bids. We estimated the cash flows of the underlying collateral for each security considering credit, interest and prepayment risk models that incorporate management's estimate of projected key assumptions including prepayment rates, collateral default rates and loss severity. Assumptions utilized vary from security to security, and are influenced by factors such as underlying loan interest rates, geographic location, borrower characteristics, vintage, and historical experience. We then used a third party to obtain information about the structure of each security, including subordination and other credit enhancements, in order to determine how the underlying collateral cash flows will be distributed to each security issued in the structure. These cash flows were then discounted at the interest rate equal to the yield anticipated at the time the security was purchased. We review the actual collateral performance of these securities on a

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quarterly basis and update the inputs as appropriate to determine the projected cash flows.
See Note 11 "Fair Value of Financial Instruments" for more information on the calculation of fair or carrying value for the investment securities.

3. Loans and Allowance for Loan Losses:
The components of loans receivable are as follows (in thousands):

	March 31, 2012				
	Loans Receivable	%		Individually Evaluated for Impairment	Collectively Evaluated for Impairment
Commercial	$114,460	22.7	%	$9,367	$105,093
Commercial real estate	172,508	34.2		7,861	164,647
Commercial construction	6,405	1.3		747	5,658
Land and land development loans	34,258	6.8		4,549	29,709
Agriculture	75,749	14.9		2,368	73,381
Multifamily	16,949	3.4		—	16,949
Residential real estate	57,879	11.5		3,868	54,011
Residential construction	2,554	0.5		—	2,554
Consumer	9,866	2.0		293	9,573
Municipal	13,369	2.7		—	13,369
Total loans receivable	503,997	100.0	%	$29,053	$474,944
Allowance for loan losses	(11,372	)			
Deferred loan fees, net of direct origination costs	358				
Loans receivable, net	$492,983				
Weighted average interest rate	5.59	%			

	December 31, 2011				
	Loans Receivable	%		Individually Evaluated for Impairment	Collectively Evaluated for Impairment
Commercial	$110,395	21.4	%	$8,585	$101,810
Commercial real estate	167,586	32.6		10,918	156,668
Commercial construction	6,335	1.2		747	5,588
Land and land development loans	38,499	7.5		5,173	33,326
Agriculture	81,316	15.8		2,423	78,893
Multifamily	26,038	5.1		—	26,038
Residential real estate	58,861	11.4		4,013	54,848
Residential construction	2,742	0.5		—	2,742
Consumer	11,847	2.3		276	11,571
Municipal	11,063	2.2		—	11,063
Total loans receivable	514,682	100.0	%	$32,135	$482,547
Allowance for loan losses	(12,690	)			
Deferred loan fees, net of direct origination costs	260				
Loans receivable, net	$502,252				
Weighted average interest rate	5.69	%			

The components of allowance for loan loss by types are as follows (in thousands):

	March 31, 2012		
	Total Allowance	Individually Evaluated Allowance	Collectively Evaluated Allowance
Commercial	$2,577	$1,009	$1,568
Commercial real estate	3,953	1,675	2,278
Commercial construction	474	262	212
Land and land development loans	2,210	746	1,464
Agriculture	138	—	138
Multifamily	77	—	77
Residential real estate	1,575	976	599
Residential construction	62	—	62
Consumer	258	175	83
Municipal	48	—	48
Total	$11,372	$4,843	$6,529

	December 31, 2011		
	Total Allowance	Individually Evaluated Allowance	Collectively Evaluated Allowance
Commercial	$2,817	$1,300	$1,517
Commercial real estate	4,880	2,804	2,076
Commercial construction	500	252	248
Land and land development loans	2,273	728	1,545
Agriculture	172	32	140
Multifamily	91	—	91
Residential real estate	1,566	939	627
Residential construction	59	—	59
Consumer	295	195	100
Municipal	37	—	37
Total	$12,690	$6,250	$6,440

A summary of current, past due and nonaccrual loans as of March 31, 2012 is as follows, (in thousands):

	Current	30-89 Days Past Due	90 Days or More Past Due and Accruing	Nonaccrual	Total
Commercial	$110,269	$151	$—	$4,040	$114,460
Commercial real estate	171,290	290	—	928	172,508
Commercial construction	6,360	—	—	45	6,405
Land and land development loans	32,080	96	—	2,082	34,258
Agriculture	75,626	—	—	123	75,749
Multifamily	16,949	—	—	—	16,949
Residential real estate	56,788	333	—	758	57,879
Residential construction	2,554	—	—	—	2,554
Consumer	9,758	84	—	24	9,866
Municipal	13,369	—	—	—	13,369
Total	$495,043	$954	$—	$8,000	$503,997

A summary of current, past due and nonaccrual loans as of December 31, 2011 is as follows, (in thousands):

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	Current	30-89 Days Past Due	90 Days or More Past Due and Accruing	Nonaccrual	Total
Commercial	$106,509	$200	$—	$3,686	$110,395
Commercial real estate	164,578	705	—	2,303	167,586
Commercial construction	6,289	—	—	46	6,335
Land and land development loans	35,835	12	—	2,652	38,499
Agriculture	81,129	—	—	187	81,316
Multifamily	26,038	—	—	—	26,038
Residential real estate	58,037	423	—	401	58,861
Residential construction	2,742	—	—	—	2,742
Consumer	11,739	91	—	17	11,847
Municipal	11,063	—	—	—	11,063
Total	$503,959	$1,431	$—	$9,292	$514,682

The following table provides a summary of Troubled Debt Restructuring ("TDR") by performing status, (in thousands).

	March 31, 2012			December 31, 2011		
Troubled Debt Restructurings	Nonaccrual	Accrual	Total	Nonaccrual	Accrual	Total
Commercial	$369	$609	$978	$571	$371	$942
Commercial real estate	—	2,048	2,048	382	1,889	2,271
Commercial construction	45	295	340	295	46	341
Land and land development loans	73	1,845	1,918	794	782	1,576
Agriculture	—	110	110	—	22	.22
Residential real estate	—	993	993	1,377	—	1,377
Consumer	—	75	75	64	27	91
Total	$487	$5,975	$6,462	$3,483	$3,137	$6,620

A modified loan is considered a TDR when two conditions are met: 1) the borrower is experiencing financial difficulty and 2) concessions are made by the Company that would not otherwise be considered for a borrower with similar credit characteristics. Modified terms are dependent upon the financial position and needs of the individual borrower, as the Company does not employ modification programs for temporary or trial periods. The most common types of modifications include interest rate adjustments, covenant modifications, forbearance and/or other concessions. If the modification agreement is violated, the loan is handled by the Company's Special Assets group for resolution, which may result in foreclosure or other asset disposition.

Generally, TDRs are classified as impaired loans and are TDRs for the remaining life of the loan. Impaired and TDR classification may be removed if the borrower demonstrates compliance with the modified terms and the restructuring agreement specifies an interest rate equal to that which would be provided to a borrower with similar credit at the time of restructuring.

The Company's loans that were modified in the three month period ended March 31, 2012 and considered a TDR are as follows (dollars in thousands):

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	Three months ended March 31, 2012		
	Number	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Commercial	1	$ 75	$ 75
Commercial real estate	1	100	100
Agriculture	1	110	110
	3	$ 285	$ 285

The balances below provide information as to how the loans were modified as TDRs during the three months ended March 31, 2012, (in thousands).

	Three months ended March 31, 2012	
	Adjusted Interest Rate Only	Other*
Commercial	$ 75	$ —
Commercial real estate	—	100
Agriculture	110	—
	$ 185	$ 100

(*) Other includes term or principal concessions or a combination of concessions, including interest rates.

As of March 31, 2012, the Company had specific reserves of $1.8 million on TDRs, and there were 2 TDRs in default totaling $178,000.
The allowance for loan losses and reserve for unfunded commitments are maintained at levels considered adequate by management to provide for probable loan losses as of the reporting dates. The allowance for loan losses and reserve for unfunded commitments are based on management's assessment of various factors affecting the loan portfolio, including problem loans, business conditions and loss experience, and an overall evaluation of the quality of the underlying collateral. Changes in the allowance for loan losses and the reserve for unfunded commitments during the three month periods ending March 31, 2012 and 2011 are as follows:

	Allowance for Loan Losses March 31, 2012				
	Balance, Beginning of Year	Charge-Offs Jan 1 through Mar 31, 2012	Recoveries Jan 1 through Mar 31 2012	Provision	Balance, End of Period
	(Dollars in thousands)				
Commercial	$ 2,817	$ (679)	$ 37	$ 402	$ 2,577
Commercial real estate	4,880	(1,137)	85	125	3,953
Commercial construction	500	—	2	(28)	474
Land and land development loans	2,273	(473)	38	372	2,210
Agriculture	172	(31)	51	(54)	138
Multifamily	91	—	—	(14)	77
Residential real estate	1,566	(163)	54	118	1,575
Residential construction	59	—	7	(4)	62
Consumer	295	(127)	59	31	258
Municipal	37	—	—	11	48
Allowance for loan losses	$ 12,690	$ (2,610)	$ 333	$ 959	$ 11,372

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Allowance for Loan Losses
March 31, 2011

	Balance, Beginning of Year	Charge-Offs Jan 1 through Mar 31, 2011	Recoveries Jan 1 through Mar 31, 2011	Provision	Balance, End of Period
	(Dollars in thousands)				
Commercial	$2,925	$—	$—	$(514)	$2,411
Commercial real estate	3,655	(477)	1	913	4,092
Commercial construction	540	(382)	58	352	568
Land and land development loans	2,408	(476)	154	392	2,478
Agriculture	779	(294)	40	320	845
Multifamily	83	—	—	(10)	73
Residential real estate	1,252	(213)	40	180	1,259
Residential construction	65	—	—	53	118
Consumer	613	(99)	42	21	577
Municipal	135	—	—	(74)	61
Allowances for loan losses	$12,455	$(1,941)	$335	$1,633	$12,482

Allowance for Unfunded Commitments

	March 31, 2012	2011
	(Dollars in thousands)	
Balance Beginning January 1	$13	$17
Adjustment	1	1
Transfers	—	—
Allowance — Unfunded Commitments at end of period	$14	$18

Management's policy is to charge off loans or portions of loans as soon as an identifiable loss amount can be determined from evidence obtained, such as current cash flow information, updated appraisals or similar real estate evaluations, equipment, inventory or similar collateral evaluations, accepted offers on loan sales or negotiated discounts, and/or guarantor asset valuations. In situations where problem loans are dependent on collateral liquidation for repayment, management obtains updated independent valuations, such as appraisals or broker opinions, generally no less frequently than once every six months and more frequently for larger or more troubled loans. In the time period between these independent valuations, the Company monitors market conditions for any significant event or events that would materially change the valuations, and updates them as appropriate. If the valuations suggest an increase in collateral values, the Company does not recover prior amounts charged off until the assets are actually sold and the increase realized. However, if the updated valuations suggest additional loss, the Company charges off the additional amount.

The following tables summarize impaired loans:

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	Impaired Loans					
	March 31, 2012			December 31, 2011		
	Recorded Investment	Principal Balance	Related Allowance	Recorded Investment	Principal Balance	Related Allowance
	(Dollars in thousands)					
With an allowance recorded:						
Commercial	$2,976	$3,304	$1,009	$2,942	$3,323	$1,300
Commercial real estate	5,094	5,485	1,675	7,439	8,732	2,804
Commercial construction	452	588	262	747	902	252
Land and land development loans	2,166	3,693	746	1,745	3,237	728
Agriculture	—	—	—	32	405	32
Multifamily	—	—	—	—	—	—
Residential real estate	1,827	2,026	976	1,928	2,165	939
Residential construction	—	—	—	—	—	—
Consumer	251	252	175	247	264	195
Municipal	—	—	—	—	—	—
Total	$12,766	$15,348	$4,843	$15,080	$19,028	$6,250
Without an allowance recorded:						
Commercial	$6,391	$10,457	$—	$5,643	$9,099	$—
Commercial real estate	2,767	4,545	—	3,479	5,038	—
Commercial construction	295	295	—	—	198	—
Land and land development loans	2,383	4,614	—	3,428	6,165	—
Agriculture	2,368	2,423	—	2,391	2,512	—
Multifamily	—	—	—	—	—	—
Residential real estate	2,041	2,350	—	2,085	2,296	—
Residential construction	—	—	—	—	—	—
Consumer	42	67	—	29	56	—
Municipal	—	—	—	—	—	—
Total	$16,287	$24,751	$—	$17,055	$25,364	$—
Total:						
Commercial	$9,367	$13,761	$1,009	$8,585	$12,422	$1,300
Commercial real estate	7,861	10,030	1,675	10,918	13,770	2,804
Commercial construction	747	883	262	747	1,100	252
Land and land development loans	4,549	8,307	746	5,173	9,402	728
Agriculture	2,368	2,423	—	2,423	2,917	32
Multifamily	—	—	—	—	—	—
Residential real estate	3,868	4,376	976	4,013	4,461	939
Residential construction	—	—	—	—	—	—
Consumer	293	319	175	276	320	195
Municipal	—	—	—	—	—	—
Total	$29,053	$40,099	$4,843	$32,135	$44,392	$6,250

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	Impaired Loans			
	Three Months Ended March 31, 2012		Three Months Ended March 31, 2011	
	Average Recorded Investment	Interest Income Recognized (*)	Average Recorded Investment	Interest Income Recognized (*)
	(Dollars in thousands)			
With an allowance recorded:				
Commercial	$2,959	$81	$2,137	$42
Commercial real estate	6,267	113	5,403	261
Commercial construction	600	24	406	6
Land and land development loans	1,956	177	3,401	34
Agriculture	16	—	274	11
Multifamily	—	—	—	—
Residential real estate	1,878	42	1,318	41
Residential construction	—	—	55	23
Consumer	249	7	507	12
Municipal	—	—	—	—
Total	$13,925	$444	$13,501	$430
Without an allowance recorded:				
Commercial	$6,017	$959	$8,820	$542
Commercial real estate	3,123	211	6,894	369
Commercial construction	148	5	167	11
Land and land development loans	2,906	224	5,888	316
Agriculture	2,380	125	942	77
Multifamily	—	—	—	—
Residential real estate	2,063	73	1,839	69
Residential construction	—	—	223	3
Consumer	36	4	341	5
Municipal	—	—	—	—
Total	$16,673	$1,601	$25,114	$1,392
Total:				
Commercial	$8,976	$1,040	$10,957	$584
Commercial real estate	9,390	324	12,297	630
Commercial construction	748	29	573	17
Land and land development loans	4,862	401	9,289	350
Agriculture	2,396	125	1,216	88
Multifamily	—	—	—	—
Residential real estate	3,941	115	3,157	110
Residential construction	—	—	278	26
Consumer	285	11	848	17
Municipal	—	—	—	—
Total	$30,598	$2,045	$38,615	$1,822

(*) Interest Income on individually impaired loans is calculated using the cash-basis method.

Loan Risk Factors

The following is a recap of the risk characteristics associated with each of the Company's major loan portfolio segments.

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Commercial Loans: Although the impacts of the long economic downturn have increased losses and continue to heighten risk in the commercial portfolio, management does not consider the portfolio to present “concentration risk” at this time. Management believes there is adequate diversification by type, industry, and geography to mitigate excessive risk. The commercial portfolio includes a mix of term loan facilities and operating loans and lines made to a variety of different business types in the markets it serves. The Company utilizes SBA, USDA and other government-assisted or guaranteed financing programs whenever advantageous to further mitigate risk in this area. With the exception of the agricultural portfolio discussed in more detail below, there is no other significant concentration of industry types in its loan portfolio, and no dominant employer or industry across all the markets it serves. Underwriting focuses on the evaluation of potential future cash flows to cover debt requirements, sufficient collateral margins to buffer against devaluations, credit history of the business and its principals, and additional support from willing and capable guarantors.

Commercial Real Estate Loans: Difficult economic conditions and depressed real estate values continue to increase risk in the non-residential component of the commercial real estate portfolio. However, in comparison to its national peer group and the risk that existed in its construction and development portfolio, the Company has less overall exposure to commercial real estate and a stronger mix of owner-occupied (where the borrower occupies and operates in at least part of the building) versus non-owner occupied loans. The loans represented in this category are spread across the Company's footprint, and there are no significant concentrations by industry type or borrower. The most significant property types represented in the portfolio are office 18.0%, industrial 14.1%, health care 12.8% and retail 9.9%. The other 45.2% is a mix of property types with smaller concentrations, including religious facilities, auto-related properties, restaurants, convenience stores, storage units, motels and commercial investment land. Finished condominiums comprise only 2.2% of the commercial real estate portfolio.

While 66.2% of the Company's commercial real estate portfolio is in its Northern Idaho/Eastern Washington region, this region is a large and diverse region with differing local economies and real estate markets. Given this diversity, and the diversity of property types and industries represented, management does not believe that this concentration represents a significant concentration risk.

Non-owner occupied commercial real estate loans are made only to borrowers with established track records and the ability to fund potential project cash flow shortfalls from other income sources or liquid assets. Project due diligence is conducted by the Bank, to help provide for adequate contingencies, collateral and/or government guaranties. The Company has largely avoided speculative financing of investment properties, particularly of the types most vulnerable in the current downturn, including investment office buildings and retail strip developments. Management believes geographic, borrower and property-type diversification, and prudent underwriting and monitoring standards applied by seasoned commercial lenders mitigate concentration risk in this segment, although general economic weakness continues to negatively impact results.

Construction and Development Loans: After the aggressive reduction efforts of the last three years, the land development and construction loan components pose much lower concentration risk for the total loan portfolio. However, the weakness of the overall construction sector still poses risk to the remaining construction and development portfolio. Residential real estate values tend to fluctuate with economic conditions, and have been falling rapidly in many of the Company's markets for the last three years, although the rate of decline is generally slowing. Management is maintaining its aggressive resolution efforts to further reduce its risk.

Agricultural Loans: The agricultural portfolio represents a larger percentage of the loans in the Bank's southern Idaho region. At the end of the period, agricultural loans and agricultural real estate loans totaled $75.7 million or 15.0% of the total loan portfolio. The agricultural portfolio consists of loans secured by livestock, crops and real estate. Agriculture has typically been a cyclical industry with periods of both strong and weak performance. Current conditions are very strong and are projected to remain solid for the next couple years. To mitigate credit risk, specific underwriting is applied to retain only borrowers that have proven track records in the agricultural industry. Many of Intermountain's agricultural borrowers are third or fourth generation farmers and ranchers with limited real estate debt, which reduces overall debt coverage requirements and provides extra flexibility and collateral for equipment and operating borrowing needs. In addition, the Bank has hired senior lenders with significant experience in agricultural lending to administer these loans. Further mitigation is provided through frequent collateral inspections, adherence to farm operating budgets, and annual or more frequent review of financial performance. The Company has minimal exposure to the dairy industry, the significant agricultural segment that has been under extreme pressure for the past few years.

Multifamily: The multifamily segment comprises $16.9 million or 3.4% of the total loan portfolio at the end of the period. This portfolio represents relatively low risk for the Company, as a result of the strong current market for multifamily properties and low vacancy rates across the Company's footprint.

Residential Real Estate, Residential Construction and Consumer: Residential real estate, residential construction and consumer loans total $70.3 million or 13.9% of the total loan portfolio. Management does not believe they represent significant concentration

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risk. However, continuing high unemployment and loss of equity is putting pressure on segments of this portfolio, particularly home equity lines and second mortgages.

Municipal loans: Municipal loans comprise $13.4 million or 2.7% of the total loan portfolio. The small size of the portfolio and careful underwriting of the loans within it limit overall concentration risk in this segment.

Credit quality indicators

The risk grade analyses included as part of the Company's credit quality indicators for loans and leases are developed through review of individual borrowers on an ongoing basis. Each loan is evaluated at the time of origination and each subsequent renewal. Loans with principal balances exceeding $500,000 are evaluated on a more frequent basis.
Trigger events (such as loan delinquencies, customer contact, and significant collateral devaluation) also require an updated credit quality review. Loans with risk grades four through eight are evaluated at least annually with more frequent evaluations often done as borrower, collateral or market conditions change. In situations where problem loans are dependent on collateral liquidation for repayment, management obtains updated independent valuations, generally no less frequently than once every six months and more frequently for larger or more troubled loans.
Other measurements used to assess credit quality, including delinquency statistics, non accrual and OREO levels, net chargeoff activity, and classified asset trends, are updated and evaluated monthly.
These risk grades are defined as follows:

Satisfactory — A satisfactory rated loan is not adversely classified because it does not display any of the characteristics for adverse classification.

Watch — A watch loan has a solid but vulnerable repayment source. There is loss exposure only if the primary repayment source and collateral experience prolonged deterioration. Loans in this risk grade category are subject to frequent review and change due to the increased vulnerability of repayment sources and collateral valuations.

Special mention — A special mention loan has potential weaknesses that deserve management’s close attention. If left uncorrected, such potential weaknesses may result in deterioration of the repayment prospects or collateral position at some future date. Special mention loans are not adversely classified and do not warrant adverse classification.

Substandard — A substandard loan is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as substandard generally have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. These loans are characterized by the distinct possibility of loss if the deficiencies are not corrected.

Doubtful — A loan classified doubtful has all the weaknesses inherent in a loan classified substandard with the added characteristic that the weaknesses make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions, and values.

Loss — Loans classified loss are considered uncollectible and of such little value that their continuing to be carried as an asset is not warranted. This classification does not necessarily mean that there is to no potential for recovery or salvage value, but rather that it is not appropriate to defer a full write-off even though partial recovery may be realized in the future.

Credit quality indicators by loan segment are summarized as follows:

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Loan Portfolio Credit Grades by Type
March 31, 2012

	Satisfactory Grade 1-3	Internal Watch Grade 4	Special Mention Grade 5	Substandard Grade 6	Doubtful Grade 7	Total
	(Dollars in thousands)					
Commercial	$69,499	$31,674	$192	$13,095	$—	$114,460
Commercial real estate	113,273	45,523	—	13,712	—	172,508
Commercial construction	593	5,065	—	747	—	6,405
Land and land development loans	8,788	18,057	—	7,413	—	34,258
Agriculture	60,593	12,524	—	2,632	—	75,749
Multifamily	899	9,577	—	6,473	—	16,949
Residential real estate	43,270	9,640	—	4,969	—	57,879
Residential construction	2,554	—	—	—	—	2,554
Consumer	8,782	614	—	470	—	9,866
Municipal	13,195	174	—	—	—	13,369
Loans receivable, net	$321,446	$132,848	$192	$49,511	$—	$503,997

Loan Portfolio Credit Grades by Type
December 31, 2011

	Satisfactory Grade 1-3	Internal Watch Grade 4	Special Mention Grade 5	Substandard Grade 6	Doubtful Grade 7	Total
	(Dollars in thousands)					
Commercial	$65,844	$32,293	$—	$12,259	$—	$110,396
Commercial real estate	107,984	43,305	—	16,297	—	167,586
Commercial construction	412	5,175	—	747	—	6,334
Land and land development loans	8,658	20,031	1,392	8,418	—	38,499
Agriculture	65,563	12,827	—	2,926	—	81,316
Multifamily	9,721	9,708	—	6,609	—	26,038
Residential real estate	43,419	10,066	—	5,376	—	58,861
Residential construction	2,742	—	—	—	—	2,742
Consumer	10,476	797	—	574	—	11,847
Municipal	11,063		—		—	11,063
Loans receivable, net	$325,882	$134,202	$1,392	$53,206	$—	$514,682

A summary of non-performing assets and classified loans at the dates indicated is as follows:

	March 31, 2012	December 31, 2011
	(Dollars in thousands)	
Loans past due in excess of 90 days and still accruing	$—	$—
Non-accrual loans	8,000	9,292
Total non-performing loans	8,000	9,292
Other real estate owned (“OREO”)	6,852	6,650
Total non-performing assets (“NPAs”)	$14,852	$15,942
Classified loans (1)	$49,511	$53,206

1)

Classified loan totals are inclusive of non-performing loans and may also include troubled debt restructured loans, depending on the grading of these restructured loans.

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Classified loans include non-performing loans and performing substandard loans where management believes that the loans may not return principal and interest per their original contractual terms. A loan that is classified may not necessarily result in a loss.

4. Other Real Estate Owned:
At the applicable foreclosure date, OREO is recorded at the fair value of the real estate, less the estimated costs to sell the real estate. The carrying value of OREO is regularly evaluated and, if necessary, the carrying value is reduced to net realizable value. The following table presents OREO for the periods presented:

	Three Months Ended	
	March 31, 2012	March 31, 2011
	(Dollars in thousands)	
Balance, beginning of period	$6,650	$4,429
Additions to OREO	620	888
Proceeds from sale of OREO	(438)	(1,270)
Valuation Adjustments in the period (1)	20	(361)
Balance, end of period, March 31	$6,852	$3,686

(1) Amount includes chargedowns and gains/losses on sale of OREO

The balance of OREO increased by $202,000 during the first quarter, 2012, primarily as a result of additions to OREO. For the periods indicated, OREO assets consisted of the following (in thousands):

	March 31, 2012		December 31, 2011	
Single family residence	$349	5.1%	$166	2.5%
Developed residential lots	2,339	34.1%	2,048	30.8%
Commercial buildings	324	4.7%	483	7.3%
Raw land	3,840	56.1%	3,953	59.4%
Total OREO	$6,852	100.0%	$6,650	100.0%

The Company’s Special Assets Group continues to dispose of OREO properties through a combination of individual sales to investors and bulk sales to investors.

5. Advances from the Federal Home Loan Bank of Seattle:
Panhandle State Bank, the banking subsidiary of Intermountain, has a credit line with FHLB of Seattle that allows it to borrow funds up to a percentage of its total assets, subject to collateralization requirements. Certain loans are used as collateral for these borrowings. At March 31, 2012 and December 31, 2011, this credit line represented a total borrowing capacity of $127.7 million and $100.3 million, of which $96.6 million and $69.3 million was available, respectively. The advances from FHLB at March 31, 2012 and December 31, 2011 are repayable as follows (in thousands):

	March 31, 2012		December 31, 2011	
	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
Due within 1 year	$25,000	2.06%	$25,000	2.06%
Due in 1 to 2 years	—	—		—
Due in 2 to 3 years	4,000	3.11	4,000	3.11
Due in 3 to 4 years	—	—	—	—
Due in 4 to 5 years	—	—	—	—

	$29,000	2.20 %	$29,000	2.20 %

Only member institutions have access to funds from the Federal Home Loan Banks. As a condition of membership, Panhandle is

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required to hold FHLB stock. As of March 31, 2012 and December 31, 2011, Panhandle held $2.3 million of FHLB stock. The FHLB of Seattle announced that they would no longer pay dividends or redeem or repurchase capital stock until further notice. Each FHLB continues to monitor its capital and other relevant financial measures as a basis for determining a resumption of dividends and capital stock repurchases at some later date.

6. Other Borrowings:
The components of other borrowings are as follows (in thousands):

	March 31, 2012	December 31, 2011
Term note payable (1)	$8,279	$8,279
Term note payable (2)	8,248	8,248
Total other borrowings	$16,527	$16,527

(1) In January 2003, the Company issued $8.0 million of Trust Preferred securities through its subsidiary, Intermountain Statutory Trust I. The debt associated with these securities bears interest on a variable basis tied to the 90-day LIBOR (London Inter-Bank Offering Rate) index plus 3.25%, with interest only paid quarterly. The rate on this borrowing was 3.72% at March 31, 2012. The debt is callable by the Company quarterly and matures in March 2033. See Note A and B below.

(2) In March 2004, the Company issued $8.0 million of Trust Preferred securities through its subsidiary, Intermountain Statutory Trust II. The debt associated with these securities bears interest on a variable basis tied to the 90-day LIBOR index plus 2.8%, with interest only paid quarterly. The rate on this borrowing was 3.37% at March 31, 2012. The debt is callable by the Company quarterly and matures in April 2034. During the third quarter of 2008, the Company entered into an interest rate swap contract with Pacific Coast Bankers Bank. The purpose of the $8.2 million notional value swap is to convert the variable rate payments made on our Trust Preferred I obligation to a series of fixed rate payments at 7.38% for five years, as a hedging strategy to help manage the Company's interest-rate risk. See Note A and B below:

A) Intermountain's obligations under the debentures issued to the trusts referred to above constitute a full and unconditional guarantee by Intermountain of the Statutory Trusts' obligations under the Trust Preferred Securities. In accordance with ASC 810, Consolidation, the trusts are not consolidated and the debentures and related amounts are treated as debt of Intermountain.

B) To conserve the liquid assets of the parent Company, the Company's Board of Directors decided to defer regularly scheduled interest payments on its outstanding Junior Subordinated Debentures related to its Trust Preferred Securities ("TRUPS Debentures") beginning in December 2009. The Company is permitted to defer payments of interest on the TRUPS Debentures for up to 20 consecutive quarterly periods without default. During the deferral period, the Company may not pay any dividends or distributions on, or redeem, purchase or acquire, or make a liquidation payment with respect to the Company's capital stock, or make any payment of principal or interest on, or repay, repurchase or redeem any debt securities of the Company that rank equally or junior to the TRUPS Debentures.

7. Earnings Per Share:
The following table presents the basic and diluted earnings per share computations (numbers in thousands):

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	Three Months Ended March 31, 2012	2011
Numerator:		
Net income - basic and diluted	$801	$1
Preferred stock dividend	466	443
Net income (loss) applicable to common stockholders	$335	$(442)
Denominator:		
Weighted average shares outstanding	17,778,027	8,396,495
Effect of participating preferred shares on an as converted basis	26,500,283	—
Weighted average shares outstanding — basic	44,278,310	8,396,495
Dilutive effect of common stock options, warrants, restricted stock awards	148,422	—
Weighted average shares outstanding — diluted	44,426,732	8,396,495
Earnings (loss) per share — basic and diluted:		
Earnings (loss) per share — basic	$0.01	$(0.05)
Effect of dilutive common stock options, warrants, restricted stock awards	—	—
Earnings (loss) per share — diluted	$0.01	$(0.05)
Anti-dilutive securities not included in diluted earnings per share:		
Common stock options	153,095	196,057
Common stock warrant - Series A	653,226	653,226
Restricted shares	—	29,649
Total anti-dilutive shares	806,321	878,932

Common stock equivalents were calculated using the treasury stock method. Series B preferred shares issued as part of the Company's January 2012 capital raise (see Note 8 Stockholders' Equity) have been included on an "as converted" basis in the calculation of basic earnings per share. These preferred shares are automatically convertible into non-voting common stock upon the approval of the issuance of non-voting common by the Company's shareholders, which is expected in the second quarter of 2012. The preferred shares and the non-voting common shares into which they would convert maintain the same dividend rights as the voting common shares of the Company.

As part of the same capital raise, warrants were issued for 1,700,000 shares of non-voting common stock (or the economically equivalent number of Series B preferred shares if non-voting common stock is not available). The impacts of these warrants were included in diluted earnings per share, and were calculated using the treasury stock method.

8. Stockholders' Equity:

On December 19, 2008, the Company issued 27,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, no par value with a liquidation preference of $1,000 per share ("Preferred Stock") and a ten-year warrant to purchase up to 653,226 shares of Common Stock, no par value, as part of the Troubled Asset Relief Program Capital Purchase Program of the U.S. Department of Treasury ("U.S. Treasury"). The $27.0 million cash proceeds were allocated between the Preferred Stock and the warrant to purchase common stock based on the relative estimated fair values at the date of issuance, and the estimated value of the warrants was included in equity. The fair value of the warrants was determined under the Black-Scholes model. The model includes assumptions regarding the Company's common stock prices, dividend yield, and stock price volatility as well as assumptions regarding the risk-free interest rate. The strike price for the warrant is $6.20 per share.

Dividends on the Series A Preferred Stock will accrue and be paid quarterly at a rate of 5% per year for the first five years and thereafter at a rate of 9% per year. During the third quarter of 2009, the Board of Directors of the Company approved the deferral of regularly scheduled quarterly dividends on the Series A Preferred Stock, beginning in December 2009. The shares of Series A Preferred Stock have no stated maturity, do not have voting rights except in certain limited circumstances and are not subject to mandatory redemption or a sinking fund.

The Series A Preferred Stock has priority over the Company’s common stock with regard to the payment of dividends and liquidation distributions. The Series A Preferred Stock qualifies as Tier 1 capital. The agreement with the U.S. Treasury contains limitations on certain actions of the Company, including the payment of quarterly cash dividends on the Company’s common stock in excess of current cash dividends paid in the previous quarter and the repurchase of its common stock during the first three years of the agreement. In addition, the Company agreed that, while the U.S. Treasury owns the Series A Preferred Stock, the Company's employee benefit plans and other executive compensation arrangements for its senior executive officers must comply with Section 111(b) of the Emergency Economic Stabilization Act of 2008.

As part of the Company's capital raise in January, 2012, the Company authorized up to 864,600 shares of Mandatorily Convertible Cumulative Participating Preferred Stock, Series B, no par value with a liquidation preference of $0.01 per share ("Series B Preferred Stock"), 698,993 of which were outstanding as of March 31, 2012, and of which each share of Series B Preferred Stock will automatically convert into 50 shares of a new series of non-voting common stock at a conversion price of $1.00 per share (the "Non-Voting Common Stock") upon shareholder approval of such Non-Voting Common Stock. The Series B Preferred Stock will, with respect to dividend rights and rights on liquidation, winding-up and dissolution, rank (i) on a parity with Series A Preferred Stock and (ii) senior to the Company's Common Stock and the Non-Voting Common Stock. Under the terms of the Series B Preferred Stock, until the authorization of the Non-Voting Common Stock is approved, and prior to June 30, 2012, if the Company pays a dividend or other distribution in respect of our Common Stock, the then holders of the Series B Preferred Stock will be entitled to receive a dividend equal to the product of (x) the per share dividend or other distribution paid in respect to each share of Common Stock and (y) the number of shares of Non-Voting Common Stock into which the Series B Preferred Stock is convertible. Additionally, if the authorization of the Non-Voting Common Stock is not approved by June 30, 2012, then, until such approval is subsequently attained, holders of the Series B Preferred Stock will be entitled to receive dividends at an annual rate equal to 15%, where such rate is calculated with respect to the original issue price of $50.00 per share of Series B Preferred stock. The shares of Series B Preferred Stock have no stated maturity, do not have voting rights except in certain limited circumstances and are not subject to mandatory redemption or a sinking fund.

In addition, as part of the Company's January 2012 capital raise, warrants to purchase 1,700,000 shares of the Company's Voting Common or Non-Voting Common (or an economically equivalent number of Series B Preferred shares if Non-Voting Common is not available) to two of the shareholders participating in the raise. The cash proceeds of the January offering were allocated between the warrants, the Common Stock and the Series B Preferred Stock based on the relative estimated fair values at the date of issuance. The fair value of the warrants was determined under the Black-Scholes model. The model includes assumptions regarding the Company's common stock prices, dividend yield, and stock price volatility as well as assumptions regarding the risk-free interest rate. The strike price for the warrant is $1.00 per share, but is adjusted down if the Company recorded or otherwise issues shares at a price lower than the strike price. As such, the warrants are accounted for as a liability and listed at fair value on the Company's financial statements. Adjustments to the fair value are measured quarterly and any changes are recorded through non-interest income.

Reflecting the Company's ongoing strategy to prudently manage through the current economic cycle, the decision to maximize equity and liquidity at the Bank level had correspondingly reduced cash available at the parent Company. Consequently, to conserve the liquid assets of the parent Company, the Company's Board of Directors decided to defer regularly scheduled interest payments on its outstanding Junior Subordinated Debentures related to its Trust Preferred Securities ("TRUPS Debentures"), and also defer regular quarterly cash dividend payments on its preferred stock held by the U.S. Treasury, beginning in December 2009. The Company is permitted to defer payments of interest on the TRUPS Debentures for up to 20 consecutive quarterly periods without default. During the deferral period, the Company may not pay any dividends or distributions on, or redeem, purchase or acquire, or make a liquidation payment with respect to the Company's capital stock, or make any payment of principal or interest on, or repay, repurchase or redeem any debt securities of the Company that rank equally or junior to the TRUPS Debentures. Under the terms of the preferred stock, if the Company does not pay dividends for six quarterly dividend periods (whether or not consecutive), Treasury would be entitled to appoint two members to the Company's board of directors. Deferred payments compound for both the TRUPS Debentures and preferred stock. Although these expenses will be accrued on the consolidated income statements for the Company, deferring these interest and dividend payments will preserve approximately $477,000 per quarter in cash for the Company.

Notwithstanding the pending deferral of interest and dividend payments, the Company fully intends to meet all of its obligations to the Treasury and holders of the TRUPS Debentures as quickly as it is prudent to do so. The Company is currently evaluating its position and future plans regarding these dividends.

9. Income Taxes:

For both periods ended March 31, 2012 and March 31, 2011, the Company recorded no income tax provision due to net losses incurred. Intermountain maintained a net deferred tax asset of $13.3 million and $13.2 million as of March 31, 2012 and December 31, 2011, net of a valuation allowance of $8.8 million for each period end.
Intermountain uses an estimate of future earnings, future reversal of taxable temporary difference, and tax planning strategies to determine whether it is more likely than not that the benefit of the deferred tax asset will be realized. At March 31, 2012, Intermountain assessed whether it was more likely than not that it would realize the benefits of its deferred tax asset. Intermountain

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determined that the negative evidence associated with a three-year cumulative loss for the period ended December 31, 2011, and challenging economic conditions continued to outweigh the positive evidence. Therefore, Intermountain maintained the valuation allowance of $8.8 million against its deferred tax asset that was established in 2010. The Company analyzes the deferred tax asset on a quarterly basis and may increase the allowance or release a portion or all of this allowance depending on actual results and estimates of future profitability.

In conducting its valuation allowance analysis, the Company developed an estimate of future earnings to determine both the need for a valuation allowance and the size of the allowance. In conducting this analysis, management has assumed economic conditions will continue to be very challenging in 2012, followed by gradual improvement in the ensuing years. These assumptions are in line with both national and regional economic forecasts. As such, its estimates include elevated credit losses in 2012, but at lower levels than those experienced in 2009 through 2011, followed by improvement in ensuing years as the Company's loan portfolio continues to turn over. It also assumes: (1) a compressed net interest margin in 2012, with gradual improvement in future years, as the Company is able to convert some of its cash position to higher yielding instruments; and (2) reductions in operating expenses as credit costs abate and its other cost reduction strategies continue.

The completion of the $47.3 million capital raise in January, 2012 will trigger Internal Revenue Code Section 382 limitations on the amount of tax benefit from net operating loss carryforwards that the Company can utilize annually, because of the level of investment by several of the larger investors. This could impact the amount and timing of the release of the valuation allowance, largely depending on the level of market interest rates and the fair value of the Company's balance sheet at the time the offering was completed. The evaluation of this impact is still being completed and will likely not be known until the end of 2012.

Intermountain has performed an analysis of its uncertain tax positions and has not recorded any potential penalties, interest or additional tax in its financial statements as of March 31, 2012. Intermountain's tax positions for the years 2008 through 2011 remain subject to review by the Internal Revenue Service. Intermountain does not expect unrecognized tax benefits to significantly change within the next twelve months.

10. Derivative Financial Instruments:

Management uses derivative financial instruments to protect against the risk of interest rate movements on the value of certain assets and liabilities and on future cash flows. The instruments that have been used by the Company include interest rate swaps and cash flow hedges with indices that relate to the pricing of specific assets and liabilities. Derivative instruments have inherent risks, primarily market risk and credit risk. Market risk is associated with changes in interest rates and credit risk relates to the risk that the counterparty will fail to perform according to the terms of the agreement. The amounts potentially subject to market and credit risks are the streams of interest payments under the contracts and the market value of the derivative instrument which is determined based on the interaction of the notional amount of the contract with the underlying instrument, and not the notional principal amounts used to express the volume of the transactions.

Management monitors the market risk and credit risk associated with derivative financial instruments as part of its overall Asset/Liability management process.

In accordance with ASC 815, Derivatives and Hedging, the Company recognizes all derivative financial instruments in the consolidated financial statements at fair value regardless of the purpose or intent for holding the instrument. Derivative financial instruments are included in other assets or other liabilities, as appropriate, on the Consolidated Balance Sheet. Changes in the fair value of derivative financial instruments are either recognized periodically in income or in stockholders' equity as a component of other comprehensive income depending on whether the derivative financial instrument qualifies for hedge accounting, and if so, whether it qualifies as a fair value hedge or cash flow hedge. Generally, changes in fair values of derivatives accounted for as fair value hedges are recorded in income in the same period and in the same income statement line as changes in the fair values of the hedged items that relate to the hedged risk(s). Changes in fair values of derivative financial instruments accounted for as cash flow hedges, to the extent they are effective hedges, are recorded as a component of other comprehensive income, net of deferred taxes. Changes in fair values of derivative financial instruments not qualifying as hedges pursuant to ASC 815 are reported in non-interest income. Derivative contracts are valued by the counter party and are periodically validated by management.

Interest Rate Swaps — Previously designated as Cash Flow Hedges

The tables below identify the Company's interest rate swap which was entered into to hedge certain LIBOR-based trust preferred debentures and designated as a cash flow hedges pursuant to ASC 815, which no longer qualifies for hedge accounting as of March 31, 2012 (dollars in thousands):

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Maturity Date	Notional Amount	Fair Value (Loss)	March 31, 2012 Receive Rate (LIBOR)	Pay Rate (Fixed)
Pay Fixed, Receive Variable:				
October 2013	$8,248	$(547)	0.25%	4.58%

Maturity Date	Notional Amount	Fair Value (Loss)	December 31, 2011 Receive Rate (LIBOR)	Pay Rate (Fixed)
Pay Fixed, Receive Variable:				
October 2013	$8,248	$(635)	0.2495%	4.58%

The fair value loss of $547,000 at March 31, 2012 and $635,000 at December 31, 2011 are included in other liabilities. The Company has deferred the interest payments on the related Trust Preferred borrowing beginning with the January 2010 scheduled remittance. As a result of the deferred interest payments, a calculation of the effectiveness of the hedge has been prepared each quarter. In March, 2012, it was concluded that the hedge no longer qualified for hedge accounting treatment, based on the mismatch between the deferred payments on the underlying Trust Preferred instrument and the required and expected payments on the derivative. As a result, the Company recorded $163,033 in interest expense and $384,000 in a fair value adjustment on its cash flow hedge in the Company's Statement of Operations. Net cash flows from these interest rate swaps are included in interest expense on trust preferred debentures. At March 31, 2012, Intermountain had $600,000 in restricted cash pledged as collateral for the cash flow hedge. The following table provides a reconciliation of cash flow hedges measured at fair value during the periods indicated (in thousands):

	Three Months Ended March 31, 2012	December 31, 2011
Unrealized loss at beginning of period	$(635)	$(892)
Amount of gross gain (loss) recognized in earnings gain (loss)	(458)	86
Amount of gross gain (loss) recognized in other comprehensive income gain (loss)	546	171
Unrealized loss at end of period	$(547)	$(635)

Interest Rate Swaps — Not Designated as Hedging Instruments Under ASC 815

The Company has purchased certain derivative products to allow the Company to effectively convert a fixed rate loan to a variable rate payment stream. The Company economically hedges derivative transactions by entering into offsetting derivatives executed with third parties upon the origination of a fixed rate loan with a customer. Derivative transactions executed as part of this program are not designated as ASC 815 hedge relationships and are, therefore, marked to market through earnings each period. In most cases the derivatives have mirror-image terms to the underlying transaction being hedged, which result in the positions' changes in fair value offsetting completely through earnings each period. However, to the extent that the derivatives are not a mirror-image, changes in fair value will not completely offset, resulting in some earnings impact each period. Changes in the fair value of these interest rate swaps are included in other non-interest income. The following table summarizes these interest rate swaps as of March 31, 2012 and December 31, 2011 (in thousands):

	March 31, 2012		December 31, 2011	
	Notional Amount	Fair Value Loss	Notional Amount	Fair Value Loss

Interest rate swaps with third party financial institutions	$2,559	$(205)	$2,559	$(215)

At March 31, 2012, loans receivable included ($205,000) of derivative assets and other liabilities included $0 of derivative assets related to these interest rate swap transactions. At March 31, 2012, the interest rate swaps had a maturity date of March 2019 and April 2024 and Intermountain had $72,000 in restricted cash as collateral for the interest rate swaps.

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11. Fair Value of Financial Instruments:
Fair value is defined under ASC 820-10 as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal market for the asset or liability in an orderly transaction between market participants on the measurement date. Fair value estimates are based on quoted market prices, if available. If quoted market prices are not available fair value estimates are based on quoted market prices of similar assets or liabilities, or the present value of expected future cash flows and other valuation techniques. These valuations are significantly affected by discount rates, cash flow assumptions, and risk and other assumptions used. Therefore, fair value estimates may not be substantiated by comparison to independent markets and are not intended to reflect the proceeds that may be realizable in an immediate settlement of the instruments.

Fair value is determined at one point in time and is not representative of future value. These amounts do not reflect the total value of a going concern organization. Management does not have the intention to dispose of a significant portion of its assets and liabilities and therefore, the unrealized gains or losses should not be interpreted as a forecast of future earnings and cash flows.
In support of these representations, ASC 820-10 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy is as follows:
Level 1 inputs — Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.
Level 2 inputs — Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.
Level 3 inputs — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair values requires significant management judgment or estimation.
The following tables present information about the Company's assets measured at fair value on a recurring basis as of March 31, 2012, and December 31, 2011, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value (in thousands).

	Fair Value Measurements At March 31, 2012, Using			
	Fair Value	Quoted Prices In Active Markets for Identical Assets	Other Observable Inputs	Significant Unobservable Inputs
Description	March 31, 2012	(Level 1)	(Level 2)	(Level 3)
Available-for-Sale Securities:				
State and municipal securities	41,409		41,409	
Residential mortgage backed securities ("MBS")	222,904	—	208,786	14,118
Other Assets — Derivative	(205)	—	—	(205)
Total Assets Measured at Fair Value	$264,108	$—	$250,195	$13,913
Other Liabilities — Derivatives	$547	$—	$—	$547
Unexercised Warrants	1,007	—	—	1,007
Total Liabilities Measured at Fair Value	1,554	—	—	1,554

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Description	Fair Value Measurements At December 31, 2011 Using Fair Value December 31, 2011	Quoted Prices In Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-Sale Securities:				
U.S. treasury securities and obligations of U.S. government agencies	$—	$—	$—	$—
State and municipal securities	37,135		37,135	
Residential mortgage backed securities ("MBS")	181,904	—	167,130	14,774
Other Assets — Derivative	(215)	—	—	(215)
Total Assets Measured at Fair Value	$218,824	$—	$204,265	$14,559
Other Liabilities — Derivatives	$635	$—	$—	$635

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis as of March 31, 2012 and December 31, 2011 are summarized as follows (in thousands):

Description	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Residential MBS	Derivatives	Total
January 1, 2012 Balance	$14,774	$(215)	$14,559
Total gains or losses (realized/unrealized):			
Included in earnings	(271)	10	(261)
Included in other comprehensive income	244	—	244
Principal Payments	(629)	—	(629)
Sales of Securities	—	—	—
Transfers in and /or out of Level 3	—	—	—
March 31, 2012 Balance	$14,118	$(205)	$13,913

Description	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Unexercised Warrants	Derivatives	Total
January 1, 2012 Balance	$—	$635	$635
Total gains or losses (realized/unrealized):			
Included in earnings	—	458	458
Included in other comprehensive income	—	(546)	(546)
Unexercised warrants issued in capital raise	1,007	—	1,007
Transfers in and /or out of Level 3	—	—	—
March 31, 2012 Balance	$1,007	$547	$1,554

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Description	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Residential MBS	Derivatives	Total
January 1, 2011 Balance	$ 29,514	$ (38)	$ 29,476
Total gains or losses (realized/unrealized):			
Included in earnings	(1,273)	(177)	(1,450)
Included in other comprehensive income	2,338	—	2,338
Principal Payments	(3,874)	—	(3,874)
Sales of Securities	(11,931)	—	(11,931)
Transfers in and /or out of Level 3	—	—	—
December 31, 2011 Balance	$ 14,774	$ (215)	$ 14,559

Description	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Derivatives
January 1, 2011 Balance	$ 892
Total gains or losses:	
Included in earnings	(86)
Included in other comprehensive income	(171)
December 31, 2011 Balance	$ 635

The following tables present additional quantitative information about assets and liabilities measured at fair value on a recurring basis and for which the company has utilized Level 3 inputs to determine fair value, as of March 31, 2012:

	Quantitative Information about Level 3 Fair Value Measurements - Assets			
March 31, 2012	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range of Inputs
Residential mortgage-backed securities	$ 14,118	Discounted cash flow and consensus pricing	Prepayment	4.03 to 43.03 CPR (1)
			Default rates	0 to 11.63 CDR (2)
			Loss severities	0% to 227.5%
Interest Rate Derivatives	$ (205)	Discounted cash flow modeling and market indications	Cash flows of underlying instruments	Various payment mismatches based on characteristics of underlying loans
			Swap rates	0.50% to 1.00%
			LIBOR rates	0.25% to 0.75%

(1) CPR: Constant prepayment rate
(2) CDR: Constant default rate

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March 31, 2012	Quantitative Information about Level 3 Fair Value Measurements - Liabilities Fair Value Estimate	Valuation Techniques	Unobservable Input	Range of Inputs
Unexercised Warrants	$ 1,007	Black Scholes model	Estimated underlying stock price volatility	90% to 100%
			Duration	2.5 to 3.0 years
			Risk-free rate	0.40% to 1.00%
Interest Rate Derivatives	$ 547	Discounted cash flow modeling and market indications	Cash flows of underlying instruments	Various payment mismatches based on characteristics of underlying loans
			Swap rates	0.50% to 1.00%
			LIBOR rates	0.25% to 0.75%

Intermountain may be required, from time to time, to measure certain other financial assets at fair value on a non-recurring basis. The following table presents the carrying value for these financial assets as of March 31, 2012 and December 31, 2011 (in thousands):

	Fair Value Measurements At March 31, 2012, Using			
	Fair Value	Quoted Prices In Active Markets for Identical Assets	Other Observable Inputs	Significant Unobservable Inputs
Description	March 31, 2012	(Level 1)	(Level 2)	(Level 3)
Loans(1)	$24,210	$—	$—	$24,210
OREO	6,852	—	—	6,852
Total Assets Measured at Fair Value	$31,062	$—	$—	$31,062

(1) Represents impaired loans, net of allowance for loan loss, which are included in loans.

	Fair Value Measurements At December 31, 2011, Using			
	Fair Value	Quoted Prices In Active Markets for Identical Assets	Other Observable Inputs	Significant Unobservable Inputs
Description	December 31, 2011	(Level 1)	(Level 2)	(Level 3)
Loans(1)	$ 25,885	$ —	$ —	$ 25,885
OREO	6,650	—	—	6,650
Total Assets Measured at Fair Value	$ 32,535	$ —	$ —	$ 32,535

(1) Represents impaired loans, net of allowance for loan loss, which are included in loans.

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the company has utilized Level 3 inputs to determine fair value:

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March 31, 2012	Quantitative Information about Level 3 Fair Value Measurements - Liabilities			
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range of Inputs
Impaired Loans	$24,210	Discounted cash flows and appraisal of collateral	Amount and timing of cash flows	No payment deferral to indefinite payment deferral
			Discount Rate	4% to 9%
			Appraisal adjustments	10% to 15%
			Liquidations Expenses	10% to 15%
OREO	$6,852	Appraisal of collateral	Appraisal adjustments	10% to 35%
			Liquidation Expenses	10% to 15%

The loans above represent impaired loans that have been adjusted to fair value. When a loan is identified as impaired, the impairment is measured using either the present value of the estimated future cash flows of the loan or for loans that are collateral dependent, the current fair value of the collateral, less selling costs. Depending on the characteristics of a loan, the fair value of collateral is generally estimated by obtaining external appraisals or other market-based valuation methods. If the value of the impaired loan is determined to be less than the recorded investment in the loan, the impairment is recognized and the carrying value of the loan is adjusted to fair value through the allowance for loan and lease losses. The carrying value of loans fully charged-off is zero.

OREO represents real estate which the Company has taken control of in partial or full satisfaction of loans. At the time of foreclosure, OREO is recorded at the lower of the carrying amount of the loan or fair value less estimated costs to sell, which becomes the property’s new basis. Any write-downs based on the asset’s fair value at the date of acquisition are charged to the allowance for loan and lease losses. After foreclosure, management periodically performs valuations such that the real estate is carried at the lower of its new cost basis or fair value, net of estimated costs to sell. Fair value adjustments on other real estate owned are recognized within net loss on real estate owned as a component of non-interest expense.

The following is a further description of the principal valuation methods used by the Company to estimate the fair values of its financial instruments.

Securities. The fair values of securities, other than those categorized as level 3 described above, are based principally on market prices and dealer quotes. Certain fair values are estimated using pricing models or are based on comparisons to market prices of similar securities. The fair value of stock in the FHLB equals its carrying amount since such stock is only redeemable at its par value.

Available for Sale Securities. Securities totaling $250.2 million classified as available for sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtained fair value measurements from an independent pricing service and internally validated these measurements. 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.

The available for sale portfolio also includes $14.1 million in super senior or senior tranche collateralized mortgage obligations not backed by a government or other agency guarantee. These securities are collateralized by fixed rate prime or Alt A mortgages, are structured to provide credit support to the senior tranches, and are carefully analyzed and monitored by management. Because of disruptions in the current market for mortgage-backed securities and collateralized mortgage obligations, an active market did not exist for these securities at March 31, 2012. This is evidenced by a significant widening in the bid-ask spread for these types of securities and the limited volume of actual trades made. As a result, less reliance can be placed on easily observable market data, such as pricing on transactions involving similar types of securities, in determining their current fair value. As such, significant adjustments were required to determine the fair value at the March 31, 2012 measurement date. These securities are valued using Level 3 inputs.

In valuing these securities, the Company utilized the same independent pricing service as for its other available-for-sale securities and internally validated these measurements. In addition, it utilized FHLB indications, which are backed by significant experience in whole-loan collateralized mortgage obligation valuation and another market source to derive independent valuations and used this data to evaluate and adjust the original values derived. In addition to the observable

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market-based input including dealer quotes, market spreads, live trading levels and execution data, both the pricing service and the FHLB pricing also employed a present-value income model that considered the nature and timing of the cash flows and the relative risk of receiving the anticipated cash flows as agreed. The discount rates used were based on a risk-free rate, adjusted by a risk premium for each security. In accordance with the requirements of ASC 820-10, the Company has determined that the risk-adjusted discount rates utilized appropriately reflect the Company's best estimate of the assumptions that market participants would use in pricing the assets in a current transaction to sell the asset at the measurement date. Risks include nonperformance risk (that is, default risk and collateral value risk) and liquidity risk (that is, the compensation that a market participant receives for buying an asset that is difficult to sell under current market conditions). To the extent possible, the pricing services and the Company validated the results from these models with independently observable data.

Loans. Periodically, the Company records nonrecurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Nonrecurring adjustments also include certain impairment amounts for impaired loans when establishing the allowance for credit losses. Such amounts are generally based on either the estimated fair value of the cash flows to be received or the fair value of the underlying collateral supporting the loan less selling costs. Real estate collateral on these loans and the Company's OREO is typically valued using appraisals or other indications of value based on recent comparable sales of similar properties or assumptions generally observable in the marketplace. Management reviews these valuations and makes additional valuation adjustments, as necessary, including subtracting estimated costs of liquidating the collateral or selling the OREO. The related nonrecurring fair value measurement adjustments have generally been classified as Level 3 because of the significant assumptions required estimating future cash flows on these loans, and the rapidly changing and uncertain collateral values underlying the loans. Volatility and the lack of relevant and current sales data in the Company's market areas for various types of collateral create additional uncertainties and require the use of multiple sources and management judgment to make adjustments. Loans subject to nonrecurring fair value measurement were $24.2 million at December 31, 2011 all of which were classified as Level 3.

Other Real Estate Owned. At the applicable foreclosure date, OREO is recorded at fair value of the real estate, less the estimated costs to sell the real estate. Subsequently, OREO is carried at the lower of cost or net realizable value (fair value less estimated selling costs), and is periodically assessed for impairment based on fair value at the reporting date. Fair value is determined from external appraisals and other valuations using judgments and estimates of external professionals. Many of these inputs are not observable and, accordingly, these measurements are classified as Level 3. The Company's OREO at March 31, 2012 totaled $6.9 million, all of which was classified as Level 3.

Interest Rate Swaps. During the third quarter of 2008, the Company entered into an interest rate swap contract with Pacific Coast Bankers Bank. The purpose of the $8.2 million notional value swap is to convert the variable rate payments made on the Trust Preferred I obligation (see Note 6 — Other Borrowings) to a series of fixed rate payments for five years, as a hedging strategy to help manage the Company's interest-rate risk.

This contract is carried as an asset or liability at fair value, and as of March 31, 2012, it was a liability with a fair value of $547,000.

During the first quarter of 2009, the Company entered into an interest rate swap contract with Pacific Coast Bankers Bank. The purpose of the $1.6 million notional value swap is to convert the fixed rate payments earned on a loan receivable to a series of variable rate payments for ten years, as a hedging strategy to help manage the Company's interest-rate risk. This contract is carried as an asset or liability at fair value, and as of March 31, 2012, it was an asset with a fair value of ($128,000). During the second quarter of 2009, the Company entered into an interest rate swap contract with Pacific Coast Bankers Bank. The purpose of the $1.0 million notional value swap is to convert the fixed rate payments earned on a loan receivable to a series of variable rate payments for ten years, as a hedging strategy to help manage the Company's interest-rate risk. This contract is carried as an asset or liability at fair value, and as of December 31, 2011, it was an asset with a fair value of ($77,000).

Unexercised Warrant Liability. A liability for unexercised warrants was created as part of the Company's capital raise in January, 2012 (see Note 8--Stockholders' Equity). The liability is carried at fair value and adjustments are made periodically through non-interest income to record changes in the fair value. The fair value is measured using the Black Scholes, we seeks to estimate the market price that the unexercised options would bring if sold. Assumptions used in calculating the value include the volatility of the underlying stock, the risk-free interest rate, the expected term of the warrants, the market price of the underlying stock and the dividend yield on the stock. The fair value at March 31, 2012 was a liability of $1.0 million.

Intermountain is required to disclose the estimated fair value of financial instruments, both assets and liabilities on and off the balance sheet, for which it is practicable to estimate fair value. These fair value estimates are made at March 31, 2012 based on relevant market information and information about the financial instruments. Fair value estimates are intended to represent the price an asset could be sold at or the price a liability could be settled for. However, given there is no active market or observable market transactions for many of the Company's financial instruments, the Company has made estimates of many of these fair values which are subjective in nature, involve uncertainties and matters of significant judgment and therefore cannot be determined

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with precision. Changes in assumptions could significantly affect the estimated values.
The estimated fair value of the financial instruments as of March 31, 2012 and December 31, 2011, are as follows (in thousands):

	March 31, 2012				
	Carrying Amount	Fair Value	Quoted Priced in Active Markets for identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets:					
Cash, cash equivalents, restricted cash and federal funds sold	$102,785	$102,785	$102,785	$—	$—
Available-for-sale securities	264,313	264,313	—	250,195	14,118
Held-to-maturity securities	15,024	16,399	—	16,399	—
Loans held for sale	4,172	4,172	—	4,172	—
Loans receivable, net	492,983	505,452	—	—	505,452
Accrued interest receivable	4,108	4,108	—	4,108	—
BOLI	9,214	9,214	—	9,214	—
Financial liabilities:				—	—
Deposit liabilities	731,458	712,526	—	—	712,526
Borrowings	109,162	108,885	—	—	108,885
Accrued interest payable	1,821	1,821	—	1,821	—
Unexercised warrants	1,007	1,007	—	—	1,007

	December 31, 2011	
	Carrying Amount	Fair Value
Financial assets:		
Cash, cash equivalents, restricted cash and federal funds sold	$109,868	$109,868
Interest bearing certificates of deposit	—	—
Available-for-sale securities	219,039	219,039
Held-to-maturity securities	16,143	17,471
Loans held for sale	5,561	5,561
Loans receivable, net	502,252	515,737
Accrued interest receivable	4,100	4,100
BOLI	9,127	9,127
Financial liabilities:		
Deposit liabilities	729,373	709,534
Borrowings	130,631	131,202
Accrued interest payable	1,676	1,676

The methods and assumptions used to estimate the fair values of each class of financial instruments are as follows:
Cash, Cash Equivalents, Federal Funds and Certificates of Deposit
The carrying value of cash, cash equivalents, federal funds sold and certificates of deposit approximates fair value due to the relatively short-term nature of these instruments.
Investments and BOLI

See the discussion above regarding the fair values of investment securities. The fair value of BOLI is equal to the cash surrender value of the life insurance policies.

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Loans Receivable and Loans Held For Sale
The fair value of performing mortgage loans, commercial real estate, construction, consumer and commercial loans is estimated by discounting the cash flows using interest rates that consider the interest rate risk inherent in the loans and current economic and lending conditions. See the above discussion for fair valuation of impaired loans. Non-accrual loans are assumed to be carried at their current fair value and therefore are not adjusted.
Deposits
The fair values for deposits subject to immediate withdrawal such as interest and non-interest bearing checking, savings and money market deposit accounts are discounted using market rates for replacement dollars and using Company and industry statistics for decay/maturity dates. The carrying amounts for variable-rate certificates of deposit and other time deposits approximate their fair value at the reporting date. Fair values for fixed-rate certificates of deposit are estimated by discounting future cash flows using interest rates currently offered on time deposits with similar remaining maturities.
Borrowings
The carrying amounts of short-term borrowings under repurchase agreements approximate their fair values due to the relatively short period of time between the origination of the instruments and their expected payment. The fair value of long-term FHLB Seattle advances and other long-term borrowings is estimated using discounted cash flow analyses based on the Company’s current incremental borrowing rates for similar types of borrowing arrangements with similar remaining terms.
Accrued Interest
The carrying amounts of accrued interest payable and receivable approximate their fair value.

12. Subsequent Events:

On April 23, 2012, the Company commenced a rights offering for up to $8.7 million that will allow existing shareholders to purchase common shares at $1.00 per share, the same purchase price per share as the private placement investors paid in the $47.3 million capital raise that the Company completed in January 2012. Certain investors from the January private placement have agreed, subject to applicable regulatory limitations, to purchase shares that any existing shareholders do not purchase in the rights offering.
The Company expects to use the proceeds from the planned rights offering to strengthen its balance sheet, reinvest in its communities and for other general corporate purposes, including using all or a portion of such proceeds to redeem its Series A Preferred Stock held by the U.S. Treasury as part of the TARP Capital Purchase Program.

13. New Accounting Pronouncements:

In April 2011, the FASB issued ASU No. 2011-03, “Reconsideration of Effective Control for Repurchase Agreements.” ASU No. 2011-03 modifies the criteria for determining when repurchase agreements would be accounted for as a secured borrowing rather than as a sale. Currently, an entity that maintains effective control over transferred financial assets must account for the transfer as a secured borrowing rather than as a sale. The provisions of ASU No. 2011-03 removes from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee. The FASB believes that contractual rights and obligations determine effective control and that there does not need to be a requirement to assess the ability to exercise those rights. ASU No. 2011-03 does not change the other existing criteria used in the assessment of effective control. The provisions of ASU No. 2011-03 are effective prospectively for transactions, or modifications of existing transactions, that occur on or after January 1, 2012. As the Company accounts for all of its repurchase agreements as collateralized financing arrangements, the adoption of this ASU did not have a material impact on the Company's statements of operation and financial condition.

In May 2011, the FASB issued ASU No. 2011-04, “Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.” ASU No. 2011-04 results in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between U.S. GAAP and International Financial Reporting Standards (“IFRS”). The changes to U.S. GAAP as a result of ASU No. 2011-04 are as follows: (1) The concepts of highest and best use and valuation premise are only relevant when measuring the fair value of nonfinancial assets (that is, it does not apply to financial assets or any liabilities); (2) U.S. GAAP currently prohibits application of a blockage factor in valuing financial instruments with quoted prices in active markets. ASU No. 2011-04 extends that prohibition to all fair value measurements; (3) An exception is provided to the basic fair value measurement principles for an entity that holds a group of financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk that are managed on the basis of the entity's net exposure to either of those risks. This exception allows the entity, if certain criteria are met, to measure the fair value of the net asset or liability position in a manner consistent with how market participants would price the net risk position; (4) Aligns the fair value measurement of instruments classified within an entity's shareholders' equity with the guidance for liabilities; and (5) Disclosure requirements have been enhanced for recurring Level 3 fair value measurements to disclose quantitative information about unobservable inputs and assumptions used, to describe the valuation processes used by the entity, and to describe the sensitivity of fair value measurements to changes in unobservable inputs and interrelationships between those inputs. In addition, entities must report the level in the fair value hierarchy of items that are not measured at fair value in the statement of condition but whose fair value must be disclosed. The provisions of ASU No. 2011-04 are effective for the Company's interim reporting period beginning on or after December 15, 2011. The adoption of ASU No. 2011-04 did not have a material impact on the Company's statements of operation and financial condition.

In June 2011, the FASB issued ASU No. 2011-05, “Presentation of Comprehensive Income.” The provisions of ASU No. 2011-05 allow 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 two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The statement(s) are required to be presented with equal prominence as the other primary financial statements. ASU No. 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity but does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The provisions of ASU No. 2011-05 are effective for the Company's interim reporting period beginning on or after December 15, 2011, with retrospective application required. The adoption of ASU No. 2011-05 is expected to result in presentation changes to the Company's statements of operations and the addition of a statement of comprehensive income. The adoption of ASU No. 2011-05 did not have an impact on the Company's statements of condition.

In September 2011, the FASB issued ASU No. 2011-08, “Testing Goodwill for Impairment.” The provisions of ASU No. 2011-08 permits an entity an option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity believes, as a result of its qualitative assessment, that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further impairment testing is required. ASU No. 2011-08 includes examples of events and circumstances that may indicate that a reporting unit's fair value is less than its carrying amount. The provisions of ASU No. 2011-08 are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted provided that the entity has not yet performed its annual impairment test for goodwill. The Company performs its annual impairment test for goodwill in the fourth quarter of each year. The adoption of ASU No. 2011-08 did not have a material impact on the Company's statements of operation and financial condition.

Item 2 — Management’s Discussion and Analysis of Financial Condition and Results of Operations

This report contains forward-looking statements. For a discussion about such statements, including the risks and uncertainties inherent therein, see “Forward-Looking Statements.” Management’s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Consolidated Financial Statements and Notes presented elsewhere in this report and in Intermountain’s Form 10-K for the year ended December 31, 2011.

General (Overview & History)

Intermountain Community Bancorp (“Intermountain” or the “Company”) is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was formed as Panhandle Bancorp in October 1997 under the laws of the State of Idaho in connection with a holding company reorganization of Panhandle State Bank (the “Bank”) that was approved by the stockholders on November 19, 1997 and became effective on January 27, 1998. In September 2000, Panhandle Bancorp changed its name to Intermountain Community Bancorp.

Panhandle State Bank, a wholly owned subsidiary of the Company, was first opened in 1981 to serve the local banking needs of Bonner County, Idaho. Panhandle State Bank is regulated by the Idaho Department of Finance, the State of Washington Department of Financial Institutions, the Oregon Division of Finance and Corporate Securities and by the Federal Deposit Insurance Corporation (“FDIC”), its primary federal regulator and the insurer of its deposits. Since opening in 1981, the Bank has continued to grow by opening additional branch offices throughout Idaho and has also expanded into the states of Oregon and Washington. Intermountain also operates a Trust & Investment Services division, which provides investment, insurance, wealth management and trust services to its clients.

The national economic recession and continuing soft local markets have slowed the Company's growth over the past several years. In response, Company management shifted its priorities to improving asset quality, raising additional capital, maintaining a conservative balance sheet and improving the efficiency of its operations. Significant progress has been made in these areas, and management is now implementing plans to pursue prudent growth opportunities.

Intermountain offers banking and financial services that fit the needs of the communities it serves. Lending activities include consumer, commercial, commercial real estate, residential construction, mortgage and agricultural loans. A full range of deposit services are available including checking, savings and money market accounts as well as various types of certificates of deposit. Trust and wealth management services, investment and insurance services, and business cash management solutions round out the Company's product offerings.

Business Strategy & Opportunities

Intermountain seeks to differentiate itself by attracting, retaining and motivating highly experienced employees who are local market leaders, and supporting them with advanced technology, training and compensation systems. This approach allows the Bank to provide local marketing and decision-making to respond quickly to customer opportunities and build leadership in its communities. Simultaneously, the Bank has focused on standardizing and centralizing administrative and operational functions to improve risk management, efficiency and the ability of the branches to serve customers effectively.

The Company's strengths include a strong, committed team of experienced banking officers, a loyal and low-cost deposit base, a strong net interest margin, a sophisticated and increasingly effective risk management system, and a strong operational and compliance infrastructure. In the current slow-growth environment, the Company is leveraging these strengths to seek prudent growth opportunities, further reduce risk on its balance sheet, and lower interest and non-interest expense. In particular, Company management is focused on the following:

- Increasing and diversifying its loan origination activity by pursuing attractive small and mid-market commercial credits in its markets, originating commercial real estate loans to strong borrowers at lower real estate prices, originating and seasoning mortgage loans to strong borrowers at conservative loan-to-values in rural and smaller suburban areas not well-served by current secondary market appraisal standards, expanding and diversifying its agricultural portfolio, and expanding its already strong government-guaranteed loan marketing efforts.
- Maintaining a conservative balance sheet and effectively managing Company risk amidst a still uncertain economic and regulatory environment.
- Increasing the efficiency of its operations by continuing to restructure processes, re-negotiate contracts and rationalize various business functions.
- Increasing local, transactional deposit balances while continuing to minimize interest expense by increasing referral activity and targeting specific business and non-profit groups.
- Offsetting anticipated regulatory pressures on current non-interest income streams by expanding its trust, investment and insurance sales, restructuring current product pricing plans, and pursuing opportunities to diversify into new fee-based programs serving both its existing clientele and new potential markets.

In further pursuit of these goals, the Company continues to pursue additional capital. The Company successfully closed on a private offering that netted $42.3 million in new capital for the Company in January, 2012, ("Rights Offering"). It has now commenced an $8.7 million rights offering to existing shareholders of record as of January 20, 2012, which will allow them to buy shares at the same $1.00 share price that the private placement investors received. The Company expects to use the proceeds from the capital raise and the rights offering to make capital contributions to further strengthen its balance sheet, reinvest in its communities and for other general corporate purposes, including, subject to regulatory approval, using all or a portion of such proceeds to redeem its Series A Preferred Stock held by the U.S. Treasury as part of the TARP Capital Purchase Program.

Once completed the two capital offerings will allow the Company additional flexibility to pursue the above goals. In addition, management believes that disruption and consolidation in the market may lead to other opportunities as well, either through direct acquisition of other banks or by capitalizing on opportunities created by market disruption to attract strong new employees and customers.

Critical Accounting Policies

The accounting and reporting policies of Intermountain conform to Generally Accepted Accounting Principles ("GAAP") and to general practices within the banking industry. The preparation of the financial statements in conformity with GAAP requires

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management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Intermountain's management has identified the accounting policies described below as those that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of Intermountain's Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

Investments. Assets in the investment portfolio are initially recorded at cost, which includes any premiums and discounts. Intermountain amortizes premiums and discounts as an adjustment to interest income using the interest yield method over the life of the security. The cost of investment securities sold, and any resulting gain or loss, is based on the specific identification method.

Management determines the appropriate classification of investment securities at the time of purchase.

Held-to-maturity securities are those securities that Intermountain has the intent and ability to hold to maturity, and are recorded at amortized cost. Available-for-sale securities are those securities that would be available to be sold in the future in response to liquidity needs, changes in market interest rates, and asset-liability management strategies, among others. Available-for-sale securities are reported at fair value, with unrealized holding gains and losses reported in stockholders' equity as a separate component of other comprehensive income, net of applicable deferred income taxes.

Management evaluates investment securities for other-than-temporary declines in fair value on a periodic basis. If the fair value of an investment security falls below its amortized cost and the decline is deemed to be other-than-temporary, the security's fair value will be analyzed based on market conditions and expected cash flows on the investment security. The unrealized loss is considered an other-than-temporary impairment. The Company then calculates a credit loss charge against earnings by subtracting the estimated present value of estimated future cash flows on the security from its amortized cost. The other-than-temporary impairment less the credit loss charge against earnings is a component of other comprehensive income.

Allowance For Loan Losses. In general, determining the amount of the allowance for loan losses requires significant judgment and the use of estimates by management. This analysis is designed to determine an appropriate level and allocation of the allowance for losses among loan types and loan classifications by considering factors affecting loan losses, including: specific losses; levels and trends in impaired and nonperforming loans; historical bank and industry loan loss experience; current national and local economic conditions; volume, growth and composition of the portfolio; regulatory guidance; and other relevant factors. Management monitors the loan portfolio to evaluate the adequacy of the allowance. The allowance can increase or decrease based upon the results of management's analysis.

The amount of the allowance for the various loan types represents management's estimate of probable incurred losses inherent in the existing loan portfolio based upon historical bank and industry loan loss experience for each loan type. The allowance for loan losses related to impaired loans is based on the fair value of the collateral for collateral dependent loans, and on the present value of expected cash flows for non-collateral dependent loans. For collateral dependent loans, this evaluation requires management to make estimates of the value of the collateral and any associated holding and selling costs, and for non-collateral dependent loans, estimates on the timing and risk associated with the receipt of contractual cash flows.

Management believes the allowance for loan losses was adequate at March 31, 2012. While management uses available information to provide for loan losses, the ultimate collectability of a substantial portion of the loan portfolio and the need for future additions to the allowance will be based on changes in economic conditions and other relevant factors. A further slowdown in economic activity could adversely affect cash flows for both commercial and individual borrowers, as a result of which the Company could experience increases in nonperforming assets, delinquencies and losses on loans. The allowance requires considerable judgment on the part of management, and material changes in the allowance can have a significant impact on the Company's financial position and results of operations.

Fair Value Measurements. ASC 820 "Fair Value Measurements" establishes a standard framework for measuring fair value in GAAP, clarifies the definition of "fair value" within that framework, and expands disclosures about the use of fair value measurements. A number of valuation techniques are used to determine the fair value of assets and liabilities in Intermountain's financial statements. These include quoted market prices for securities, interest rate swap valuations based upon the modeling of termination values adjusted for credit spreads with counterparties, and appraisals of real estate from independent licensed appraisers, among other valuation techniques. Fair value measurements for assets and liabilities where there exists limited or no observable market data are based primarily upon estimates, and are often calculated based on the economic and competitive environment, the characteristics of the asset or liability and other factors. Therefore, the results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability. Additionally, there are inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results of current or future values. Significant changes in the aggregate fair value of assets and liabilities required to be measured at fair value or for impairment will be recognized in the income statement under the framework established by GAAP. If impairment is determined, it could limit the ability of Intermountain's banking subsidiaries to pay dividends or make other payments to the Holding Company. See Note 11 to the Consolidated Financial Statements for more information on fair value measurements.

Derivative Financial Instruments and Hedging Activities. In various aspects of its business, the Company uses derivative financial instruments to modify its exposure to changes in interest rates and market prices for other financial instruments. Many of these derivative financial instruments are designated as hedges for financial accounting purposes. Intermountain's hedge accounting policy requires the assessment of hedge effectiveness, identification of similar hedged item groupings, and measurement of changes in the fair value of hedged items. If the derivative financial instruments identified as hedges no longer qualify for hedge accounting treatment, changes in the fair value of these hedged items are recognized in current period earnings, and the impact on the consolidated results of operations and reported earnings could be significant. During March, 2012, the Company identified one derivative that no longer qualified for hedge accounting, resulting in a reduction in earnings for the quarter. See Note 10 to the Consolidated Financial Statements for more information on this derivative.

Income Taxes. Income taxes are accounted for using the asset and liability method. Under this method a deferred tax asset or liability is determined based on the enacted tax rates which will be in effect when the differences between the financial statement carrying amounts and tax basis of existing assets and liabilities are expected to be reported in the Company's income tax returns. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established to reduce the net carrying amount of deferred tax assets if it is determined to be more likely than not, that all or some portion of the potential deferred tax asset will not be realized. The Company uses an estimate of future earnings, an evaluation of its loss carryback ability and tax planning strategies to determine whether or not the benefit of its net deferred tax asset may be realized. The analysis used to determine whether a valuation allowance is required and if so, the amount of the allowance, is based on estimates of future taxable income and the effectiveness of future tax planning strategies. These estimates require significant management judgment about future economic conditions and Company performance.

At March 31, 2012, Intermountain assessed whether it was more likely than not that it would realize the benefits of its deferred tax asset. Intermountain determined that the negative evidence associated with a three-year cumulative loss for the period ended December 31, 2011, and challenging economic conditions continued to outweigh the positive evidence. Therefore, Intermountain maintained a valuation allowance of $8.8 million against its deferred tax asset. The company analyzes the deferred tax asset on a quarterly basis and may recapture a portion or all of this allowance depending on future profitability. Including the valuation allowance, Intermountain had a net deferred tax asset of $13.3 million as of March 31, 2012, compared to a net deferred tax asset of $13.2 million as of December 31, 2011. The completion of the capital raise noted in the "Business Strategy & Opportunities" section above will trigger Internal Revenue Code Section 382 limitations on the amount of tax benefit from net operating loss carryforwards that the Company can claim annually. The effect of this limitation is currently being evaluated and is influenced by the level of market interest rates and the fair value of the Company's balance sheet at the time the planned offering was completed. This could impact the amount and timing of the release of the valuation allowance. The evaluation of this impact is currently in process and will likely not be known until the end of 2012.

Note 13, "New Accounting Pronouncements" in the Notes to the Consolidated Financial Statements, discusses new accounting pronouncements adopted by Intermountain and the expected impact of accounting pronouncements recently issued or proposed, but not yet required to be adopted.

Results of Operations

Overview. Intermountain recorded net income applicable to common stockholders of $335,000, or $0.01 per diluted share for the three months ended March 31, 2012, compared with net income applicable to common stockholders of $907,000 or $0.11 per diluted share for the fourth quarter of 2012 (the "sequential quarter") and a net loss applicable to common stockholders of $442,000 or $0.05 per diluted share, for the three months ended March 31, 2011.

The annualized return on average assets ("ROAA") was 0.34%, 0.58%, and 0.0% for the three months ended March 31, 2012, December 31, 2011, and March 31, 2011, respectively. The annualized return on average common equity ("ROAE") was 3.23%, 10.28% and -5.37% for the three months ended March 31, 2012, December 31, 2011 and March 31, 2011, respectively.

Net Interest Income. The most significant component of earnings for the Company is net interest income, which is the difference between interest income from the Company’s loan and investment portfolios, and interest expense on deposits, repurchase agreements and other borrowings. During the three months ended March 31, 2012, December 31, 2011 and March 31, 2011, net interest income was $7.6 million, $8.3 million, and $8.7 million, respectively. The decrease in net interest income from the sequential quarter and the prior period last year reflects lower interest income on loans resulting from declines in both volume and rate. Very low market rates and intense competition for strong borrowers are pressuring both the Company's and its competitors' loan yields. Decreasing rates are also impacting the Company's investment portfolio, but the impact in the first quarter was offset by increasing volumes. Interest expense on deposits continued to decrease as deposit rates declined in response to lower market rates, and CD volumes continued to contract. The increase in interest expense on short-term borrowings from the sequential quarter reflected higher interest expense on an ineffective cash flow hedge.

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Average interest-earning assets decreased by 5.2% to $861.1 million for the three months ended March 31, 2011, compared to $908.6 million for the three months ended March 31, 2011. The decrease was driven by a reduction of $49.8 million or 8.9% in average loans. Average investments and cash increased by $2.2 million or 0.6% over the three month period in 2011. Lower loan volumes continued to reflect paydowns and liquidation of existing loan balances, and lower loan demand caused by the slow economy and tighter underwriting standards.

Average interest-bearing liabilities decreased by 8.9% or $82.3 million for the three month period ended March 31, 2012 compared to March 31, 2011. Average deposit balances decreased $42.6 million, or 5.5%, while borrowings decreased $39.7 million, or 25.6%. The decreases reflected management's focus on lowering interest expense and reducing higher rate or non-relationship funding. Part of this money transitioned into non-FDIC insured investments offered through the Company's trust and investments division.

The net interest margin was 3.55% for the three months ended March 31, 2012 as compared to 3.94% in the fourth quarter of 2011 and 3.89% in the first quarter of last year. Decreases in the average yields on both loans and investments more than offset lower borrowing costs.

The Company continues to focus on lowering its overall cost of funds, while maintaining transaction deposit balances from core relationship customers. The cost on interest-bearing liabilities dropped from 0.78% for the first three months of 2011 to 0.71% for the same period in 2012, even with the impact of the ineffective hedge noted above. Management believes that some opportunities still remain to further lower funding costs. However, given the already low level of market rates and the Company's cost of funds, any future gains are likely to be less than those already experienced. Asset yields are likely to remain compressed in the short-term, although management is working to boost yields through the conversion of cash into either the investment or loan portfolio, and the conversion of investment funds into the loan portfolio.

Provision for Losses on Loans & Credit Quality. Management's policy is to establish valuation allowances for estimated losses by charging corresponding provisions against income. This evaluation is based upon management's assessment of various factors including, but not limited to, current and anticipated future economic trends, historical loan losses, delinquencies, underlying collateral values, and current and potential risks identified in the portfolio.

The provision for losses on loans totaled 959,000 for the three months ended March 31, 2012, compared to a provision of $706,000 for the sequential quarter and $1.6 million for the three months ended March 31, 2011. Lower provision costs over the past two quarters reflect continued improvements in the quality of the Company's loan portfolio. The following table summarizes provision and loan loss allowance activity for the periods indicated.

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	March 31, 2012	2011
	(Dollars in thousands)	
Balance Beginning January 1	$(12,690)	$(12,455)
Charge-Offs		
Commercial loans	679	—
Commercial real estate loans	1,137	477
Commercial construction loans	—	382
Land and land development loans	473	476
Agriculture loans	31	294
Multifamily loans	—	—
Residential loans	163	213
Residential construction loans	—	—
Consumer loans	127	99
Municipal loans	—	—
Total Charge-offs	2,610	1,941
Recoveries		
Commercial loans	(37)	—
Commercial real estate loans	(85)	(1)
Commercial construction loans	(2)	(58)
Land and land development loans	(38)	(154)
Agriculture loans	(51)	(40)
Multifamily loans	—	—
Residential loans	(54)	(40)
Residential construction loans	(7)	—
Consumer loans	(59)	(42)
Municipal loans	—	—
Total Recoveries	(333)	(335)
Net charge-offs	2,277	1,606
Transfers	—	—
Provision for losses on loans	(959)	(1,633)
Sale of loans	—	—
Balance at March 31	$(11,372)	$(12,482)
Allowance — Unfunded Commitments Balance Beginning January 1	$(13)	$(17)
Adjustment	(1)	(1)
Transfers	—	—
Allowance — Unfunded Commitments at March 31	$(14)	$(18)

Net chargeoffs totaled $2.3 million in the first three months of 2012, compared to $1.6 million in the first quarter of 2011. The increase reflected final resolution of a number of credits for which the Company had previously reserved and had been working on. These credits were concentrated in the commercial and commercial real estate segments, while other segments generally experienced lower chargeoff activity. In general, portfolio losses are no longer concentrated in any particular industry or loan type, as prior efforts to reduce exposure in construction, land development and commercial real estate loans have decreased the exposure in these segments considerably. The Company continues to resolve or liquidate its problem loans aggressively, particularly those with higher loss exposures, and now believes that the risk of future large losses is reduced. The loan loss allowance to total loans ratio was 2.25% at March 31, 2012, compared to 2.46% at December 31, 2011 and 2.26% at March 31, 2011, respectively. At the end of the quarter, the allowance for loan losses totaled 142.2% of non-performing loans compared to 136.6% at December 31, 2011 and 66.7% at March 31, 2011. The increase in this coverage ratio reflects the reduction of non-performing loans over both prior periods.

Given current economic uncertainty, management continues to evaluate and adjust the loan loss allowance carefully and frequently to reflect the most current information available concerning the Company's markets and loan portfolio. In its evaluation, management considers current economic and borrower conditions in both the pool of loans subject to specific impairment, and the pool subject to a more generalized allowance based on historical and other factors. When a loan is characterized as impaired, the Company performs a specific evaluation of the loan, focusing on potential future cash flows likely to be generated by the loan, current collateral values underlying the loan, and other factors such as government guarantees or guarantor support that may impact repayment. Based on this evaluation, it sets aside a specific reserve for this loan and/or charges down the loan to its net realizable value (selling price less estimated closing costs) if it is unlikely that the Company will receive any cash flow beyond the amount obtained from liquidation of the collateral. If the loan continues to be impaired, management periodically re-evaluates the loan for additional potential impairment, and charges it down or adds to reserves if appropriate. On the pool of loans not subject to specific impairment, management evaluates regional, bank and loan-specific historical loss trends to develop its base reserve level on a loan-by-loan basis. It then modifies those reserves by considering the risk grade of the loan, current economic conditions, the recent trend of defaults, trends in collateral values, underwriting and other loan management considerations, and unique market-specific factors such as water shortages or other natural phenomena. The ending allowance still reflected higher levels of problem assets and heightened concerns about current economic and market conditions. However, management believes that it has already incurred the most significant losses and reduced its concentrations in riskier assets, particularly its residential land and construction portfolio.

General trending information with respect to non-performing loans, non-performing assets, and other key portfolio metrics is as follows (dollars in thousands):

Credit Quality Trending

	March 31, 2012	December 31, 2011	September 30, 2011	March 31, 2011
	(Dollars in thousands)			
Loans past due in excess of 90 days and still accruing	$—	$—	$—	$1
Non-accrual loans	8,000	9,292	10,329	18,716
Total non-performing loans ("NPLs")	8,000	9,292	10,329	18,717
OREO	6,852	6,650	7,378	3,686
Total non-performing assets ("NPAs")	$14,852	$15,942	$17,707	$22,403
Classified loans (1)	$49,511	$53,207	$58,018	$61,239
Troubled debt restructured loans (2)	$6,462	$6,620	$5,651	$6,360
Total allowance related to non-accrual loans	$305	$676	$508	$1,254
Interest income recorded on non-accrual loans (3)	$63	$716	$482	$156
Non-accrual loans as a percentage of net loans receivable	1.62 %	1.85 %	1.97 %	3.46 %
Total non-performing loans as a % of net loans receivable	1.62 %	1.85 %	1.97 %	3.46 %
Allowance for loan losses ("ALLL") as a percentage of non-performing loans	142.2 %	136.6 %	139.1 %	66.7 %
Total NPAs as a % of total assets (4)	1.55 %	1.71 %	1.91 %	2.28 %
Total NPAs as a % of tangible capital + ALLL ("Texas Ratio") (4)	13.01 %	21.51 %	23.69 %	31.41 %
Loan delinquency ratio (30 days and over)	0.19 %	0.28 %	0.30 %	0.54 %

(1) Classified loan totals are inclusive of non-performing loans and may also include troubled debt restructured loans, depending on the grading of these restructured loans.

(2) Includes accruing restructured loans of $6.0 million and non-accruing restructured loans of $487,000. No other funds are available for disbursement on restructured loans.

(3) Interest income on non-accrual loans based on year-to-date interest totals

The decrease in NPLs and classified loans from the same period one year ago reflects continued loan resolution activity. The Company’s special assets team continues to migrate loans through the collections process and has made steady progress in reducing classified and non-accrual loans through multiple management strategies, including borrower workouts, individual asset sales to

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local and regional investors, and a limited number of bulk sales and auctions of like properties. The Company continues to monitor its non-accrual loans closely and revalue the collateral on a periodic basis. This re-evaluation may create the need for additional write-downs or additional loss reserves on these assets. Loan delinquencies (30 days or more past due) were down to 0.19% from 0.28% at December 31, 2011 and 0.54% in the first quarter of 2011.

The following tables summarize NPAs by type and geographic region, and provides trending information over the past year:

Nonperforming Asset Trending By Category

	3/31/2012	12/31/2011	3/31/2011
	(Dollars in thousands)		
Commercial loans	$4,040	$3,686	$4,423
Commercial real estate loans	1,252	2,786	4,935
Commercial construction loans	43	44	46
Land and land development loans	8,262	8,653	9,713
Agriculture loans	123	187	614
Multifamily loans	—	—	—
Residential real estate loans	1,106	567	2,181
Residential construction loans	2	2	111
Consumer loans	24	17	380
Total NPAs by Categories	$14,852	$15,942	$22,403

March 31, 2012	North Idaho — Eastern Washington	Magic Valley Idaho	Greater Boise Area	E. Oregon, SW Idaho Excluding Boise	Other	Total	% of Loan Type to Total Non-Performing Assets
	(Dollars in thousands)						
Commercial loans	$3,234	$508	$244	$54	$—	$4,040	27.2 %
Commercial real estate loans	693	155	207	197	—	1,252	8.4 %
Commercial construction loans	43	—	—	—	—	43	0.3 %
Land and land development loans	8,216	25	7	—	14	8,262	55.7 %
Agriculture loans	—	58	41	24	—	123	0.8 %
Multifamily loans	—	—	—	—	—	—	— %
Residential real estate loans	689	—	45	240	132	1,106	7.4 %
Residential construction loans	2	—	—	—	—	2	— %
Consumer loans	17	—	—	2	5	24	0.2 %
Total	$12,894	$746	$544	$517	$151	$14,852	100.0 %
Percent of total NPAs	86.8 %	5.0 %	3.7 %	3.5 %	1.0 %	100.0 %	
Percent of NPAs to total loans in each region	4.5 %	2.3 %	1.1 %	0.5 %	0.5 %	3.0 %	

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NPAs by location December 31, 2011	North Idaho —Eastern Washington	Magic Valley Idaho	Greater Boise Area	E. Oregon, SW Idaho Excluding Boise	Other	Total	% of Loan Type to Total Non-Performing Assets
	(Dollars in thousands)						
Commercial loans	$3,030	$357	$252	$27	$20	$3,686	23.0 %
Commercial real estate loans	841	131	332	238	1,244	2,786	17.5 %
Commercial construction loans	44	—	—	—	—	44	0.3 %
Land and land development loans	8,308	76	240	14	15	8,653	54.3 %
Agriculture loans	—	36	66	53	32	187	1.2 %
Multifamily loans	—	—	—	—	—	—	— %
Residential real estate loans	308	—	78	75	106	567	3.6 %
Residential construction loans	2	—	—	—	—	2	— %
Consumer loans	15	—	—	—	2	17	0.1 %
Total	$12,548	$600	$968	$407	$1,419	$15,942	100.0 %
Percent of total NPAs	78.7 %	3.8 %	6.1 %	2.5 %	8.9 %	100.0 %	
Percent of NPAs to total loans in each region	4.3 %	1.7 %	1.7 %	0.4 %	5.0 %	3.1 %	

Land development assets continue to represent the highest segment of non-performing assets, and largely reflect one large $5.3 million OREO property. The totals for the other segments are relatively small and have largely declined since last year. The geographic breakout of NPAs reflects the OREO property noted above, the stronger market presence the Company holds in Northern Idaho and Eastern Washington, and aggressive reductions in non-performing assets in the greater Boise and Magic Valley markets through property sales and loan writedowns. The overall level of NPAs remains below the average of the Company’s peer group.

At March 31, 2012 and December 31, 2011 classified loans (loans with risk grades 6, 7 or 8) by loan type are as follows:

	March 31, 2012		December 31, 2011	
	Amount	% of Total	Amount	% of Total
	(Dollars in thousands)			
Commercial loans	$13,095	26.4 %	$12,259	23.0 %
Commercial real estate loans	13,712	27.7	16,297	30.6
Commercial construction loans	747	1.5	748	1.4
Land and land development loans	7,413	15.0	8,418	15.8
Agriculture loans	2,632	5.3	2,927	5.5
Multifamily loans	6,473	13.1	6,609	12.4
Residential real estate loans	4,969	10.0	5,375	10.1
Residential construction loans	—	—	—	—
Consumer loans	470	1.0	574	1.2
Municipal loans	—	—	—	—
Total classified loans	$49,511	100.0 %	$53,207	100.0 %

Classified loans are loans for which management believes it may experience some problems in obtaining repayment under the contractual terms of the loan, and are inclusive of the Company's non-accrual loans. However, categorizing a loan as classified does not necessarily mean that the Company will experience any or significant loss of expected principal or interest.

Classified loans decreased by $3.7 million from December 31, 2011, and $11.7 million from March 31, 2011. The commercial real estate and land development segments experienced the largest decreases, as the Company continued to focus on reducing exposure in these higher risk areas. Classified commercial loans increased modestly from December, reflecting the addition of a couple government-guaranteed loans.

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As with NPAs, the geographical distribution of the Company's classified loans reflects the distribution of the Company's loan portfolio, with higher distributions in the "North Idaho/Eastern Washington" region, and decreased levels in southern Idaho. As noted above, the Company worked rapidly to reduce its exposure in the Greater Boise area, and the other southern Idaho regions have strong agri-business components, a sector of the economy that is performing well.

Local economies are still challenged but appear now to be growing slowly, with variations in the strength of different industry segments. Agriculture, manufacturing, technology, health-care and mining businesses are strong and improving, offset by continued weakness in the construction and government sectors. Full recovery in the region is likely to occur slowly and over a multi-year period. As such, management believes that classified loans and non-performing assets will likely remain elevated through the remainder of 2011 and 2012, but at levels lower than those experienced in recent periods. In addition, as noted above, loss exposure from these loans appears to have decreased significantly, and should continue to be lower than the heavy losses experienced in 2009 and 2010. Given market volatility and future uncertainties, as with all forward-looking statements, management cannot assure nor guarantee the accuracy of these future forecasts.

Management continues to focus its efforts on managing and reducing the level of non-performing assets, classified loans and delinquencies. It uses a variety of analytical tools and an integrated stress testing program involving both qualitative and quantitative modeling to assess the current and projected state of its credit portfolio. The results of this program are integrated with the Company's capital and liquidity modeling programs to manage and mitigate future risk in these areas as well.

Other Income.

The following table details dollar amount and percentage changes of certain categories of other income for the three month periods ended March 31, 2012 and 2011.

Three Months Ended	March 31, 2012	% of	Percent Change	March 31, 2011	% of
Other Income	Amount	Total	Previous Year	Amount	Total
	(Dollars in thousands)				
Fees and service charges	$1,625	66 %	(3)%	$1,670	63 %
Loan related fee income	582	24 %	1 %	575	22 %
Net gain (loss) on sale of securities	585	24 %	100 %	—	— %
Other-than-temporary credit impairment on investment securities	(271)	(11)%	(100)%	—	— %
BOLI income	87	4 %	(2)%	89	3 %
Hedge Fair Value	(384)	(16)%	100 %	—	
Other income	212	9 %	(35)%	329	12 %
Total	$2,436	100 %	6 %	$2,663	100 %

Total other income was $2.4 million, $2.7 million and $2.7 million for the three months ended March 31, 2012, December 31, 2011 and March 31, 2011.

Fees and service charges earned on deposit, trust and investment accounts continue to be the Company's primary sources of other income. Fees and service charges in the first quarter decreased by $185,000 from the sequential quarter and by $45,000 from the previous year. The decreases largely reflect seasonal factors and lower overdraft fee income as a result of regulatory requirements issued in July of last year.

Loan related fee income was up from both the sequential quarter and the same period last year, as a result of stronger mortgage refinance activity. Continued low mortgage rates, government programs and modest improvements in the housing market should continue to drive additional activity for the next couple quarters.

The Company recognized a $585,000 gain on the sale of two longer-maturity municipal securities, which helped offset additional credit impairments on the two securities that are classified as other than temporarily impaired ("OTTI"). Greater loss severities on defaulted loans underlying these securities resulted in the increased loss. The

Company also recorded a $385,000 fair value adjustment related to a cash flow hedge on one of the Company's trust preferred obligations. The adjustment resulted from the loss of hedge effectiveness on the instrument and will be recovered as the hedge reaches maturity in 2013.

BOLI income was relatively flat from the prior year as yields were stable and the Company did not purchase or liquidate BOLI assets. Other non-interest income totaled $212,000 for quarter ended March 31, 2012, compared to $228,000 for the sequential quarter and $329,000 in the same period last year. The reductions reflect continued decreases in the Company's secured card contract as accounts continue to runoff with no replacement.

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The Company continues to build its trust and investment division, expand its cash management services, evaluate new fee structures and explore other new opportunities to offset decreases in other income created by changing regulatory requirements and its secured card contract.

Operating Expenses.

The following table details dollar amount and percentage changes of certain categories of other expense for the three months ended March 31, 2012 and March 31, 2011.

Three Months Ended	March 31, 2012	% of	Percent Change	March 31, 2011	% of
Other Expense	Amount	Total	Previous Year	Amount	Total
	(Dollars in thousands)				
Salaries and employee benefits	$4,136	51 %	(16)%	$4,947	51 %
Occupancy expense	1,684	20	(6)%	1,787	18
Advertising	112	1	(14)%	130	1
Fees and service charges	622	7	(5)%	651	7
Printing, postage and supplies	300	4	(11)%	337	3
Legal and accounting	350	4	49 %	235	2
FDIC assessment	313	4	(30)%	445	5
OREO operations(1)	104	1	(78)%	476	5
Other expense	677	8	(8)%	732	8
Total	$8,298	100 %	(15)%	$9,740	100 %

(1) Amount includes chargedowns and gains and losses on sale of OREO

Operating expense for the first quarter 2012 totaled $8.3 million, down $868,000 from the sequential quarter and $1.4 million from the same period a year ago.

At $4.1 million, compensation and benefits expense was stable from the fourth quarter and down $811,000, or 16.4% from the first quarter of 2011. The impacts of continued staffing reductions were offset in the first quarter by higher unemployment premiums and benefits expenses, which are front-loaded in the first part of the calendar year. The employee full time equivalent (“FTE”) number at March 31, 2012 totaled 270, a reduction of 10 and 73 FTEs from the fourth and first quarters of last year, respectively.

Occupancy expenses decreased $15,000 and $103,000 from the sequential quarter and first quarter of 2011, respectively. The decreases reflect lower depreciation and rent expense as a result of reduced purchases of software and equipment and the termination of equipment and administrative office leases no longer needed. The Company continues to review asset and software purchases carefully, re-negotiate contracts, and otherwise work with its vendors to lower costs, which should produce additional cost savings in this area.

The advertising expense decrease of $18,000 from the sequential quarter reflects seasonal differences. The $34,000 decrease from a year ago is a result of reductions in general advertising and media expenses, as the Company has focused marketing efforts on more targeted audiences and reduced expenditures on broad print, yellow page and other media. Lower collection and credit service fees produced lower fees and service charges from both prior periods, and OREO operations expense declined significantly as new OREO activity slowed. Printing, postage and supplies was up from the sequential quarter but down over last year, as timing differences offset lower overall check printing, postage and statement rendering expenses. Legal and accounting fees decreased by $38,000 from the prior quarter but were up from last year as a result of higher consulting fees related to the Company's restructuring efforts.

FDIC expenses increased $12,000 over the sequential period because of higher assessment volumes, but were down $132,000 from last year as a result of changes in the FDIC assessment formula and lower asset balances than in the prior year.

Other expenses decreased $55,000 and $93,000 from the fourth and first quarters of last year, respectively, reflecting the Company's ongoing efforts to reduce operational losses and training, travel, courier, armored car and meeting expenses. The Company continues to evaluate opportunities for additional expense reduction in many of the

categories included in this line item, and anticipates further reductions in 2012.
Annualized operating expense as a percentage of average assets was 3.53%, 3.91% and 3.98% for the quarters ending March 31, 2012, December 31, 2011 and March 31, 2011, respectively. The Company's efficiency ratio (noninterest expense divided by

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the sum of net interest income and noninterest income) was 82.5% for the three months ended March 31, 2012, compared to 82.7% and 85.6% for the sequential quarter and the same period one year ago. With economic conditions likely to remain challenging in the near future, the Company continues to develop and implement additional efficiency and cost-cutting efforts. Management anticipates that as it completes its current initiatives, the efficiency and expense ratios will continue to improve. Stabilization and improvement in economic conditions in the future should also improve efficiency, as net interest income rebounds and credit-related costs continue to subside.

Income Tax Provision.

The Company did not record an income tax provision for the three months ended March 31, 2012 compared to an income tax benefit of $152,000 in the fourth quarter of 2011 and $0 in the first quarter of 2011. The effective tax rates used to calculate the tax provision or benefit were 0.0%, (101.8%) and 0% for the quarters ended March 31, 2012, December 31, 2011, and March 31, 2011, respectively. Intermountain maintained a net deferred tax asset of $13.3 million and $13.2 million as of March 31, 2012 and December 31, 2011, net of a valuation allowance of $8.8 million in each period.

Intermountain uses an estimate of future earnings, future reversal of taxable temporary difference, and tax planning strategies to determine whether it is more likely than not that the benefit of the deferred tax asset will be realized. At March 31, 2012, Intermountain assessed whether it was more likely than not that it would realize the benefits of its deferred tax asset. Intermountain determined that the negative evidence associated with a three-year cumulative loss for the period ended December 31, 2011, and challenging economic conditions continued to outweigh the positive evidence. Therefore, Intermountain maintained the valuation allowance of $8.8 million against its deferred tax asset that was established in 2010. The Company analyzes the deferred tax asset on a quarterly basis and may increase the allowance or release a portion or all of this allowance depending on actual results and estimates of future profitability. In conducting its valuation allowance analysis, the Company developed an estimate of future earnings to determine both the need for a valuation allowance and the size of the allowance. In conducting this analysis, management has assumed economic conditions will continue to be very challenging in 2012, followed by gradual improvement in the ensuing years. These assumptions are in line with both national and regional economic forecasts. As such, its estimates include elevated credit losses in 2012, but at lower levels than those experienced in 2009 through 2011, followed by improvement in ensuing years as the Company's loan portfolio continues to turn over. It also assumes: (1) a compressed net interest margin in 2012, with gradual improvement in future years, as the Company is able to convert some of its cash position to higher yielding instruments; and (2) reductions in operating expenses as credit costs abate and its other cost reduction strategies continue.

The completion of the $47.3 million capital raise in January, 2012 will trigger Internal Revenue Code Section 382 limitations on the amount of tax benefit from net operating loss carryforwards that the Company can utilize annually, because of the level of investment by several of the larger investors. This could impact the amount and timing of the release of the valuation allowance, largely depending on the level of market interest rates and the fair value of the Company's balance sheet at the time the offering was completed. The evaluation of this impact is still being completed and will likely not be known until the end of 2012.

Financial Position

Assets. At March 31, 2012, Intermountain's assets were $958.6 million, up $24.4 billion from $934.2 million at December 31, 2011. The Company's January capital raise created the increase, and the funds received were used to purchase additional investments and to offset seasonal reductions in repurchase agreements during the period.

Investments. Intermountain's investment portfolio at March 31, 2012 was $279.3 million, an increase of $44.2 million, or 18.8% from the December 31, 2011 balance of $235.2 million. The increase was primarily due to the purchase of $62.4 million in available-for-sale securities in the first quarter as the Company deployed funds from the capital raise and from lower yielding cash equivalents into higher yielding investments. Management remains cautious about the volatile investment environment and continues to maintain short portfolio duration with strong regular incoming cash flows. As of March 31, 2012, the balance of the unrealized gain on investment securities, net of federal income taxes, was $2.1 million, compared to an unrealized gain at December 31, 2011 of $2.4 million. The decrease reflected the sale of several securities and the conversion of unrealized gain into recognized income.

The Company currently holds two residential MBS, with an unpaid principal balance totaling $9.3 million that are determined to have other than temporary impairments ("OTTI"), as detailed in the table below (dollars in thousands):

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Security	Principal Balance	Fair Value	Unrealized (Loss) Gain	Cumulative OTTI Credit Loss Recorded in Income	Cumulative OTTI Impairment Loss Recorded in OCI
Security 1	$2,020	$1,696	$444	$(983)	$(768)
Security 2	5,819	4,839	—	(786)	(979)
Total	$7,839	$6,535	$444	$(1,769)	$(1,747)

As indicated in the table above, impairment for these two securities totals $3.5 million, of which $1.8 million has been recorded as credit loss impairment in income and the remainder in other comprehensive income. The Company recorded an additional credit loss impairment for Security 1 in the first quarter of 2012 of $37,000 and an additional impairment for Security 2 of $233,000. At this time, the Company anticipates holding the two securities until their value is recovered or until maturity, and will continue to adjust its net income (loss) and other comprehensive income (loss) to reflect potential future credit loss impairments and the security's market value. The Company calculated the credit loss charges against earnings each quarter by subtracting the estimated present value of future cash flows on the securities from their amortized cost less the total of previous credit loss impairment at the end of each period.

Loans Receivable. At March 31, 2012 net loans receivable totaled $493.0 million, down $9.3 million or 1.9% from $502.3 million at December 31, 2011. The decrease reflected seasonal paydowns of agricultural borrowing lines and the liquidation of several larger problem assets.

The following table sets forth the composition of Intermountain's loan portfolio at the dates indicated. Loan balances exclude deferred loan origination costs and fees and allowances for loan losses.

	March 31, 2012		December 31, 2011	
	Amount	%	Amount	%
	(Dollars in thousands)			
Commercial loans	$114,460	22.7	$110,395	21.4
Commercial real estate loans	172,508	34.2	167,586	32.6
Commercial construction loans	6,405	1.3	6,335	1.2
Land and land development loans	34,258	6.8	38,499	7.5
Agriculture loans	75,749	15.0	81,316	15.8
Multifamily loans	16,949	3.4	26,038	5.1
Residential real estate loans	57,879	11.5	58,861	11.4
Residential construction loans	2,554	0.5	2,742	0.5
Consumer loans	9,866	2.0	11,847	2.3
Municipal loans	13,369	2.6	11,063	2.2
Total loans	503,997	100.0	514,682	100.0
Allowance for loan losses	(11,372)		(12,690)	
Deferred loan fees, net of direct origination costs	358		260	
Loans receivable, net	$492,983		$502,252	
Weighted average interest rate	5.59%		5.69%	

Land and land development loans continue to post the largest decreases reflecting ongoing liquidation activity. The decrease in agricultural borrowing was partially offset by increases in commercial and municipal loans, as borrowing demand picked up in these segments. The decrease in multifamily loans and the increase in commercial real estate loans was partly attributable to the reclassification of one large loan between the two segments. The modest reductions in the consumer and residential segments reflected refinance activity and the generally muted consumer borrowing demand in the Company's market areas.

The commercial portfolio is diversified by industry with a variety of small business customers that have held up relatively well during this economic downturn. As slow economic conditions continue, however, the Company continues to experience a moderate increase in stress in this portfolio. Most of the commercial credits are smaller, however, and Intermountain carries a higher proportion of SBA and USDA guaranteed loans than many of its peers, reducing the overall risk in this portfolio. Commercial customers continue to watch economic conditions very closely, but have recently shown more optimism and stronger borrowing

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demand. Quality commercial borrowers are highly sought after, resulting in keen competition and competitive pricing for these customers.

The commercial real estate portfolio is also well-diversified and consists of a mix of owner and non-owner occupied properties, with relatively few true non-owner-occupied investment properties. The Company has lower concentrations in this segment than most of its peers, and has underwritten these properties cautiously. In particular, it has limited exposure to speculative investment office buildings and retail strip malls, two of the higher risk segments in this category. While tough economic conditions continue to heighten the risk in this portfolio, it continues to perform well with relatively low delinquency and loss rates. The Company believes it has some opportunity to increase prudent lending in this area and did fund some new activity during the first quarter, but again competition is keen for these borrowers.

Most agricultural markets continue to perform very well, and the Company has very limited exposure to the severely impacted dairy market. As noted above, the sector has performed so well that many of its best borrowing customers are using excess cash generated over the past couple of years to reduce their overall borrowing position. As production costs increase, borrowing activity may pick up in this sector.

The residential and consumer portfolios consist primarily of first and second mortgage loans, unsecured loans to individuals, and auto, boat and RV loans. These portfolios have generally performed well with limited delinquencies and defaults, although the Company has seen some pressure on its home equity portfolio. While these loans have generally been underwritten with relatively conservative loan-to-values and strong debt-to-income ratios, the continued weak economy and falling home prices have resulted in some losses in this loan type.

High unemployment and decreased asset values continue to challenge Intermountain’s customers and its loan portfolios. Economic conditions and property values remain volatile, but now appear to be improving slowly in most of the Company's markets. Management believes that its underwriting standards and aggressive identification and management of credit problems are having a positive impact on its credit portfolios. Losses are projected to continue declining through the balance of the next couple years.

Geographic Distribution

As of March 31, 2012, the Company’s loan portfolio by loan type and geographical market area was:

Loan Portfolio by Location	North Idaho — Eastern Washington	Magic Valley Idaho	Greater Boise Area	E. Oregon, SW Idaho, excluding Boise	Other	Total	% of Loan type to total loans	
	(Dollars in thousands)							
Commercial loans	$78,164	$6,064	$7,945	$18,731	$3,556	$114,460	22.7	%
Commercial real estate loans	114,250	11,143	13,094	15,021	19,000	172,508	34.2	%
Commercial construction loans	2,853	3,137	74	131	210	6,405	1.3	%
Land and land development loans	24,470	2,135	4,930	1,542	1,181	34,258	6.8	%
Agriculture loans	1,297	3,926	14,499	53,615	2,412	75,749	15.0	%
Multifamily loans	9,849	—	7,100	—	—	16,949	3.4	%
Residential real estate loans	38,322	4,084	3,416	8,204	3,853	57,879	11.5	%
Residential construction loans	2,554	—	—	—	—	2,554	0.5	%
Consumer loans	5,806	1,047	712	2,021	280	9,866	2.0	%

Municipal loans	11,916	1,453	—	—	—	13,369	2.6	%
Total	$289,481	$32,989	$51,770	$99,265	$30,492	$503,997	100.0	%
Percent of total loans in geographic area	57.4 %	6.5 %	10.3 %	19.7 %	6.1 %	100.0 %		
Percent of total loans where real estate is the primary collateral	66.5 %	67.4 %	59.0 %	37.9 %	81.1 %	61.1 %		

As of December 31, 2011, the Company’s loan portfolio by loan type and geographical market area was:

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Loan Portfolio by Location	North Idaho — Eastern Washington	Magic Valley Idaho	Greater Boise Area	E. Oregon, SW Idaho, excluding Boise	Other	Total	% of Loan type to total loans
	(Dollars in thousands)						
Commercial loans	$75,677	$6,785	$7,686	$18,498	$1,749	$110,395	21.4 %
Commercial real estate loans	114,211	11,763	14,242	15,692	11,678	167,586	32.6 %
Commercial construction loans	2,964	3,137	74	—	160	6,335	1.2 %
Land and land development loans	28,844	2,229	5,095	1,202	1,129	38,499	7.5 %
Agriculture loans	1,168	4,097	17,237	57,154	1,660	81,316	15.8 %
Multifamily loans	10,378	—	7,299	—	8,361	26,038	5.1 %
Residential real estate loans	39,610	5,031	3,273	7,723	3,224	58,861	11.4 %
Residential construction loans	2,742	—	—	—	—	2,742	0.5 %
Consumer loans	6,745	1,176	1,082	2,605	239	11,847	2.3 %
Municipal loans	9,592	1,471	—	—	—	11,063	2.2 %
Total	$291,931	$35,689	$55,988	$102,874	$28,200	$514,682	100.0 %
Percent of total loans in geographic area	56.7 %	6.9 %	10.9 %	20.0 %	5.5 %	100.0 %	
Percent of total loans where real estate is the primary collateral	68.2 %	67.2 %	57.2 %	36.4 %	87.9 %	61.7 %	

As illustrated, 57% of the Company’s loans are in north Idaho and eastern Washington, with the next highest percentage in the rural markets of southwest Idaho outside of Boise. Economic trends and real estate valuations are showing modest improvement in all the Company's markets now, after a four-year decline, with relatively weaker conditions still prevailing in northern Idaho. The southwest Idaho and Magic Valley markets are largely agricultural areas which have not seen levels of price appreciation or depreciation as steep as other areas over the last few years. The “Other” category noted above largely represents loans made to local borrowers where the collateral is located outside the Company’s communities. The mix in this category is relatively diverse, with the highest proportions in Oregon, Washington, California, Nevada and Arizona, but no single state comprising more than 2.7% of the total loan portfolio.

Participation loans where Intermountain purchased part of the loan and was not the lead bank totaled $7.9 million at March 31, 2012. $6.6 million of the total is a condominium project in Boise that is currently classified, but is being managed very closely, and for which no loss is expected. The remaining loans are all within the Company’s footprint and management believes they do not present significant risk at this time.

The following table sets forth the composition of Intermountain’s loan originations for the periods indicated.

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	Three Months Ended March 31,		
	2012	2011	% Change
	(Dollars in thousands)		
Commercial loans	$8,535	$24,973	(65.8)
Commercial real estate loans	781	1,766	(55.8)
Commercial construction loans	454	—	—
Land and land development loans	466	644	(27.6)
Agriculture loans	12,657	18,408	(31.2)
Multifamily loans	—	—	—
Residential real estate loans	20,647	18,567	11.2
Residential construction loans	316	700	(54.9)
Consumer	529	947	(44.1)
Municipal	297	16,770	(98.2)
Total loans originated (1)	$44,682	$82,775	(46.0)
Renewed Loans (1)	$58,911	$—	

(1) 2011 totals include all new loans plus renewed loans that were assigned a new loan number. 2012 totals were segmented to reflect new loans separately. 2012 renewed loans include all renewed loans.

Overall, 2012 origination activity continues to reflect the muted borrowing demand from virtually all sectors in the current environment, as commercial borrowers remain cautious about pursuing new real estate purchase, expansion or construction activities, and as agricultural customers experience strong cash flows. However, economic conditions and borrowing demand did pickup moderately in the first quarter, with modestly stronger commercial and agricultural activity. The pickup in residential activity primarily reflects refinance activity created by record low interest rates and government refinance programs. Origination activity is likely to continue improving from earlier totals, but will still be under pressure from slow economic and employment growth and aggressive industry competition for strong borrowers. Those banks that have low-cost funding structures and strong relationship networks will perform relatively better in this environment.

Office Properties and Equipment. Office properties and equipment decreased 1.4% to $37.2 million at March 31, 2012 from year end as a result of depreciation as the Company continues to limit new purchase activity.

Other Real Estate Owned. Other real estate owned increased by $202,000 to $6.9 million at March 31, 2012. The Company sold 4 properties totaling $439,000 in the first quarter, had net valuation adjustments of $20,000 and added 5 properties totaling $620,000. A total of 14 properties remained in the OREO portfolio at quarter end, consisting of $6.2 million in construction and land development properties, $117,000 in commercial real estate properties, and $340,000 in residential real estate.

Overall, the Company’s current OREO portfolio is lower than most of its peer group and management anticipates reductions in the total in the future. The following table details OREO activity during the most recent quarter.

Other Real Estate Owned Activity

	2012	2011
	(Dollars in thousands)	
Balance, beginning of period, January 1	$6,650	$4,429
Additions to OREO	620	888
Proceeds from sale of OREO	(438)	(1,270)
Valuation Adjustments in the period(1)	20	(361)
Balance, end of period, March 31	$6,852	$3,686

(1) Amount includes chargedowns and gains/losses on sale of OREO

Intangible Assets. Intangible assets now consist only of a small core deposit intangible derived from prior acquisitions that is amortizing down as time progresses.

Deferred Tax Asset. At March 31, 2012, the Company’s deferred tax asset, net of the valuation allowance noted above, totaled

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$13.3 million, up $100,000 from the end of last year. The modest increase reflected the impact of lower unrealized securities gains on the deferred tax asset. At March 31, 2012, Intermountain assessed whether it was more-likely-than-not that it would realize the benefits of its deferred tax asset. Intermountain determined that the negative evidence associated with a three-year cumulative loss for the period ending December 31, 2011, and the continued uncertain economic conditions outweighed the positive evidence. Therefore, Intermountain maintained a valuation allowance of $8.8 million against its deferred tax asset. See the Income Tax Provision section above for more information.

BOLI and All Other Assets. Bank-owned life insurance ("BOLI") and other assets decreased to $19.6 million at March 31, 2012 from $21.5 million at year end, 2011. The decrease reflected lower prepaid expenses and other miscellaneous assets.

Deposits. Total deposits increased $2.1 million to $731.5 million at March 31 30, 2011 from $729.4 million at December 31, 2011. Increases in non-interest bearing demand and money market balances offset continued planned reductions in the CD portfolio, including a $10.3 million decrease in brokered CDs. The Company continues to focus on managing relationship customers closely, lowering its cost of funds, and moving CD customers seeking higher yields into our investment products. Overall, transaction account deposits comprised 70.7% of total deposits at March 31, 2012, up from 68.4% at the prior year end.

The following table sets forth the composition of Intermountain's deposits at the dates indicated.

	March 31, 2012			December 31, 2011		
	Amount	% of total deposits		Amount	% of total deposits	
	(Dollars in thousands)					
Non-interest bearing demand accounts	$197,749	27.1	%	$190,074	26.1	%
NOW and money market 0.0% to 4.07%	319,624	43.7	%	308,713	42.3	%
Savings and IRA 0.0% to 4.91%	72,839	10.0	%	73,493	10.1	%
Certificate of deposit accounts (CDs)	55,855	7.6	%	59,199	8.1	%
Jumbo CDs	57,275	7.8	%	56,177	7.7	%
Brokered CDs	26,667	3.6	%	37,000	5.1	%
CDARS CDs to local customers	1,449	0.2	%	4,717	0.6	%
Total deposits	$731,458	100.0	%	$729,373	100.0	%
Weighted average interest rate on certificates of deposit		1.44	%		1.23	%
Core Deposits as a percentage of total deposits (1)		88.2	%		86.2	%
Deposits generated from the Company's market area as a % of total deposits		96.4	%		94.9	%

(1) Core deposits consist of non-interest bearing checking, money market checking, savings accounts, and certificate of deposit accounts of less than $100,000 (excluding public deposits).

The Company's strong local, core funding base, high percentage of checking, money market and savings balances and careful management of its brokered CD funding provide lower-cost, more reliable funding to the Company than many of its peers and add to the liquidity strength of the Bank. Maintaining the local funding base at a reasonable cost remains a critical priority for the Company's management and production staff. The Company uses a combination of proactive branch staff efforts and a dedicated team of deposit sales specialists to target low-cost deposit balances. It emphasizes personalized service, local community involvement and targeted campaigns to generate deposits, rather than media campaigns or advertised rate specials.

Deposits by location are as follows (dollars in thousands):

Deposits by Location	March 31, 2012	% of total deposits		December 31, 2011	% of total deposits		March 31, 2011	% of total deposits	
North Idaho — Eastern Washington	$348,793	47.7	%	$ 351,643	48.2	%	$364,055	47.5	%

Magic Valley Idaho	70,066	9.6	%	65,629	9.0	%	68,669	8.9	%
Greater Boise Area	67,635	9.2	%	70,094	9.6	%	72,993	9.5	%
Southwest Idaho — Oregon, excluding Boise	155,084	21.2	%	154,446	21.2	%	164,307	21.4	%
Administration, Secured Savings	89,880	12.3	%	87,561	12.0	%	97,617	12.7	%
Total	$731,458	100.0	%	$ 729,373	100.0	%	$767,641	100.0	%

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The Company attempts to, and has been successful in balancing loan and deposit balances in each of the market areas it serves. Northern Idaho and eastern Washington deposits currently exceed those in the Company's southern Idaho and eastern Oregon markets, reflecting the longer presence it has had in these markets. The Company's deposit market share has grown significantly over the past ten years, and it now ranks third in overall market share in its core markets. Intermountain continues to be the deposit market share leader in five of the eleven counties in which it operates.

Borrowings. Deposit accounts are Intermountain's primary source of funds. Intermountain also relies upon advances from the Federal Home Loan Bank of Seattle, repurchase agreements and other borrowings to supplement its funding, reduce its overall cost of funds, and to meet deposit withdrawal requirements. These borrowings totaled $109.1 million and $130.6 million at March 31, 2012 and December 31, 2011, respectively. The decrease from year end reflects seasonal fluctuations in municipal repurchase activity.

Interest Rate Risk

The results of operations for financial institutions may be materially and adversely affected by changes in prevailing economic conditions, including rapid changes in interest rates, declines in real estate market values and the monetary and fiscal policies of the federal government. Like all financial institutions, Intermountain's net interest income and its NPV (the net present value of financial assets, liabilities and off-balance sheet contracts), are subject to fluctuations in interest rates. Intermountain utilizes various tools to assess and manage interest rate risk, including an internal income simulation model that seeks to estimate the impact of various rate changes on the net interest income and net income of the bank. This model is validated by comparing results against various third-party estimations. Currently, the model and third-party estimates indicate that Intermountain's interest rate profile is neutral to slightly asset-sensitive. An asset-sensitive bank generally sees improved net interest income and net income in a rising rate environment, as its assets reprice more rapidly and/or to a greater degree than its liabilities. The opposite is true in a falling interest rate environment. When market rates fall, an asset-sensitive bank tends to see declining income. The Company has become less asset-sensitive over the preceding year, as many of its variable-rate loans have hit contractual floors and the duration of its liability portfolio has shortened.

To minimize the long-term impact of fluctuating interest rates on net interest income, Intermountain promotes a loan pricing policy of utilizing variable interest rate structures that associates loan rates to Intermountain's internal cost of funds and to the nationally recognized prime or London Interbank Offered ("LIBOR") lending rates. While this strategy has had adverse impacts in the current unusually low rate environment, the approach historically has contributed to a relatively consistent interest rate spread over the long-term and reduces pressure from borrowers to renegotiate loan terms during periods of falling interest rates. Intermountain currently maintains over fifty percent of its loan portfolio in variable interest rate assets.

Additionally, the extent to which borrowers prepay loans is affected by prevailing interest rates. When interest rates increase, borrowers are less likely to prepay loans. When interest rates decrease, borrowers are generally more likely to prepay loans. Prepayment speeds accelerated in 2009, most of 2010 and over the last couple of quarters, as borrowers refinanced into lower rates, paid down debt to improve their financial position, or liquidated assets as part of problem loan work-out strategies. Prepayments may affect the levels of loans retained in an institution's portfolio, as well as its net interest income. Prepayments on loans and mortgage-backed securities are likely to continue at a higher pace in the next couple quarters as a result of continuing low interest rates and government-sponsored refinance programs, but will likely stabilize or slow thereafter, particularly when the economy improves and rates begin rising.

On the liability side, Intermountain seeks to manage its interest rate risk exposure by maintaining a relatively high percentage of non-interest bearing demand deposits, interest-bearing demand deposits, savings and money market accounts. These instruments tend to lag changes in market rates and may afford the Bank more protection in increasing interest rate environments than other short-term borrowings, but can also be changed relatively quickly in a declining rate environment. The Bank utilizes various deposit pricing strategies and other borrowing sources to manage its rate risk. As noted above, the duration of the Company's liabilities has generally shortened over the past 2 years, as customers have preferred shorter-term deposit products and the Company has not replaced longer-term brokered and wholesale funding instruments as they have come due.

Intermountain maintains an asset and liability management program intended to manage net interest income through interest rate cycles and to protect its income by controlling its exposure to changing interest rates. As part of this program, Intermountain uses a simulation model designed to measure the sensitivity of net interest income and net income to changes in interest rates. This simulation model is designed to enable Intermountain to generate a forecast of net interest income and net income given various interest rate forecasts and alternative strategies. The model is also designed to measure the anticipated impact that prepayment risk, basis risk, customer maturity preferences, volumes of new business and changes in the relationship between long-term and short-term interest rates have on the performance of Intermountain. The results of modeling indicate that the estimated impact of changing rates on net interest income in a 100 and 300 basis point upward adjustment are within the guidelines established by management. The estimated impact of changing rates on net interest income in a 100 basis point downward adjustment in market interest rates is just outside of the Company's guidelines over a 12-month and 24-month forward looking period. The impacts of changing rates on the Company's modeled economic value of equity are also within the Company's guidelines and reflect a minimum risk profile. The current scenario analysis for net income has been impacted by the unusual current and prior year operating results of the Company, which increases the impact of both upward and downward adjustments on the percentage increase and decrease. Given this, management has tended to place more reliance on the net interest income and economic value of equity modeling.

Intermountain is continuing to pursue strategies to manage the level of its interest rate risk while increasing its long-term net interest income and net income: 1) through the origination and retention of a diversified mix of variable and fixed-rate consumer, business banking, commercial real estate loans, and residential loans which generally have higher yields than alternative investments; 2) by prudently managing its investment portfolio to provide relative stability in the face of changing rate environments; and 3) by increasing the level of its core deposits, which are generally a lower-cost, less rate-sensitive funding source than wholesale borrowings. There can be no assurance that Intermountain will be successful implementing any of these strategies or that, if these strategies are implemented, they will have the intended effect of reducing interest rate risk or increasing net interest income.

Liquidity and Sources of Funds

As a financial institution, Intermountain’s primary sources of funds from assets include the collection of loan principal and interest payments, cash flows from various investment securities, and sales of loans, investments or other assets. Liability financing sources consist primarily of customer deposits, repurchase obligations with local customers, advances from FHLB Seattle and correspondent bank borrowings.

Deposits increased to $731.5 million at March 31, 2012 from $729.3 million at December 31, 2011, as increases in non-interest bearing demand and money market balances offset decreases in CDs. Repurchase agreements decreased by $21.5 million, reflecting seasonal fluctuations in municipal repurchase activity. Increases in the Company's capital and decreases in loans and cash and cash equivalents offset the reductions in repurchase agreements and an increase in the Company's investments available for sale during the quarter, cumulatively resulting in a decrease of $17.0 million in the Company’s unrestricted cash position at March 31, 2012 from year end, 2011.

During the quarter ended March 31, 2012, cash used by investing activities consisted primarily of the purchase of available-for-sale investment securities, partially offset by sales of investment securities and paydowns on the Company's mortgage-backed security portfolio. During the same period, cash provided by financing activities consisted primarily of increases in common and preferred stock and increases in checking and money market deposits, partially offset by decreases in CDs and repurchase agreements.

Securities sold subject to repurchase agreements totaled $63.6 million at March 31, 2012. These borrowings are required to be collateralized by investments with a market value exceeding the face value of the borrowings. Under certain circumstances, Intermountain could be required to pledge additional securities or reduce the borrowings.

Intermountain’s credit line with FHLB Seattle provides for borrowings up to a percentage of its total assets subject to general collateralization requirements. At March 31, 2012, the Company’s FHLB Seattle credit line represented a total borrowing capacity of approximately $127.7 million, of which $31.1 million was being utilized. Additional collateralized funding availability at the Federal Reserve totaled $25.9 million. Both of these collateral secured lines could be expanded more with the placement of additional collateral. Overnight-unsecured borrowing lines have been established at US Bank and Pacific Coast Bankers Bank (“PCBB”). At March 31, 2012, the Company had approximately $35.0 million of overnight funding available from its unsecured correspondent banking sources.

Intermountain and its subsidiary Bank maintain an active liquidity monitoring and management plan, and have worked aggressively over the past several years to expand sources of alternative liquidity. Given continuing volatile economic conditions, the Bank has taken additional protective measures to enhance liquidity, including issuance of new capital, movement of funds into more liquid assets and increased emphasis on relationship deposit-gathering efforts. Because of its relatively low reliance on non-core funding sources and the additional efforts undertaken to improve liquidity discussed above, management believes that the subsidiary Bank’s current liquidity risk is moderate and manageable.

Management continues to monitor its liquidity position carefully and conducts periodic stress tests to evaluate future potential liquidity concerns in the subsidiary Bank. It has established contingency plans for potential liquidity shortfalls. Longer term, the Company intends to fund asset growth primarily with core deposit growth, and it has initiated a number of organizational changes and programs to spur this growth when needed.

Liquidity for the parent Company depends substantially on dividends from the Bank. As discussed more fully in “Risk Factors”, the Bank is currently prohibited from paying dividends to the parent Company without prior regulatory approval. The other primary sources of liquidity for the Parent Company are capital or borrowings. In January 2012, the Company successfully completed a private capital raise, which netted approximately $42 million in additional funds. The Company immediately transferred $30 million of the funds to the subsidiary Bank, resulting in increased liquidity for both the Bank and the parent company. Management projects that available resources will be sufficient to meet the parent Company’s projected funding needs for quite some time, and is now pursuing an additional $8.7 million in capital in a shareholder rights offering, as noted in the “Capital Resources” section below.

Capital Resources

Intermountain’s total stockholders’ equity was $102.9 million at March 31, 2012, compared with $61.6 million at December 31, 2011, reflecting the addition of $42.3 million in capital from the Company's successful private offering in January, 2012. Stockholders’ equity and tangible stockholders' equity was 10.7% of total assets at March 31, 2012 and 6.6% at December 31, 2011, respectively. Tangible common equity as a percentage of tangible assets was 5.0% at March 31, 2012 and 3.8% for December 31, 2011.

At March 31, 2012 Intermountain had unrealized gains of $2.1 million (including cumulative OTTI recognized through other comprehensive income), net of related income taxes, on investments classified as available-for-sale and $0 in unrealized losses on cash flow hedges, net of related income taxes, as compared to unrealized gains of $2.4 million, net of related income taxes, on investments classified as available-for-sale and $330,000 unrealized losses on cash flow hedges at December 31, 2011. The decrease in the unrealized gain on investments reflected the sale of several securities and the conversion of unrealized gain into recognized income. The unrealized loss on cash flow hedges converted to a reported loss during the quarter as the Company recorded a $385,000 fair value adjustment. The adjustment resulted from the loss of hedge effectiveness on the instrument and will be recovered as the interest rate swap reaches maturity in 2013.

On January 23, 2012, the Company announced that it had successfully closed a $47.3 million private capital raise led by Castle Creek Capital Partners IV, L.P. ("Castle Creek") and affiliates of Stadium Capital Management, LLC ("Stadium") through the issuance and sale of shares of common stock at $1.00 per share and a newly-created mandatorily convertible series of preferred stock which will automatically convert into shares of a new series of non-voting common stock at a conversion price of $1.00 upon shareholder approval of such non-voting common stock. The Company also issued to each of Castle Creek and Stadium, for no additional consideration, warrants to purchase 850,000 shares of non-voting common stock (or an economically equivalent number of Series B Preferred shares if Non-Voting Common is not available) at $1.00 per share.

The Company has also commenced a rights offering for up to $8.7 million that will allow existing shareholders to purchase common shares at the same purchase price per share as the private placement investors. Certain private placement investors have agreed, subject to applicable regulatory limitations, to purchase shares that any existing shareholders do not purchase in the rights offering.

The Company expects to use the proceeds from both offerings to strengthen its balance sheet, reinvest in its communities and for other general corporate purposes, including, subject to regulatory approval, using all or a portion of such proceeds to redeem its Series A Preferred Stock held by the U.S. Treasury as part of the TARP Capital Purchase Program.

On December 19, 2008, the Company entered into a definitive agreement with the U.S. Treasury. Pursuant to this Agreement, the Company sold 27,000 shares of Series A Preferred Stock, no par value, having a liquidation amount equal to $1,000 per share, including a warrant (“The Warrant”) to purchase 653,226 shares of the Company’s common stock, no par value, to the U.S. Treasury. The Warrant has a 10-year term and has an exercise price, subject to anti-dilution adjustments, equal to $6.20 per share of common stock.

The Series A Preferred Stock qualifies as Tier 1 capital and provides for cumulative dividends at a rate of 5% per year, for the first five years, and 9% per year thereafter. The Series A Preferred Stock may be redeemed with the approval of the U.S. Treasury in the first three years with the proceeds from the issuance of certain qualifying Tier 1 capital or after three years at par value plus accrued and unpaid dividends. The original terms governing the Series A Preferred Stock prohibited the Company from redeeming the shares during the first three years other than from proceeds received from a qualifying equity offering. However, subsequent legislation was passed that would now permit the Company to redeem the shares of Series A Preferred Stock upon the approval of Treasury and the Company's primary federal regulator.

Intermountain issued and has outstanding $16.5 million of Trust Preferred Securities. The indenture governing the Trust Preferred Securities limits the ability of Intermountain under certain circumstances to pay dividends or to make other capital distributions. The Trust Preferred Securities are treated as debt of Intermountain. These Trust Preferred Securities can be called for redemption by the Company at 100% of the aggregate principal plus accrued and unpaid interest. See Note 6 of "Notes to Consolidated Financial Statements."

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Intermountain and the Bank are required by applicable regulations to maintain certain minimum capital levels and ratios of total and Tier 1 capital to risk-weighted assets, and of Tier I capital to average assets. Intermountain and the Bank plan to maintain their capital resources and regulatory capital ratios through the retention of earnings and the management of the level and mix of assets. At March 31, 2012, Intermountain exceeded the minimum published regulatory capital requirements to be considered "well-capitalized" pursuant to Federal Financial Institutions Examination Council "FFIEC" regulations. However, the Bank executed an informal agreement with its primary regulators in the first quarter of 2010 which among other conditions, requires the Bank to increase its capital by $30 million by June 16, 2010 and maintain a 10% Tier 1 capital to average assets ratio. Although the Company was not able to meet the capital requirement by the June 16, 2010 deadline, the downstream of $30 million in funds to the Bank as a result of the January 2012 capital raise noted above satisfies this condition of the agreement, and results in regulatory capital ratios that compare favorably to most of its peer group.

	Actual			Capital Requirements			Well-Capitalized Requirements		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
Total capital (to risk-weighted assets):									
The Company	$116,425	19.53	%	$47,701	8	%	$59,626	10	%
Panhandle State Bank	113,197	19.00	%	47,667	8	%	59,584	10	%
Tier I capital (to risk-weighted assets):									
The Company	108,991	18.28	%	23,850	4	%	35,775	6	%
Panhandle State Bank	105,763	17.75	%	23,834	4	%	35,751	6	%
Tier I capital (to average assets):									
The Company	108,991	11.48	%	37,968	4	%	47,460	5	%
Panhandle State Bank	105,763	11.28	%	37,517	4	%	46,896	5	%

Reflecting the Company's ongoing strategy to prudently manage through the current economic cycle, the decision to maximize equity and liquidity at the Bank level has correspondingly reduced cash available at the parent Company. Consequently, to conserve liquid assets, in December 2009 the Company decided to defer regularly scheduled interest payments on its outstanding Junior Subordinated Debentures related to its Trust Preferred Securities ("TRUPS Debentures"), and regular quarterly cash dividend payments on its preferred stock held by the U.S. Treasury. The Company is permitted to defer payments of interest on the TRUPS Debentures for up to 20 consecutive quarterly periods without default. During the deferral period, the Company may not pay any dividends or distributions on, or redeem, purchase or acquire, or make a liquidation payment with respect to the Company's capital stock, or make any payment of principal or interest on, or repay, repurchase or redeem any debt securities of the Company that rank equally or junior to the TRUPS Debentures. Under the terms of the preferred stock, if the Company does not pay dividends for six quarterly dividend periods (whether or not consecutive), Treasury would be entitled to appoint two members to the Company's board of directors. The tenth payment deferral occurred in April, 2012, allowing Treasury the contractual right to appoint the two directors. Deferred payments compound for both the TRUPS Debentures and preferred stock. Although these expenses will be accrued on the consolidated income statements for the Company, deferring these interest and dividend payments preserves approximately $477,000 per quarter in cash for the Company.

Off Balance Sheet Arrangements and Contractual Obligations

The Company, in the conduct of ordinary business operations routinely enters into contracts for services. These contracts may require payment for services to be provided in the future and may also contain penalty clauses for the early termination of the contracts. The Company is also 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. Management does not believe that these off-balance sheet arrangements have a material current effect on the Company’s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources, but there is no assurance that such arrangements will not have a future effect.

Tabular Disclosure of Contractual Obligations

The following table represents the Company’s on-and-off balance sheet aggregate contractual obligations to make future payments as of March 31, 2012.

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	Payments Due by Period				
	Total	Less than 1 Year	1 to 3 Years	3 to 5 Years	More than 5 Years
	(in thousands)				
Long-term debt (1)	$33,374	$711	$5,354	$1,173	$26,136
Short-term debt	88,936	88,936	—	—	—
Capital lease obligations	—	—	—	—	—
Operating lease obligations (2)	13,264	1,039	1,644	1,686	8,895
Direct financing obligations (3)	32,090	1,635	3,352	3,433	23,670
Total	$167,664	$92,321	$10,350	$6,292	$58,701

(1) Includes interest payments related to long-term debt agreements.

(2) Excludes recurring accounts payable, accrued expenses and other liabilities, repurchase agreements and customer deposits, all of which are recorded on the registrant’s balance sheet. See Notes 5 and 6 of Notes to Consolidated Financial Statements.

(3) Sandpoint Center Building lease payments related to direct financing transaction executed in August 2009.

New Accounting Pronouncements

In April 2011, the FASB issued ASU No. 2011-03, “Reconsideration of Effective Control for Repurchase Agreements.” ASU No. 2011-03 modifies the criteria for determining when repurchase agreements would be accounted for as a secured borrowing rather than as a sale. Currently, an entity that maintains effective control over transferred financial assets must account for the transfer as a secured borrowing rather than as a sale. The provisions of ASU No. 2011-03 removes from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee. The FASB believes that contractual rights and obligations determine effective control and that there does not need to be a requirement to assess the ability to exercise those rights. ASU No. 2011-03 does not change the other existing criteria used in the assessment of effective control. The provisions of ASU No. 2011-03 are effective prospectively for transactions, or modifications of existing transactions, that occur on or after January 1, 2012. As the Company accounts for all of its repurchase agreements as collateralized financing arrangements, the adoption of this ASU did not have a material impact on the Company's statements of operation and financial condition.

In May 2011, the FASB issued ASU No. 2011-04, “Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.” ASU No. 2011-04 results in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between U.S. GAAP and International Financial Reporting Standards (“IFRS”). The changes to U.S. GAAP as a result of ASU No. 2011-04 are as follows: (1) The concepts of highest and best use and valuation premise are only relevant when measuring the fair value of nonfinancial assets (that is, it does not apply to financial assets or any liabilities); (2) U.S. GAAP currently prohibits application of a blockage factor in valuing financial instruments with quoted prices in active markets. ASU No. 2011-04 extends that prohibition to all fair value measurements; (3) An exception is provided to the basic fair value measurement principles for an entity that holds a group of financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk that are managed on the basis of the entity's net exposure to either of those risks. This exception allows the entity, if certain criteria are met, to measure the fair value of the net asset or liability position in a manner consistent with how market participants would price the net risk position; (4) Aligns the fair value measurement of instruments classified within an entity's shareholders' equity with the guidance for liabilities; and (5) Disclosure requirements have been enhanced for recurring Level 3 fair value measurements to disclose quantitative information about unobservable inputs and assumptions used, to describe the valuation processes used by the entity, and to describe the sensitivity of fair value measurements to changes in unobservable inputs and interrelationships between those inputs. In addition, entities must report the level in the fair value hierarchy of items that are not measured at fair value in the statement of condition but whose fair value must be disclosed. The provisions of ASU No. 2011-04 are effective for the Company's interim reporting period beginning on or after December 15, 2011. The adoption of ASU No. 2011-04 did not have a material impact on the Company's statements of operation and financial condition.

In June 2011, the FASB issued ASU No. 2011-05, “Presentation of Comprehensive Income.” The provisions of ASU No. 2011-05 allow 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 two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The statement(s) are required to be presented with equal prominence as the other primary financial statements. ASU No. 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity but does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The provisions of ASU No. 2011-05 are effective for the Company's interim reporting period beginning on or after December 15, 2011, with retrospective application required. The adoption of ASU No. 2011-05 is expected to result in presentation changes to the Company's statements of operation and the addition of a statement of comprehensive income. The adoption of ASU No. 2011-05 did not have an impact on the Company's statements of condition.

In September 2011, the FASB issued ASU No. 2011-08, “Testing Goodwill for Impairment.” The provisions of ASU No. 2011-08 permits an entity an option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity believes, as a result of its qualitative assessment, that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further impairment testing is required. ASU No. 2011-08 includes examples of events and circumstances that may indicate that a reporting unit's fair value is less than its carrying amount. The provisions of ASU No. 2011-08 are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted provided that the entity has not yet performed its annual impairment test for goodwill. The Company performs its annual impairment test for goodwill in the fourth quarter of each year. The adoption of ASU No. 2011-08 did not have a material impact on the Company's statements of operation and financial condition.

Forward-Looking Statements

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, statements about our plans, objectives, expectations and intentions that are not historical facts, such as the statements in this report regarding expected or projected asset quality and losses, expenses, the closing of the Company's announced rights offering and resulting capital levels, and the parent Company's liquidity, and other statements identified by words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “will likely," “should,” “projects,” “seeks,” “estimates” or words of similar meani forward-looking statements are based on current beliefs and expectations of management and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. In addition to the factors set forth in the sections titled “Risk Factors,” “Business” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, as applicable, in this report and our Annual Report on Form 10-K for the year ended December 31, 2011, the following factors, among others, could cause actual results to differ materially from the anticipated results:

- further deterioration in economic conditions that could result in increased loan and lease losses;
- risks associated with concentrations in real estate-related loans;
- declines in real estate values supporting loan collateral;
- our ability to comply with the requirements of regulatory orders issued to us and/or our banking subsidiary;
- the effects of any further adverse regulatory action;
- our ability to raise capital or incur debt on reasonable terms;
- regulatory limits on our subsidiary bank’s ability to pay dividends to the Company;
- applicable laws and regulations and legislative or regulatory changes, including the ultimate financial and operational burden of financial regulatory reform legislation and related regulations and the restrictions imposed on participants in the Troubled Asset Relief Program (“TARP”) Capital Purchase Program, including the impact of executive compensation restrictions, which may affect our ability to retain and recruit executives in competition with other firms

who do not operate under those restrictions;

- inflation and interest rate levels, and market and monetary fluctuations;
- the risks associated with lending and potential adverse changes in credit quality;
- changes in market interest rates and spreads, which could adversely affect our net interest income and profitability;

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- increased loan delinquency rates;
- trade, monetary and fiscal policies and laws, including interest rate and income tax policies of the federal government;
- the timely development and acceptance of new products and services of Intermountain;
- the willingness of customers to substitute competitors' products and services for Intermountain's products and services;
- technological and management changes;
- our ability to recruit and retain key management and staff;
- changes in estimates and assumptions used in financial accounting;
- the Company's critical accounting policies and the implementation of such policies;
- growth and acquisition strategies;
- lower-than-expected revenue or cost savings or other issues in connection with mergers and acquisitions;
- changes in consumer spending, saving and borrowing habits;
- the strength of the United States economy in general and the strength of the local economies in which Intermountain conducts its operations;
- our ability to attract new deposits and loans and leases;
- competitive market pricing factors;
- stability of funding sources and continued availability of borrowings;
- Intermountain's success in gaining regulatory approvals, when required;
- results of regulatory examinations that could restrict growth; and
- Intermountain's success at managing the risks involved in the foregoing.

Please take into account that forward-looking statements speak only as of the date of this report. We do not undertake any obligation to publicly correct or update any forward-looking statement whether as a result of new information, future events or otherwise.

Item 3 —Quantitative and Qualitative Disclosures About Market Risk

There have not been any material changes to the information set forth under the caption "Item 7A. Quantitative and Qualitative Disclosures about Market Risk" included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Item 4 —Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures: Intermountain's management, with the participation of Intermountain's principal executive officer and principal financial officer, has evaluated the effectiveness of Intermountain's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, Intermountain's principal executive officer and principal financial officer have concluded that, as of the end of such period, Intermountain's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by Intermountain in the reports that it files or submits under the Exchange Act.

(b) Changes in Internal Control over Financial Reporting: In the three months ended March 31, 2012, there were no changes in Intermountain's internal control over financial reporting that materially affected, or are reasonably likely to materially affect, Intermountain's internal control over financial reporting.

PART II — Other Information

Item 1. LEGAL PROCEEDINGS

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Intermountain and Panhandle are parties to various claims, legal actions and complaints in the ordinary course of business. In Intermountain's opinion, all such matters are adequately covered by insurance, are without merit or are of such kind, or involve such amounts, that unfavorable disposition would not have a material adverse effect on the consolidated financial position or results of operations of Intermountain.

Item 1A. RISK FACTORS

Our business exposes us to certain risks. The following is a discussion of what we currently believe are the most significant risks and uncertainties that may affect our business, financial condition or results of operations, or the value of our common stock.

The continued challenging economic environment could have a material adverse effect on our future results of operations or market price of our stock.

The national economy and the financial services sector in particular, are still facing significant challenges. Substantially all of our loans are to businesses and individuals in northern, southwestern and south central Idaho, eastern Washington and southwestern Oregon, markets facing many of the same challenges as the national economy, including elevated unemployment and declines in commercial and residential real estate. Although some economic indicators are improving both nationally and in the markets we serve, unemployment remains high and there remains substantial uncertainty regarding when and how strongly a sustained economic recovery will occur. A further deterioration in economic conditions in the nation as a whole or in the markets we serve could result in the following consequences, any of which could have an adverse impact, which may be material, on our business, financial condition, results of operations and prospects, and could also cause the market price of our stock to decline:

- economic conditions may worsen, increasing the likelihood of credit defaults by borrowers;
- loan collateral values, especially as they relate to commercial and residential real estate, may decline further, thereby increasing the severity of loss in the event of loan defaults;
- nonperforming assets and write-downs of assets underlying troubled credits could adversely affect our earnings;
- demand for banking products and services may decline, including services for low cost and non-interest-bearing deposits; and
- changes and volatility in interest rates may negatively impact the yields on earning assets and the cost of interest-bearing liabilities.

Our allowance for loan losses may not be adequate to cover actual loan losses, which could adversely affect our earnings.

We maintain an allowance for loan losses in an amount that we believe is adequate to provide for losses inherent in our loan portfolio. While we strive to carefully manage and monitor credit quality and to identify loans that may be deteriorating, at any time there are loans included in the portfolio that may result in losses, but that have not yet been identified as potential problem loans. Through established credit practices, we attempt to identify deteriorating loans and adjust the loan loss reserve accordingly. However, because future events are uncertain, there may be loans that deteriorate in an accelerated time frame. As a result, future additions to the allowance may be necessary. Because the loan portfolio contains a number of loans with relatively large balances, deterioration in the credit quality of one or more of these loans may require a significant increase to the allowance for loan losses. Future additions to the allowance may also be required based on changes in the financial condition of borrowers, such as have resulted due to the current economic conditions or as a result of actual events turning out differently than forecasted in the assumptions we use to determine the allowance for loan losses. With respect to real estate loans and property taken in satisfaction of such loans ("other real estate owned" or "OREO"), we can be required to recognize significant declines in the value of the underlying real estate collateral or OREO quite suddenly as new appraisals are performed in the normal course of monitoring the credit quality of the loans. There are many factors that can cause the appraised value of real estate to decline, including declines in the general real estate market, changes in methodology applied by the appraiser, and/or using a different appraiser than was used for the prior appraisal. Our ability to recover on real estate loans by selling or disposing of the underlying real estate collateral is adversely impacted by declining appraised

values, which increases the likelihood we will suffer losses on defaulted loans beyond the amounts provided for in the allowance for loan losses. This, in turn, could require material increases in our provision for loan losses.
Additionally, federal banking regulators, as an integral part of their supervisory function, periodically review our allowance for loan losses. These regulatory agencies may require us to recognize further loan loss provisions or charge-offs based upon their judgments, which may be different from ours. Any increase in the allowance for loan losses would have a negative effect, which may be material, on our financial condition and results of operations.
We have entered into an informal agreement with our regulators to take steps to further strengthen the Bank.
The Bank has entered into an informal agreement with the FDIC and the Idaho Department of Finance to take steps to further

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strengthen the Bank within specified timeframes, including, among other items, increasing capital by at least $30 million by June 16, 2010 and thereafter maintaining a minimum 10% Tier 1 Capital to Average Assets ratio, not paying dividends from the Bank to the Company without prior approval, achieving staged reductions in the Bank's adversely classified assets and not engaging in transactions that would materially alter our balance sheet composition. Management has taken numerous steps to satisfy the conditions of the agreement, including raising net proceeds of approximately $42.2 million in the recent capital raise and contributing $30 million as additional capital to the Bank. Although management has taken these steps, there can be no assurance as to when, or if, the informal agreement will be lifted.

If the proceeds from the recent private placement and the expected proceeds from the Rights Offering are not sufficient to satisfy our capital and liquidity needs or to satisfy changing regulatory requirements, we may need even more capital and could be subject to further regulatory restrictions, either of which could significantly adversely affect us and the trading price of our stock.

The proceeds from the recent private placement and the expected proceeds from the Rights Offering have been raised, or will be raised, to strengthen our common equity capital base. Despite this increase in our capital base, if the proceeds from the private placement and the expected proceeds from the Rights Offering are not sufficient, or if economic conditions continue to be difficult or worsen or fail to improve in a timely manner, or if there is further deterioration in economic conditions in the nation as a whole or in the markets we serve, particularly in the residential and commercial real estate markets, we may need to raise significant additional capital. Factors affecting whether we would need to raise additional capital include, among others, changing requirements of regulators, further decline in loan collateral values, additional provisions for loan losses and loan charge-offs, and other risks discussed in this “Risk Factors” section. If we were to need to raise additional capital, there can be no assurance that we would be able to do so in the amounts required and in a timely manner, or at all. In addition, any such additional capital raised may be significantly dilutive to our existing shareholders and may result in the issuance of securities that have rights, preferences and privileges that are senior to our Common Stock.

As a result of the transactions contemplated by the securities purchase agreements with certain investors "Purchase Agreements", Castle Creek Capital Partners IV, L.P. (“Castle Creek”) and affiliates of Stadium Capital Management LLC (“Stadium”) became substantial holders of our Common Stock.

Upon the completion of the transactions contemplated by the Purchase Agreements, Castle Creek and Stadium each became holders of a 33.3% ownership interest, and 9.9% and 14.9% voting interest, respectively, in Intermountain (after giving effect to the exercise of certain warrants issued thereby). Stadium has a representative on our board and each has the right to an observer and has a representative on the Bank's Board of Directors. Although Castle Creek and Stadium each entered into certain passivity agreements with the Federal Reserve in connection with their investments in us, Castle Creek and Stadium each have substantial influence over our corporate policy and business strategy. In pursuing their economic interests, Castle Creek and Stadium may have interests that are different from the interests of our other shareholders.

Resales of our Common Shares in the public market may cause the market price of our Common Shares to fall.

We issued a large number of shares of Common Stock and securities convertible into common stock to the Investors pursuant to the Purchase Agreements. The Investors have certain registration rights with respect to the shares of Common Stock and securities convertible into common stock held by them. The registration rights for certain Investors will allow them to sell their shares without compliance with the volume and manner of sale limitations under Rule 144 promulgated under the Securities Act. The market value of our Common Stock could decline as a result of sales by the Investors from time to time of a substantial amount of the shares of Common Stock and securities convertible into common stock held by them.

We have incurred significant losses in recent years and may incur losses again in the future.

We have incurred significant losses in recent years. While there has been continued improvement in the quality of our loan portfolio and a corresponding improvement in operating results, economic conditions remain uncertain. As such, significant additional provisions for credit losses may be necessary to supplement the allowance for loan and lease losses in the future, which could cause us to incur a net loss in the future and could adversely affect the price of, and market for, our common stock.

Concentration in real estate loans and the deterioration in the real estate markets we serve could require material increases in our allowance for loan losses and adversely affect our financial condition and results of operations.
The current economic downturn and sluggish recovery is significantly affecting our market areas. At March 31, 2012, 61.1% of our loans were secured with real estate as the primary collateral. Further deterioration or a slow recovery in the local economies we serve could have a material adverse effect on our business, financial condition and results of operations due to a weakening of our borrowers' ability to repay these loans and a decline in the value of the collateral securing them. In light of the continuing effects of the economic downturn of the past three years, real estate values have been adversely affected. As we have experienced, significant declines in real estate collateral can occur quite suddenly as new appraisals are performed in the normal course of monitoring the credit quality of the loan. Significant declines in the value of real estate collateral due to new appraisals can occur due to declines in the real estate market, changes in methodology applied by the appraiser, and/or using a different appraiser than

was used for the prior appraisal. Our ability to recover on these loans by selling or disposing of the underlying real estate collateral is adversely impacted by declining real estate values, which increases the likelihood we will suffer losses on defaulted loans secured by real estate beyond the amounts provided for in the allowance for loan losses. This, in turn, could require material increases in our allowance for loan losses and adversely affect our financial condition and results of operations, perhaps materially.

Our ability to receive dividends from our banking subsidiary accounts for most of our revenue and could affect our liquidity and ability to pay dividends.

We are a separate and distinct legal entity from our banking subsidiary, Panhandle State Bank. We receive substantially all of our revenue from dividends from our banking subsidiary. Under normal circumstances, these dividends are the principal source of funds to fund holding company expenses and pay dividends on our common and preferred stock and principal and interest on our outstanding debt. The other primary sources of liquidity for the parent Company are capital or borrowings. Various federal and/or state laws and regulations limit the amount of dividends that the Bank may pay us. For example, Idaho law limits a bank's ability to pay dividends subject to surplus reserve requirements. In addition, as noted above, we have entered into an informal agreement with our regulators prohibiting the payment of dividends from the Bank to the Company without prior approval. Also, our right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. Limitations on our ability to receive dividends from our subsidiary could have a material adverse effect on our liquidity and on our ability to pay dividends on common or preferred stock. Additionally, if our subsidiary's earnings are not sufficient to make dividend payments to us while maintaining adequate capital levels, we may not be able to make dividend payments to our common and preferred shareholders or principal and interest payments on our outstanding debt.

In this regard, we have suspended payments on our trust preferred securities and Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the “Series A Preferred Stock”). As of April, 2012, we have not paid dividends on the Series A Preferred Stock for a total of ten quarterly dividend periods, which gives the U.S. Treasury the right to appoint two directors to our board of directors until all accrued but unpaid dividends have been paid. At present, the U.S Treasury has not exercised this right. If we do not make payments on our trust preferred securities for over 20 consecutive quarters, we could be in default under those securities.

A continued tightening of credit markets and liquidity risk could adversely affect our business, financial condition and results of operations.

A continued tightening of the credit markets or any inability to obtain adequate funds for continued loan growth at an acceptable cost could negatively affect our asset growth and liquidity position and, therefore, our earnings capability. In addition to core deposit growth, maturity of investment securities and loan payments, the Bank also relies on alternative funding sources including unsecured borrowing lines with correspondent banks, borrowing lines with the Federal Home Loan Bank and the Federal Reserve Bank, public time certificates of deposits and out of area and brokered time certificates of deposit. Our ability to access these sources could be impaired by deterioration in our financial condition as well as factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations for the financial services industry or serious dislocation in the general credit markets. In the event such disruption should occur, our ability to access these sources could be negatively affected, both as to price and availability, which would limit, and/or potentially raise the cost of, the funds available to the Company.

The FDIC has increased insurance premiums and imposed special assessments to rebuild and maintain the federal deposit insurance fund, and any additional future premium increases or special assessments could have a material adverse effect on our business, financial condition and results of operations.

In 2009, the FDIC imposed a special deposit insurance assessment of five basis points on all insured institutions, and also required insured institutions to prepay estimated quarterly risk-based assessments through 2012.

The Dodd-Frank Act established 1.35% as the minimum deposit insurance fund reserve ratio. The FDIC has determined that the fund reserve ratio should be 2.0% and has adopted a plan under which it will meet the statutory minimum fund reserve ratio of 1.35% by the statutory deadline of September 30, 2020. The Dodd-Frank Act requires the FDIC to offset the effect on institutions with assets less than $10 billion of the increase in the statutory minimum fund reserve ratio to 1.35% from the former statutory minimum of 1.15%.

On February 7, 2011, the FDIC issued final rules, effective April 1, 2011, implementing changes to the assessment rules resulting from the Dodd-Frank Act. The adopted regulations: (1) modify the definition of an institution's deposit insurance assessment base; (2) alter certain adjustments to the assessment rates; (3) revise the assessment rate schedules in light of the new assessment base and altered adjustments; and (4) provide for the automatic adjustment of the assessment rates in the future when the reserve ratio reaches certain milestones.

Despite the FDIC's actions to restore the deposit insurance fund, the fund will suffer additional losses in the future due to failures of insured institutions. There may be additional significant deposit insurance premium increases, special assessments or prepayments in order to restore the insurance fund's reserve ratio. Any significant premium increases or special assessments could have a material adverse effect on the Company's financial condition and results of operations.

We may be required, in the future, to recognize impairment with respect to investment securities, including the FHLB stock we hold.

Our available-for-sale securities portfolio has grown to $264 million at March 31, 2012 or 27.5% of our assets from $219 million at December 31, 2011 or 23.4% of our assets. This increase is principally because of the investment of the proceeds of our recent stock offering. Our securities portfolio contains whole loan private mortgage-backed securities and currently includes securities with unrecognized losses. The national downturn in real estate markets and elevated mortgage delinquency and foreclosure rates have increased credit losses in the portfolio of loans underlying these securities and resulted in substantial discounts in their market values. Any further deterioration in the loans underlying these securities and resulting market discounts could lead to other-than-temporary impairment in the value of these investments. We evaluate the securities portfolio for any other-than-temporary impairment each reporting period, as required by generally accepted accounting principles, and as of March 31, 2012, two securities had been determined to be other than temporarily impaired ("OTTI"), with the cumulative impairment totaling $3.5 million. Of this $3.5 million, $1.8 million has been recognized as a credit loss through the Company's income statement since the determination of OTTI. The remaining $1.7 million has been recognized in other comprehensive income. Future evaluations of our securities portfolio may require us to recognize additional impairment charges with respect to these and other holdings. For example, it is possible that government-sponsored programs to allow mortgages to be refinanced to lower rates could materially adversely impact the yield on our portfolio of mortgage-backed securities, since a significant portion of our investment portfolio is composed of such securities.

In addition, as a condition to membership in the Federal Home Loan Bank of Seattle ("FHLB"), we are required to purchase and hold a certain amount of FHLB stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB. At March 31, 2012, we had stock in the FHLB of Seattle totaling $2.3 million. The FHLB stock held by us is carried at cost and is subject to recoverability testing under applicable accounting standards. The FHLB has discontinued the repurchase of its stock and discontinued the distribution of dividends. As of March 31, 2012, we did not recognize an impairment charge related to our FHLB stock holdings. However, future negative changes to the financial condition of the FHLB may require us to recognize an impairment charge with respect to FHLB stock.

Recent levels of market volatility were unprecedented and we cannot predict whether they will return.

The capital and credit markets have been experiencing volatility and disruption for over three years, at times reaching unprecedented levels. In some cases, the markets have produced downward pressure on stock prices and credit availability for certain companies without regard to those companies' underlying financial strength. If similar levels of market disruption and volatility return, we may experience various adverse effects, which may be material, on our ability to access capital and on our business, financial condition and results of operations.

We operate in a highly regulated environment and we cannot predict the effects of recent and pending federal legislation.

We are subject to extensive regulation, supervision and examination by federal and state banking authorities. In addition, as a publicly traded company, we are subject to regulation by the Securities and Exchange Commission. Any change in applicable regulations or federal, state or local legislation, or in policies or interpretations or regulatory approaches to compliance and enforcement, income tax laws and accounting principles, could have a substantial impact on us and our operations. Changes in laws and regulations may also increase our expenses by imposing additional fees or taxes or restrictions on our operations. Additional legislation and regulations that could significantly affect our powers, authority and operations may be enacted or adopted in the future, which could have a material adverse effect on our financial condition and results of operations. Failure to appropriately comply with any such laws, regulations or principles could result in sanctions by regulatory agencies or damage to our reputation, all of which could adversely affect our business, financial condition or results of operations.

In that regard, sweeping financial regulatory reform legislation was enacted in July 2010. Among other provisions, the legislation (i) created a new Bureau of Consumer Financial Protection with broad powers to regulate consumer financial products such as credit cards and mortgages, (ii) created a Financial Stability Oversight Council comprised of the heads of other regulatory agencies, (iii) will lead to new capital requirements from federal banking agencies, (iv) places new limits on electronic debit card interchange fees, and (v) requires the Securities and Exchange Commission and national stock exchanges to adopt significant new corporate governance and executive compensation reforms. The new legislation and regulations are expected to increase the overall costs of regulatory compliance. Further, regulators have significant discretion and authority to prevent or remedy unsafe or unsound practices or violations of laws or regulations by financial institutions and holding companies in the performance of their supervisory and enforcement duties. Recently, these powers have been utilized more frequently due to the serious national, regional and local economic conditions we are facing. The exercise of regulatory authority may have a negative impact on our financial condition and results of operations. Additionally, our business is affected significantly by the fiscal and monetary policies of the U.S. federal government and its agencies, including the Federal Reserve Board.

We cannot predict the full effects of recent legislation or the various other governmental, regulatory, monetary and fiscal initiatives which have been and may be enacted on the financial markets generally, or on the Company and on the Bank specifically. The terms and costs of these activities, or the failure of these actions to help stabilize the financial markets, asset prices, market liquidity and a continuation or worsening of current financial market and economic conditions could materially and adversely affect our business, financial condition, results of operations, and the trading price of our common stock.

Fluctuating interest rates could adversely affect our profitability.

Our profitability is dependent to a large extent upon our net interest income, which is the difference between the interest earned on loans, securities and other interest-earning assets and interest paid on deposits, borrowings, and other interest-bearing liabilities. Because of the differences in maturities and re-pricing characteristics of our interest-earning assets and interest-bearing liabilities, changes in interest rates do not produce equivalent changes in interest income earned on interest-earning assets and interest paid on interest-bearing liabilities. Accordingly, fluctuations in interest rates could adversely affect our net interest margin, and, in turn, our profitability. We manage our interest rate risk within established guidelines and generally seek an asset and liability structure that insulates net interest income from large deviations attributable to changes in market rates. However, our interest rate risk management practices may not be effective in a highly volatile rate environment.

The current unusual interest rate environment poses particular challenges. Market rates are extremely low right now and the Federal Reserve Board has indicated that it will likely maintain low short-term interest rates for the foreseeable future. This extended period of low rates, when combined with keen competition for high-quality borrowers, may cause additional downward pressure on the yield on the Company's loan and investment portfolios. Since the Company's cost of interest-bearing liabilities is already at record lows, the impact of decreasing asset yields may have a more adverse impact on the Company's net interest income.

Fluctuations in interest rates on loans could adversely affect our business.

Significant increases in market interest rates on loans, or the perception that an increase may occur, could adversely affect both our ability to originate new loans and our ability to grow. Conversely, decreases in interest rates could result in an acceleration of loan prepayments. An increase in market interest rates could also adversely affect the ability of our floating-rate borrowers to meet their higher payment obligations. If this occurred, it could cause an increase in nonperforming assets and charge offs, which could adversely affect our business, financial condition and results of operations.

We face strong competition from financial services companies and other companies that offer banking services.

The banking and financial services businesses in our market area are highly competitive and increased competition may adversely impact the level of our loans and deposits. Ultimately, we may not be able to compete successfully against current and future competitors. These competitors include national banks, foreign banks, regional banks, and other community banks. We also face competition from many other types of financial institutions, including savings and loan associations, finance companies, brokerage firms, insurance companies, credit unions, mortgage banks and other financial intermediaries. In particular, our competitors include both major financial companies whose greater resources may afford them a marketplace advantage by enabling them to maintain numerous locations and mount extensive promotional and advertising campaigns and credit unions, whose tax-advantaged status allow them to compete aggressively. Areas of competition include interest rates for loans and deposits, efforts to obtain loan and deposit customers, and a range in quality of products and services provided, including new technology-driven products and services. If we are unable to attract and retain banking customers, we may be unable to maintain or grow our loans or deposits.

We may not be able to successfully implement our internal growth strategy.

Over the long-term, we have pursued and intend to continue to pursue an internal growth strategy, the success of which will depend primarily on generating an increasing level of loans and deposits at acceptable risk levels and terms without proportionate increases in non-interest expenses. We may not be successful in implementing our internal growth strategy. Furthermore, the success of our growth strategy will depend on maintaining sufficient regulatory capital levels and on favorable economic conditions in our market areas.

Certain built-in losses could be limited since we experienced an ownership change, as defined in the Internal Revenue Code.

Certain of our assets, such as loans, may have built-in losses to the extent the basis of such assets exceeds fair market value. Section 382 of the Internal Revenue Code ("IRC") may limit the benefit of these built-in losses that exist at the time of an "ownership change." A Section 382 "ownership change" occurs if a shareholder or a group of shareholders, who are deemed to own at least 5% of our common stock, increase their ownership by more than 50 percentage points over their lowest ownership percentage within a rolling three-year period. If an “ownership change” occurs, Section 382 imposes an annual limit on the amount of recognized built-in losses we can use to reduce our taxable income equal to the product of the total value of our outstanding equity immediately prior to the “ownership change” and the federal long-term tax-exempt interest rate in effect for the month of the “ownership change.” A number of special rules apply to calculating this limit. The limitations contained in Section 382 apply for a five-year period beginning on the date of the “ownership change” and any recognized built-in losses that are limited by Section 382 may be carried forward and reduce our future taxable income for up to 20 years, after which they expire. The recent completion of our $47.3 million capital raise constituted an “ownership change”, which may cause the annual limit of Section 382 to defer our ability to use some, or all, of the built-in losses to offset taxable income. We are still calculating the potential impacts of the “ownership change”.

Unexpected losses, our inability to successfully implement our tax planning strategies in future reporting periods, or IRS Section 382 limitations resulting from the successful completion of the capital raise may either restrict our ability to release the existing valuation allowance against our deferred income tax assets or require us to increase the valuation allowance in the future.

We evaluate our deferred income tax assets for recoverability based on all available evidence. This process involves significant management judgment about assumptions that are subject to change from period to period based on changes in tax laws, our ability to successfully implement tax planning strategies, or variances between our future projected operating performance and our actual results. We are required to establish a valuation allowance for deferred income tax assets if we determine, based on available evidence at the time the determination is made, that it is more likely than not that some portion or all of the deferred income tax assets may not be realized. In determining the more-likely-than-not criterion, we evaluate all positive and negative available evidence as of the end of each reporting period. In this regard, we established a valuation allowance for deferred income tax assets of $8.8 million in 2010. Future adjustments to the deferred income tax asset valuation allowance, if any, will be determined based upon changes in the expected realization of the net deferred income tax assets. The realization of the deferred income tax assets ultimately depends on the existence of sufficient taxable income in either the carryback or carryforward periods under the tax law.

The recoverability of tax benefits resulting from net operating loss carryforwards will be limited by the sale of securities pursuant to the Purchase Agreements, because such sale caused an “ownership change”, as defined in IRC Section 382. In addition, risk based capital rules require a regulatory calculation evaluating the Company's deferred income tax asset balance for realization against estimated pre-tax future income and net operating loss carry backs. Under the rules of this calculation and due to significant estimates utilized in establishing the valuation allowance and the potential for changes in facts and circumstances, it is reasonably possible that we will be required to record adjustments to the valuation allowance in future reporting periods that would materially reduce our risk based capital ratios. Such a charge could also have a material adverse effect on our results of operations, financial condition and capital position.

As noted above, based on the composition of the investors, the completion of the $47.3 million capital raise is likely to trigger IRC Section 382 limitations on the amount of tax benefit from net operating losses and other carryforwards that the Company can claim annually. These anticipated IRC Section 382 limitations will impact the amount and timing of the recapture of the valuation allowance, the calculation of which is dependent on the level of market interest rates and the fair value of the Company's balance sheet at the time the capital raise closed.

We are subject to a variety of operational risks, including reputational risk, legal risk and compliance risk, and the risk of fraud or theft by employees or outsiders, which may adversely affect our business and results of operations.

We are exposed to many types of operational risks, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, and unauthorized transactions by employees or operational errors, including clerical or record-keeping errors or those resulting from faulty or disabled computer or telecommunications systems. If personal, non-public, confidential or proprietary information of customers in our possession were to be mishandled or misused, we could suffer significant regulatory consequences, reputational damage and financial loss. Such mishandling or misuse could include, for example, if such information were erroneously provided to parties who are not permitted to have the information, either by fault of our systems, employees, or counterparties, or where such information is intercepted or otherwise inappropriately taken by third parties.

Because the nature of the financial services business involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. Our necessary dependence upon automated systems to record and process transactions and our large transaction volume may further increase the risk that technical flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. We also may be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control (for example, computer viruses or electrical or telecommunications outages, or natural disasters, disease pandemics or other damage to property or physical assets) which may give rise to disruption of service to customers and to financial loss or liability. We are further exposed to the risk that our external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as we are) and to the risk that we (or our vendors') business continuity and data security systems prove to be inadequate. The occurrence of any of these risks could result in a diminished ability of us to operate our business (for example, by requiring us to expend significant resources to correct the defect), as well as potential liability to clients, reputational damage and regulatory intervention, which could adversely affect our business, financial condition and results of operations, perhaps materially.

Changes in accounting standards could materially impact our financial statements.

From time to time the Financial Accounting Standards Board and the SEC change the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can be very difficult to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in our restating prior period financial statements.

The market for our Common Stock historically has experienced significant price and volume fluctuations.

The market for our Common Stock historically has experienced and may continue to experience significant price and volume fluctuations similar to those experienced by the broader stock market in recent years. Generally, the fluctuations experienced by the broader stock market have affected the market prices of securities issued by many companies for reasons unrelated to their operating performance and may adversely affect the price of our Common Stock. In addition, our announcements of our quarterly operating results, changes in general conditions in the economy or the financial markets and other developments affecting us, our affiliates or our competitors could cause the market price of our Common Stock to fluctuate substantially.

We have not paid dividends on our Common Stock historically, are currently restricted from paying dividends, and may not pay any cash dividends on our common stock for the foreseeable future.

We have not paid cash dividends historically, nor do we expect to pay cash dividends in the foreseeable future. We are subject to certain restrictions on the amount of dividends we may pay without prior regulatory approval. In this regard, we have entered into an informal agreement with the Federal Reserve and the Idaho Department of Finance (“IDF”) which provides, among other things, that we may not pay cash dividends on our Common Stock without the prior written approval of the Federal Reserve and the IDF. In addition, we are currently restricted from paying dividends on our Common Stock due to the deferral of interest and dividend payments on our junior subordinated debentures and the Series A Preferred Stock issued to the U.S. Treasury.

Our profitability measures could be adversely affected if we are unable to effectively deploy the capital raised in our recent capital raise.

We expect to use the proceeds from the recent capital raise and the proposed rights offering to make capital contributions to and strengthen the balance sheet of the Bank, for other general corporate purposes and as otherwise provided for in the securities purchase agreements with investors. Investing the proceeds of the capital raise and the rights offering in securities until we are able to deploy the proceeds would provide lower margins than we generally earn on loans, potentially adversely impacting shareholder returns, by adversely affecting earnings per share, net interest margin, return on assets and return on equity, and other common performance measures.

We may pursue additional capital in the future, which could dilute the holders of our outstanding Common Stock and may adversely affect the market price of our Common Stock.

Although we have just completed a significant capital raise, in the current economic environment we believe it is prudent to consider alternatives for raising capital when opportunities to raise capital at attractive prices present themselves, in order to further strengthen our capital and better position ourselves to take advantage of opportunities that may arise in the future. Such alternatives may include issuance and sale of common stock or preferred stock, or borrowings by the Company, with proceeds contributed to the Bank. Any such capital raising alternatives could dilute the holders of our outstanding common stock and may adversely affect the market price of our common stock.

Our common stock is equity and therefore is subordinate to our indebtedness and preferred stock.

Shares of our common stock are equity interests in the Company and do not constitute indebtedness. As such, shares of our common stock will rank junior to all indebtedness and other non-equity claims on the Company with respect to assets available to satisfy claims on the Company, including in a liquidation of the Company. Additionally, holders of our common stock are subject to the prior dividend and liquidation rights of any holders of our preferred stock then outstanding.

Our Series A Preferred Stock diminishes the net income available to our common stockholders and earnings per common share.

We have issued $27.0 million of Series A Preferred Stock to the U.S. Treasury pursuant to the Troubled Asset Relief Program (“TARP”) Capital Purchase Program. The dividends accrued on the Series A Preferred Stock reduce the net income available to common stockholders and our earnings per common share. The Series A Preferred Stock is cumulative, which means that any dividends not declared or paid will accumulate and will be payable when the payment of dividends is resumed. We have deferred the payment of quarterly dividends on the Series A Preferred Stock, beginning in December 2009. Despite these deferrals, the Company fully intends to meet all of its obligations to the Treasury as quickly as it is prudent to do so. The dividend rate on the Series A Preferred Stock will increase from 5% to 9% per annum five years after its original issuance, or December 2013, if not earlier redeemed. If we are unable to redeem the Series A Preferred Stock prior to the date of this increase, the cost of capital to us will increase substantially. Depending on our financial condition at the time, this increase in the Series A Preferred Stock annual dividend rate could have a material adverse effect on our earnings available to common shareholders and could also adversely affect our ability to pay dividends on our common shares. Shares of Series A Preferred Stock will also receive preferential treatment in the event of the liquidation, dissolution or winding up of the Company.

Finally, the terms of the Series A Preferred Stock allow the U.S. Treasury to impose additional restrictions, including those on dividends and including unilateral amendments required to comply with changes in applicable federal law. Under the terms of the Series A Preferred Stock, our ability to declare or pay dividends on any of our shares is limited. Specifically, we are unable to declare dividend payments on common, junior preferred or pari passu preferred shares if we are in arrears on the dividends on the Series A Preferred Stock. As noted above, we have deferred the payment of dividend payments on the Series A Preferred Stock and we are therefore currently restricted from paying dividends on our common stock. Further, we are not permitted to increase dividends on our common stock above the amount of the last quarterly cash dividend per share declared prior to October 14, 2008 (which was zero) without the U.S. Treasury's approval until the third anniversary of the investment unless all of the Fixed Rate Cumulative Perpetual Preferred Stock has been redeemed or transferred.

Holders of the Series A Preferred Stock and Series B Preferred Stock (together the "Preferred Stock") have certain voting rights that may adversely affect our common shareholders, and the holders of the Preferred Stock may have interests different from our common shareholders.

In the event that we do not pay dividends on the Series A Preferred Stock for a total of at least six quarterly dividend periods (whether or not consecutive), as is currently the case, the authorized number of directors of the Corporation shall automatically be increased by two and the U.S. Treasury will have the right to appoint two directors to fill such positions on our board of directors until all accrued but unpaid dividends have been paid. At present, the U.S Treasury has not exercised this right. As noted above, we intend to pay the deferred dividends as quickly as it is prudent to do so upon receipt of regulatory approval and resume regular dividend payments. Otherwise, except as required by law, holders of the Preferred Stock have limited voting rights. So long as shares of Preferred Stock are outstanding, in addition to any other vote or consent of shareholders required by law or our Articles of Incorporation, the vote or consent of holders of at least 66 2/3% of the shares of Series A Preferred Stock, and 80% of the shares of Series B Preferred Stock, respectively outstanding is required for:

- any authorization or issuance of shares ranking senior to the respective series of preferred stock;
- any amendments to the rights of the respective series of preferred stock so as to adversely effect the rights, preferences, privileges or voting power of the respective series of preferred stock; or
- consummation of any merger, share exchange or similar transaction unless the shares of the respective series of preferred stock remain outstanding, or if we are not the surviving entity in such transaction, are converted into or exchanged for preference securities of the surviving entity and the shares of the respective series of preferred stock remaining outstanding or such preference securities have the rights, preferences, privileges and voting power of the respective series of preferred stock.

The holders of the preferred stock, including the U.S. Treasury, may have different interests from the holders of our common stock, and could vote to block the foregoing transactions, even when considered desirable by, or in the best interests of, the holders of our common stock.

Certain provisions in our Articles of Incorporation could make a third party acquisition of us difficult.

Our Articles of Incorporation contain provisions that could make it more difficult for a third party to acquire us by means of a tender offer, a proxy contest, merger or otherwise (even if doing so would be beneficial to our shareholders) and for holders of our common stock to receive any related takeover premium for their common stock. These provisions may have the effect of lengthening the time required for a person to acquire control of us through a tender offer, a proxy contest, merger or otherwise, and may deter any potentially hostile offers or other efforts to obtain control of us. These provisions could also limit the price that investors might be willing to pay in the future for shares of our common stock.

Because of our participation in TARP, we are subject to restrictions on compensation paid to our executives.

Pursuant to the terms of the TARP Capital Purchase Program, we are subject to regulations on compensation and corporate governance for the period during which the U.S. Treasury holds our Series A Preferred Stock. These regulations require us to adopt and follow certain procedures and to restrict the compensation we can pay to key employees. Key impacts of the regulations on us include, among other things:

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ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of Intermountain;

- a prohibition on cash incentive bonuses to our five most highly-compensated employees, subject to limited exceptions;
- a prohibition on equity compensation awards to our five most highly-compensated employees other than long-term restricted stock that cannot be sold, other than to pay related taxes, except to the extent the Treasury no longer holds the Series A Preferred Stock;
- a prohibition on any severance or change-in-control payments to our senior executive officers and next five most highly-compensated employees;
- a required recovery or "clawback" of any bonus or incentive compensation paid to a senior executive officer or

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any of the next twenty most highly compensated employees based on financial or other performance criteria that are later proven to be materially inaccurate; and

- an agreement not to deduct for tax purposes annual compensation in excess of $500,000 for each senior executive officer.

The combined effect of these restrictions may make it more difficult to attract and retain key executives and employees, and the change to the deductibility limit on executive compensation may increase the overall cost of our compensation programs in future.

Item 2 —Unregistered Sales of Equity Securities and Use of Proceeds
Not applicable.

Item 3 —Defaults Upon Senior Securities
Not applicable.

Item 4 —Mine Safety Disclosures

Not applicable.

Item 5 — Other Information
Not applicable.

Item 6 —Exhibits

Exhibit No.	Exhibit
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes Oxley Act of 2002.
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002.
101*	The following financial information from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 is formatted in XBRL: (i) the Unaudited Consolidated Balance Sheets, (ii) the Unaudited Consolidated Statements of Operations, (iii) the Unaudited Consolidated Statements of Changes in Cash Flows, (iv) the Unaudited Consolidated Statements of Comprehensive Income (Loss),and (v) the Notes to Unaudited Consolidated Financial Statements, tagged as blocks of text.
*	Furnished herewith

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Signatures

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

	INTERMOUNTAIN COMMUNITY BANCORP (Registrant)
May 14, 2012 Date	By: /s/ Curt Hecker Curt Hecker President and Chief Executive Officer
May 14, 2012 Date	By: /s/ Doug Wright Doug Wright Executive Vice President and Chief Financial Officer

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