

FIRST INTERSTATE BANCSYSTEM INC

Form 10-K

March 23, 2009

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington D.C. 20549  
FORM 10-K**

(Mark One)

☒ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the fiscal year ended December 31, 2008, or**

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_.**

**Commission File Number: 000-49733  
FIRST INTERSTATE BANCSYSTEM, INC.  
(Exact name of registrant as specified in its charter)**

**Montana**  
(State or other jurisdiction of incorporation or  
organization)

**81-0331430**  
(IRS Employer Identification No.)

**401 North 31st Street  
Billings, Montana**  
(Address of principal executive offices)

**59116**  
(Zip Code)

**(406) 255-5390**

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common stock without par value per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

☐ Yes ☒ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ☐ Yes ☒ No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐ Yes ☒ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

☐ Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company  
(Do not check if a smaller reporting company)

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

The registrant's common stock is not publicly traded, and there is no established trading market for its stock.

Therefore, the aggregate market value of voting and non-voting common equity held by non-affiliates, computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter, was \$0.

The number of shares outstanding of the registrant's common stock as of February 28, 2009 was 7,881,259.

**Documents Incorporated by Reference**

The registrant intends to file a definitive Proxy Statement for the Annual Meeting of Shareholders scheduled to be held May 8, 2009. The information required by Part III of this Form 10-K is incorporated by reference from such Proxy Statement.

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**PART I**

**Item 1. Business**

*The disclosures set forth in this report are qualified by Item 1A. Risk Factors included herein and the section captioned Cautionary Note Regarding Forward-Looking Statements and Factors that Could Affect Future Results included in Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.*

**Our Company**

We are a financial and bank holding company incorporated in 1971 and headquartered in Billings, Montana. As of February 28, 2009, we had consolidated assets of \$6.6 billion, deposits of \$5.3 billion and total stockholders' equity of \$544 million. Our wholly-owned bank subsidiaries, First Interstate Bank, First Western Bank and The First Western Bank Sturgis, have 70 banking offices in 42 Montana, Wyoming and South Dakota communities. Through these banks, we deliver a comprehensive range of banking products and services, including demand and savings deposits; commercial, consumer, agricultural and real estate loans; mortgage loan servicing; and, trust, employee benefit, investment and insurance services. We serve individuals, businesses, municipalities and other entities throughout our market areas.

We derive our income principally from interest charged on loans, and to a lesser extent, from interest and dividends earned on investments. We also derive income from non-interest sources such as fees received in connection with various banking and financial related services. Our principal expenses include interest expense on deposits and borrowings, operating expenses, provisions for loan losses and income tax expense. We serve a wide variety of industries, including agriculture, energy, mining, timber processing, tourism, government services, education, retail, and professional and medical services.

We are the licensee under a perpetual trademark license agreement granting us an exclusive, nontransferable license to use the First Interstate name and logo in Montana, Wyoming and surrounding states. References to we, our, and us in this report, mean First Interstate BancSystem, Inc. and our consolidated subsidiaries, unless the context indicates that we refer only to the parent company, First Interstate BancSystem, Inc. When we refer to Banks in this report, we mean First Interstate Bank, First Western Bank and The First Western Bank Sturgis, our bank subsidiaries. When we refer to South Dakota Banks in this report, we mean First Western Bank and The First Western Bank Sturgis.

**Strategic Vision and Operating Objectives**

Our strategic vision is to maintain and enhance our leadership in the financial and social fabrics of the communities we serve through a commitment to customer satisfaction, innovative management, employee development and community involvement. Our operating objectives include maintaining prudent internal growth and expanding into new and complementary markets when appropriate opportunities arise. In January 2008, we expanded our market into western South Dakota through the acquisition of the First Western banks. Details of the acquisition are presented in

Notes to Consolidated Financial Statements Acquisitions included in Part IV, Item 15 of this report. Prior to 2008, our profitability, market share and asset size had been enhanced principally through organic loan and deposit growth in the market areas served by our then existing banking offices.

**Disposal of Nonbank Subsidiary**

On December 31, 2008, we completed the sale of our data technology subsidiary, i\_Tech Corporation, or i\_Tech, to Fiserv Solutions Inc., or Fiserv. i\_Tech represented our technology services operating segment. Through i\_Tech, we provided data technology support services to affiliated and non-affiliated customers in Montana, Wyoming, South Dakota and nine additional states. As of the date of the sale, i\_Tech had net assets of \$9.4 million and net income for 2008 of \$2.9 million. Our decision to sell i\_Tech was strategic. We are now a customer rather than a competitor of Fiserv and can focus more fully on our principal strength, community banking. For additional information regarding the sale of i\_Tech, see Notes to Consolidated Financial Statements Disposals included in Part IV, Item 15.

**Operating Segments**

Due to the sale of our technology services operating segment on December 31, 2008 as discussed above, we have one reportable operating segment, community banking. Financial information and analysis of our community banking operating segment, as well as our disposed technology services operating segment, are included in Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Operating Segment

Results included in Part II, Item 7 of this report and in Notes to Consolidated Financial Statements Segment  
Reporting included in Part IV, Item 15.

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**Community Banking**

Community banking encompasses commercial and consumer banking services provided through our Banks, primarily the acceptance of deposits; extensions of credit; mortgage loan origination and servicing; and, trust, employee benefit, investment and insurance services. We believe the communities we serve provide a stable core deposit and funding base, and are economically diversified across a number of industries, including agriculture, energy, mining, timber processing, tourism, government services, education, retail, and professional and medical services. Our community banking philosophy emphasizes providing customers with commercial and consumer banking products and services locally using a personalized service approach while strengthening the communities in our market areas through community service activities. We grant our banking offices significant autonomy in delivering and pricing products in response to local market considerations and customer needs. This autonomy enables our banking offices to remain competitive and enhances their relationships with the customers they serve. We also emphasize accountability, however, by establishing performance and incentive standards that are tied to net income and other success measures at the individual banking office and market levels. We believe this combination of autonomy and accountability allows our banking offices to provide personalized customer service while remaining attentive to financial performance.

**Lending Activities**

We offer short and long-term real estate, consumer, commercial, agricultural and other loans to individuals and businesses in our market areas. We have comprehensive credit policies establishing company-wide underwriting and documentation standards to assist management in the lending process and to limit our risk. These credit policies establish lending guidelines based on the experience and authority levels of the personnel located in each banking office and market. The policies also establish thresholds at which loan requests must be recommended by our credit committee and/or approved by the Banks' boards of directors. While each loan must meet minimum underwriting standards established in our credit policies, lending officers are granted certain levels of autonomy in approving and pricing loans to assure that the banking offices are responsive to competitive issues and community needs in each market area.

**Deposit Products**

We offer traditional depository products including checking, savings and time deposits. Deposits at the Banks are insured by the Federal Deposit Insurance Corporation, or FDIC, up to statutory limits. We also offer repurchase agreements primarily to commercial and municipal depositors. Under repurchase agreements, we sell investment securities held by the Banks to our customers under an agreement to repurchase the investment securities at a specified time or on demand. The Banks do not, however, physically transfer the investment securities. All outstanding repurchase agreements are due in one business day.

**Wealth Management**

We provide a wide range of trust, employee benefit, investment management, insurance, agency and custodial services to individuals, businesses and nonprofit organizations. These services include the administration of estates and personal trusts; management of investment accounts for individuals, employee benefit plans and charitable foundations; and, insurance planning. As of February 28, 2009, the estimated fair value of trust assets held in a fiduciary or agent capacity was in excess of \$2.0 billion.

**Centralized Services**

We have centralized certain operational activities to provide consistent service levels to our customers company-wide, to gain efficiency in management of those activities and to ensure regulatory compliance. Centralized operational activities generally support our banking offices in the delivery of products and services to customers and include marketing; credit review; credit cards; mortgage loan sales and servicing; indirect consumer loan purchasing and processing; loan collections; and, other operational activities. Additionally, policy and management direction and specialized staff support services have been centralized to enable the Banks to serve their markets more effectively. These services include credit administration, finance, accounting, human resource management, internal audit and other support services.

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**Competition**

Commercial banking is highly competitive. We compete with other financial institutions located in Montana, Wyoming, South Dakota and adjoining states for deposits, loans and trust, employee benefit, investment and insurance accounts. We also compete with savings and loan associations, savings banks and credit unions for deposits and loans. In addition, we compete with large banks in major financial centers and other financial intermediaries, such as consumer finance companies, brokerage firms, mortgage banking companies, insurance companies, securities firms, mutual funds and certain government agencies as well as major retailers, all actively engaged in providing various types of loans and other financial services. We generally compete on the basis of customer service and responsiveness to customer needs, available loan and deposit products, rates of interest charged on loans, rates of interest paid for deposits and the availability and pricing of trust, employee benefit, investment and insurance services.

**Employees**

At February 28, 2008, we employed 1,771 full-time equivalent employees, none of whom are represented by a collective bargaining agreement. We strive to be the employer of choice in the markets we serve and consider our employee relations to be good.

**Regulation and Supervision**

**Regulatory Authorities**

We are subject to extensive regulation under federal and state laws. A description of the significant elements of the laws and regulations applicable to us is summarized below. This summary is not intended to include a summary of all laws applicable to us, and the description is qualified in its entirety by reference to the full text of the applicable statutes, regulations and policies. In addition to laws and regulations, state and federal banking regulatory agencies may issue policy statements, interpretive letters and similar written guidance applicable to us. Those issuances may affect the conduct of our business or impose additional regulatory obligations.

As a financial and bank holding company, we are subject to regulation under the Bank Holding Company Act of 1956 and to supervision, regulation and regular examination by the Federal Reserve. Because we are a public company, we are also subject to the disclosure and regulatory requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934 as administered by the Securities and Exchange Commission, or SEC.

First Interstate Bank is subject to supervision and regular examination by its primary banking regulators, the Federal Reserve and the State of Montana, Department of Administration, Division of Banking and Financial Institutions, and, with respect to its activities in Wyoming, the State of Wyoming, Department of Audit. The South Dakota Banks are subject to supervision and regular examination by their primary banking regulators, the Federal Reserve and the State of South Dakota, Department of Revenue & Regulation, Division of Banking. Each of the South Dakota Banks became members of the Federal Reserve System in February 2008. Prior to becoming members, the South Dakota Banks' primary federal regulator was the FDIC and the State of South Dakota.

Each of the Banks' deposits are insured by the deposit insurance fund of the FDIC in the manner and to the extent provided by law. The Banks are subject to the Federal Deposit Insurance Act, or FDIA, and FDIC regulations relating to deposit insurance and may also be subject to supervision and examination by the FDIC.

The extensive regulation of the Banks limits both the activities in which the Banks may engage and the conduct of their permitted activities. Further, the laws and regulations impose reporting and information collection obligations on the Banks. The Banks each incur significant costs relating to compliance with the various laws and regulations and the collection and retention of information.

**Financial Holding Company**

As a matter of policy, the Federal Reserve expects a bank holding company to act as a source of financial and managerial strength to its subsidiary banks and to commit resources to support its subsidiary banks. Under this source of strength doctrine, the Federal Reserve may require a bank holding company to make capital injections into a troubled subsidiary bank. The Federal Reserve may also claim that the bank holding company is engaging in unsafe and unsound practices if it fails to commit resources to such a subsidiary bank. A capital injection may be required at times when the bank holding company does not have the resources to provide it.



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We are required by the Bank Holding Company Act to obtain Federal Reserve approval prior to acquiring, directly or indirectly, ownership or control of voting shares of any bank, if, after such acquisition, we would own or control more than 5% of its voting stock.

Under the Gramm-Leach-Bliley Act of 1999, or GLB Act, we may engage in certain business activities that are determined by the Federal Reserve to be financial in nature or incidental to financial activities as well as all activities authorized to bank holding companies generally. In most circumstances, we must notify the Federal Reserve of our financial activities within a specified time period following our initial engagement in each business or activity. If the type of proposed business or activity has not been previously determined by the Federal Reserve to be financially related or incidental to financial activities, we must receive the prior approval of the Federal Reserve before engaging in the activity.

We may engage in authorized financial activities, such as providing investment services, provided that we remain a financial holding company and meet certain regulatory standards of being well-capitalized and well-managed. If we fail to meet the well-capitalized or well-managed regulatory standards, we may be required to cease our financial holding company activities or, in certain circumstances, to divest of the Banks. We do not currently engage in significant financial holding company businesses or activities not otherwise permitted to bank holding companies generally. Should we engage in certain financial activities currently authorized to financial holding companies, we may become subject to additional laws, regulations, supervision and examination by regulatory agencies.

### **Restrictions on Transfers of Funds to Us and the Banks**

Dividends from the Banks are the primary source of funds for the payment of our expenses of operating and for the payment of dividends to and the repurchase of shares from our shareholders. The Banks are limited, under both state and federal law, in the amount of dividends that may be paid from time to time. In general, the Banks are limited, without the prior consent of their primary state and federal banking regulators, to paying dividends that do not exceed the current year net profits together with retained earnings from the two preceding calendar years. In addition, the South Dakota Banks are limited under South Dakota law to declaring dividends not more frequently than once each calendar quarter.

A state or federal banking regulator may impose, by regulatory order or agreement of a Bank, specific dividend limitations or prohibitions in certain circumstances. The Banks are not currently subject to a specific regulatory dividend limitation other than generally applicable limitations. In addition to regulatory dividend limitations, First Interstate Bank dividends are limited by covenants in our debt instruments.

In addition, the Banks may not lend funds to, or otherwise extend credit to or for our benefit or the benefit of our affiliates, except on specified types and amounts of collateral and other terms required by state and federal law. The Federal Reserve also has authority to define and limit the transactions between banks and their affiliates. Federal Reserve Regulation W and relevant federal statutes, among other things, impose significant additional limitations on transactions in which the Banks may engage with us, with each other, or with other affiliates.

### **Capital Standards and Prompt Corrective Action**

Banks and bank holding companies are subject to various regulatory capital requirements administered by state and federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting and other factors.

The Federal Reserve Board and the FDIC have substantially similar risk-based capital ratio and leverage ratio guidelines for banking organizations. The guidelines are intended to ensure that banking organizations have adequate capital given the risk levels of assets and off-balance sheet financial instruments. Under the guidelines, banking organizations are required to maintain minimum ratios for tier 1 capital and total capital to risk-weighted assets (including certain off-balance sheet items, such as letters of credit). For purposes of calculating the ratios, a banking organization's assets and some of its specified off-balance sheet commitments and obligations are assigned to various risk categories. Generally, under the applicable guidelines, a financial institution's capital is divided into two tiers. These tiers are:

*Core Capital (tier 1).* Tier 1 capital includes common equity, noncumulative perpetual preferred stock (excluding auction rate issues), and minority interests in equity accounts of consolidated subsidiaries, less both goodwill and, with certain limited exceptions, all other intangible assets. Bank holding companies, however, may include up to a limit of 25% of cumulative preferred stock in their tier 1 capital.

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*Supplementary Capital (tier 2).* Tier 2 capital includes, among other things, cumulative and limited-life preferred stock, hybrid capital instruments, mandatory convertible securities, qualifying subordinated debt, and the allowance for loan and lease losses, subject to certain limitations.

Institutions that must incorporate market risk exposure into their risk-based capital requirements may also have a third tier of capital in the form of restricted short-term subordinated debt.

We, like other bank holding companies, currently are required to maintain tier 1 capital and total capital (the sum of tier 1 and tier 2 capital) equal to at least 4.0% and 8.0%, respectively, of our total risk-weighted assets. The Banks, like other depository institutions, are required to maintain similar capital levels under capital adequacy guidelines. For a depository institution to be considered well capitalized under the regulatory framework for prompt corrective action its tier 1 and total capital ratios must be at least 6.0% and 10.0% on a risk-adjusted basis, respectively.

Bank holding companies and banks are also required to comply with minimum leverage ratio requirements. The leverage ratio is the ratio of a banking organization's tier 1 capital to its total adjusted quarterly average assets (as defined for regulatory purposes). The requirements necessitate a minimum leverage ratio of 3.0% for financial holding companies and banks that either have the highest supervisory rating or have implemented the appropriate federal regulatory authority's risk-adjusted measure for market risk. All other financial holding companies and banks are required to maintain a minimum leverage ratio of 4.0%, unless a different minimum is specified by an appropriate regulatory authority. For a depository institution to be considered well capitalized under the regulatory framework for prompt corrective action, its leverage ratio must be at least 5.0%. The Federal Reserve Board has not advised us of any specific minimum leverage ratio applicable to us or the Banks.

The FDIA requires, among other things, the federal banking agencies to take prompt corrective action in respect of depository institutions that do not meet minimum capital requirements. The FDIA sets forth the following five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. A depository institution's capital tier will depend upon how its capital levels compare with various relevant capital measures and certain other factors, as established by regulation. The relevant capital measures are the total capital ratio, the tier 1 capital ratio and the leverage ratio.

Under the regulations adopted by the federal regulatory authorities, a bank will be: (i) well capitalized if the institution has a total risk-based capital ratio of 10.0% or greater, a tier 1 risk-based capital ratio of 6.0% or greater, and a leverage ratio of 5.0% or greater, and is not subject to any order or written directive by any such regulatory authority to meet and maintain a specific capital level for any capital measure; (ii) adequately capitalized if the institution has a total risk-based capital ratio of 8.0% or greater, a tier 1 risk-based capital ratio of 4.0% or greater, and a leverage ratio of 4.0% or greater (3.0% in certain circumstances) and is not well capitalized; (iii) undercapitalized if the institution has a total risk-based capital ratio that is less than 8.0%, a tier 1 risk-based capital ratio of less than 4.0% or a leverage ratio of less than 4.0% (3.0% in certain circumstances); (iv) significantly undercapitalized if the institution has a total risk-based capital ratio of less than 6.0%, a tier 1 risk-based capital ratio of less than 3.0% or a leverage ratio of less than 3.0%; and (v) critically undercapitalized if the institution's tangible equity is equal to or less than 2.0% of average quarterly tangible assets. An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. Our regulatory capital ratios and those of the Banks are in excess of the levels established for well-capitalized institutions. A bank's capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects for other purposes.

The FDIA generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be undercapitalized. Undercapitalized institutions are subject to growth limitations and are required to submit a capital restoration plan. The agencies may not accept such a plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution's capital. In addition, for a capital restoration plan to be acceptable, the depository institution's parent holding company must guarantee that the institution will comply with such capital restoration plan. The aggregate liability of the parent holding company is limited to the lesser of (i) an amount equal to 5.0% of the depository institution's total assets at the time it became

undercapitalized and (ii) the amount which is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time it fails to comply with the plan. If a depository institution fails to submit an acceptable plan, it is treated as if it is significantly undercapitalized.

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Significantly undercapitalized depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. Critically undercapitalized institutions are subject to the appointment of a receiver or conservator.

### **Safety and Soundness Standards and Other Enforcement Mechanisms**

The federal banking agencies have adopted guidelines establishing standards for safety and soundness, asset quality and earnings, as required by the Federal Deposit Insurance Corporation Improvement Act, or FDICIA. These standards are designed to identify potential concerns and ensure that action is taken to address those concerns before they pose a risk to the deposit insurance fund, or DIF. If a federal banking agency determines that an institution fails to meet any of these standards, the agency may require the institution to submit an acceptable plan to achieve compliance with the standard. If the institution fails to submit an acceptable plan within the time allowed by the agency or fails in any material respect to implement an accepted plan, the agency must, by order, require the institution to correct the deficiency.

Federal banking agencies possess broad enforcement powers to take corrective and other supervisory action on an insured bank and its holding company. Moreover, federal laws require each federal banking agency to take prompt corrective action to resolve the problems of insured banks. Bank holding companies and insured banks are subject to a wide range of potential enforcement actions by federal regulators for violation of any law, rule, regulation, standard, condition imposed in writing by the regulator, or term of a written agreement with the regulator.

### **Emergency Economic Stabilization Act of 2008**

In response to the financial crisis affecting the banking system and financial markets, the Emergency Economic Stabilization Act of 2008, or EESA, was enacted on October 3, 2008. The EESA authorizes the U.S. Treasury, or Treasury, to provide up to \$700 billion in funding to stabilize and provide liquidity to the financial markets. Pursuant to the EESA, the Treasury was initially authorized to use \$350 billion for the Troubled Asset Relief Program, or TARP. Of this amount, the Treasury allocated \$250 billion to the TARP Capital Purchase Program described below. On January 15, 2009, the second \$350 billion of TARP monies was released to the Treasury. On February 17, 2009, the American Recovery and Reinvestment Act of 2009 was enacted which amended, in certain respects, the EESA and provided an additional \$787 billion in economic stimulus funding.

Under the TARP Capital Purchase Program the Treasury will invest up to \$250 billion in senior preferred stock of U.S. banks and savings associations or their holding companies. Qualifying financial institutions may issue senior preferred stock with a value equal to not less than 1% of risk-weighted assets and not more than the lesser of \$25 billion or 3% of risk-weighted assets. In conjunction with the issuance of the senior preferred stock, participating institutions must issue to the Treasury immediately exercisable 10-year warrants to purchase common stock with an aggregate market price equal to 5% of the amount of senior preferred stock. Participating financial institutions are required to adopt the Treasury's standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under the TARP Capital Purchase Program.

We submitted an application for participation in the TARP Capital Purchase Program. In connection with the application, we requested certain exceptions to the Treasury's standard terms and conditions applicable to the program. As of the date of this report, we have not been notified whether our application has been accepted nor have we determined whether we will participate in the program if we are accepted.

### **Deposit Insurance**

The FDIC is an independent federal agency that insures deposits, up to prescribed statutory limits, of federally insured banks and savings institutions and safeguards the safety and soundness of the banking and savings industries. The FDIC insures our customer deposits through the DIF up to prescribed limits for each depositor. Pursuant to the EESA, the maximum deposit insurance amount has been increased from \$100,000 to \$250,000 until December 31, 2009. The amount of FDIC assessments paid by each DIF member institution is based on its relative risk of default as measured by regulatory capital ratios and other supervisory factors. Pursuant to the Federal Deposit Insurance Reform Act of 2005, the FDIC is authorized to set the reserve ratio for the DIF annually at between 1.15% and 1.50% of estimated insured deposits. The FDIC may increase or decrease the assessment rate schedule on a semi-annual basis. In an effort to restore capitalization levels and to ensure the DIF will adequately cover projected losses from future

bank failures, the FDIC, in October 2008, proposed a rule to alter the way in which it differentiates for risk in the risk-based assessment system and to revise deposit insurance assessment rates, including base assessment rates. First quarter 2009 assessment rates were increased to between 12 and 50 cents for every \$100 of domestic deposits, with most banks paying between 12 and 14 cents. On February 27, 2009, the FDIC approved an increase in regular premium rates for the second quarter of 2009. For most banks, the second quarter 2009 assessment rate will be between 12 and 16 cents per \$100 in domestic deposits. Premiums for the rest of 2009 have not yet been set.

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On February 27, 2009, the FDIC approved an interim rule proposing a special assessment of 20 cents per \$100 in domestic deposits to restore the DIF reserves depleted by recent bank failures. The interim rule also proposes to permit the FDIC to impose an additional special assessment after June 30, 2009 of up to 10 basis points if necessary to maintain public confidence in federal deposit insurance. Recent action by the FDIC indicates there may be reductions or other modifications to the special assessment proposed by the interim rule.

If the DIF's reserves exceed the designated reserve ratio, the FDIC is required to pay out all or, if the reserve ratio is less than 1.5%, a portion of the excess as a dividend to insured depository institutions based on the percentage of insured deposits held on December 31, 1996 adjusted for subsequently paid premiums. Insured depository institutions that were in existence on December 31, 1996 and paid assessments prior to that date (or their successors) were entitled to a one-time credit against future assessments based on their past contributions to the predecessor to the DIF. The Banks each utilized their special assessment credits to offset a portion of their deposit insurance premiums through the second quarter of 2008.

On November 21, 2008, the FDIC adopted a final rule relating to the Temporary Liquidity Guarantee Program, or TLG Program. Under the TLG Program, the FDIC will (i) guarantee, through the earlier of maturity or June 30, 2012, certain newly issued senior unsecured debt issued by participating institutions on or after October 14, 2008 and before June 30, 2009, and (ii) provide full FDIC deposit insurance coverage for non-interest bearing transaction deposit accounts, Negotiable Order of Withdrawal, or NOW, accounts paying less than 0.5% interest per annum and Interest on Lawyers Trust Accounts, or IOLTA, held at participating FDIC-insured institutions through December 31, 2009. On March 17, 2009, the FDIC extended the debt guarantee program through October 31, 2009. Each of the Banks elected to participate in the deposit insurance coverage guarantee program. The Banks have not elected to participate in the unsecured debt guarantee program because more cost-effective liquidity sources are available to us. Coverage under the TLG Program was available for the first 30 days without charge. The fee assessment for deposit insurance coverage is 10 basis points per annum on amounts in covered accounts exceeding \$250,000.

All FDIC-insured institutions are required to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation, or FICO, an agency of the Federal government established to recapitalize the predecessor to the DIF. The FICO assessment rates, which are determined quarterly, averaged 0.01% of insured deposits in fiscal 2008. These assessments will continue until the FICO bonds mature in 2017.

### **Depositor Preference**

The FDIA provides that, in the event of the liquidation or other resolution of an insured depository institution, the claims of depositors of the institution, including the claims of the FDIC as subrogee of insured depositors, and certain claims for administrative expenses of the FDIC as a receiver, will have priority over other general unsecured claims against the institution. If an insured depository institution fails, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, non-deposit creditors, including the parent bank holding company, with respect to any extensions of credit they have made to such insured depository institution.

### **Liability of Commonly Controlled Institutions**

FDIC-insured depository institutions can be held liable for any loss incurred, or reasonably expected to be incurred, by the FDIC due to the default of an FDIC-insured depository institution controlled by the same bank holding company, or for any assistance provided by the FDIC to an FDIC-insured depository institution controlled by the same bank holding company that is in danger of default. Default means generally the appointment of a conservator or receiver. In danger of default means generally the existence of certain conditions indicating that default is likely to occur in the absence of regulatory assistance.

### **Customer Privacy and Other Consumer Protections**

The GLB Act imposes customer privacy requirements on any company engaged in financial activities, including the Banks and our holding company. Under these requirements, a financial company is required to protect the security and confidentiality of customer nonpublic personal information. In addition, for customers who obtain a financial product such as a loan for personal, family or household purposes, a financial holding company is required to disclose its privacy policy to the customer at the time the relationship is established and annually thereafter. The financial company must also disclose its policies concerning the sharing of the customer's nonpublic personal information with

affiliates and third parties. Finally, a financial company is prohibited from disclosing an account number or similar item to a third party for use in telemarketing, direct mail marketing or marketing through electronic mail.

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The Banks are subject to a variety of federal and state laws and reporting obligations aimed at protecting consumers including the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, the Equal Credit Opportunity Act, the Truth in Lending Act, the Fair Credit Reporting Act and the Community Reinvestment Act, or CRA. The CRA generally requires the federal banking agencies to evaluate the record of a financial institution in meeting the credit needs of its local communities, including low and moderate income neighborhoods. In addition to substantial penalties and corrective measures that may be required for a violation of fair lending laws, the federal banking agencies may take compliance with such laws and CRA into account when regulating and supervising our other activities or in authorizing expansion activities.

In connection with its assessment of CRA performance, the appropriate bank regulatory agency assigns a rating of outstanding, satisfactory, needs to improve or substantial noncompliance. First Interstate Bank received an outstanding rating and the South Dakota Banks each received a satisfactory rating on their most recent published examinations. Although each Banks' policies and procedures are designed to achieve compliance with all fair lending and CRA laws, instances of non-compliance are occasionally identified through normal operational activities. Management responds proactively to correct all instances of non-compliance and implement procedures to prevent further violations from occurring.

### **USA Patriot Act**

The USA Patriot Act of 2001 amended the Bank Secrecy Act and adopted additional measures requiring insured depository institutions, broker-dealers, and certain other financial institutions to have policies, procedures and controls to detect, prevent and report money laundering and terrorist financing. These acts and their regulations also provide for information sharing, subject to conditions, between federal law enforcement agencies and financial institutions, as well as among financial institutions, for counter-terrorism purposes. Federal banking regulators are required, when reviewing bank holding company acquisition or merger applications, to take into account the effectiveness of the anti-money laundering activities of the applicants. The USA Patriot Improvement and Reauthorization Act of 2005, among other things, made permanent or otherwise generally extended the effectiveness of provisions applicable to financial institutions.

### **Effect of Economic Conditions, Government Policies and Legislation**

Banking depends on interest rate differentials. In general, the difference between the interest rate paid by each Bank on deposits and borrowings and the interest rate received by the Bank on loans extended to customers and on investment securities comprises a major portion of the Bank's earnings. These rates are highly sensitive to many factors that are beyond the control of the Banks. Accordingly, the earnings and potential growth of the Banks are subject to the influence of domestic and foreign economic conditions, including inflation, recession and unemployment.

The commercial banking business is not only affected by general economic conditions but is also influenced by the monetary and fiscal policies of the federal government and the policies of regulatory agencies, particularly the Federal Reserve. The Federal Reserve implements national monetary policies (with objectives such as curbing inflation and combating recession) by its open-market operations in United States government securities, by adjusting the required level of reserves for financial institutions subject to the Federal Reserve's reserve requirements and by varying the discount rates applicable to borrowings by depository institutions. The actions of the Federal Reserve in these areas influence the growth of bank loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. The nature and impact of any future changes in monetary policies cannot be predicted.

From time to time, legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of financial and bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. Such legislation could change banking statutes and our operating environment in substantial and unpredictable ways. If enacted, such legislations could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks and other financial services providers. We cannot predict whether such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations, would have on our financial condition, results of operations or cash flows.

### **Unconsolidated Subsidiaries**

Our unconsolidated subsidiaries include First Interstate Statutory Trust or FIST; FI Statutory Trust I, or Trust I; FI Capital Trust II, or Trust II; FI Statutory Trust III, or Trust III; FI Capital Trust IV, or Trust IV; FI Statutory Trust V, or Trust V; and, FI Statutory Trust VI, or Trust VI. These wholly-owned business trusts were created for the exclusive purpose of issuing trust preferred securities and using the proceeds to purchase junior subordinated debentures issued by us. Trust I, Trust II, Trust III and Trust IV were formed in 2007, and Trust V and Trust VI were formed in 2008 to partially fund the First Western acquisition.

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### **Website Access to SEC Filings**

All of our reports filed electronically with the SEC, including the Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and Proxy Statements, as well as amendments to these reports and statements filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, are accessible at no cost through our website at [www.firstinterstatebank.com](http://www.firstinterstatebank.com) as soon as reasonably practicable after they have been filed with the SEC. These reports are also accessible on the SEC's website at [www.sec.gov](http://www.sec.gov). The public may read and copy materials we file with the SEC at the public reference facilities maintained by the SEC at Room 1580, 100 F Street N.E., Washington, DC 20549. The public may obtain information on the operation of the public reference room by calling the SEC at 1-800-SEC-0330. Our website and the information contained therein or connected thereto is not intended to be incorporated into this report and should not be considered a part of this report.

### **Item 1A. Risk Factors**

Like other financial and bank holding companies, we are subject to a number of risks, many of which are outside of our control, including: (1) credit risks; (2) market risks; (3) liquidity risks; and, (4) operational risks. In addition, investors who purchase our securities are subject to (5) investment risks. If any of the events or circumstances described in the following risk factors actually occur, our business, financial condition, results of operations and prospects could be harmed. Readers should consider carefully the following important factors in evaluating us, our business and an investment in our securities.

#### ***(1) Credit Risks:***

##### **We may incur significant credit losses, particularly in light of recent market developments.**

We take credit risk by virtue of making loans and extending loan commitments and letters of credit. Our exposure to credit risk is managed through the use of consistent underwriting standards that emphasize in-market lending. Our credit administration function employs risk management techniques designed to ensure that loans adhere to corporate policy and problem loans are promptly identified. We have adopted underwriting and credit monitoring procedures and policies, including the establishment and review of the allowance for loan losses, which we believe are appropriate to mitigate the risk of loss by assessing the likelihood of nonperformance and the value of available collateral, monitoring loan performance and diversifying our credit portfolio. These procedures provide us with the information to implement policy adjustments where necessary and to take proactive corrective actions. Our credit standards, procedures and policies may not prevent us from incurring substantial credit losses, particularly in light of recent market developments. During 2008, we experienced deterioration in credit quality, particularly in certain real estate development loans, due in part to the impact resulting from the downturn in the prevailing economic, real estate and credit markets. This deterioration resulted in higher levels of non-performing assets, including other real estate owned, and internally risk classified loans, thereby increasing our provision for loan losses and decreasing our operating income in 2008. Given the current economic conditions and trends, management believes we will continue to experience credit deterioration and higher levels of non-performing loans in the near-term, which will likely have an adverse impact on our financial condition, results of operations and prospects.

##### **Our concentrations of real estate loans could subject us to increased risks in the event real estate values continue to decline due to the economic recession, a further deterioration in the real estate markets or other causes.**

At February 28, 2009, we had approximately \$3.1 billion of commercial, agricultural, construction, residential and other real estate loans representing approximately 65% of our total loan portfolio. The current economic recession and deterioration in the real estate markets have had an adverse effect on the collateral value for many of our loans and on the repayment ability of many of our borrowers. The continuation or further deterioration of these factors, including increasing foreclosures and unemployment, will continue to have the same or similar adverse effects. In addition, these factors could reduce the amount of loans we make to businesses in the construction and real estate industry, which could negatively impact our interest income and results of operations. A continued decline in real estate values could also lead to higher charge-offs in the event of defaults in our real estate loan portfolio. Similarly, the occurrence of a natural or manmade disaster in our market areas could impair the value of the collateral we hold for real estate secured loans. Any one or a combination of the factors identified above could negatively impact our business, financial condition, results of operations and prospects.



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**Many of our loans are to commercial borrowers, which have a higher degree of risk than other types of loans.**

Commercial loans, including commercial real estate loans, are often larger and involve greater risks than other types of lending. Because payments on such loans are often dependent on the successful operation or development of the property or business involved, repayment of such loans is more sensitive than other types of loans to adverse conditions in the real estate market or the general economy. Accordingly, the recent downturn in the real estate market and economy has heightened our risk related to commercial loans, particularly commercial real estate loans. Unlike residential mortgage loans, which generally are made on the basis of the borrowers' ability to make repayment from their employment and other income and which are secured by real property whose value tends to be more easily ascertainable, commercial loans typically are made on the basis of the borrowers' ability to make repayment from the cash flow of the commercial venture. If the cash flow from business operations is reduced, the borrower's ability to repay the loan may be impaired. At February 28, 2009, we had approximately \$2.4 billion of commercial loans, including commercial real estate loans, representing approximately 49% of our total loan portfolio.

**Adverse economic conditions affecting Montana, Wyoming and South Dakota could harm our business.**

Our customers with loan and/or deposit balances are located predominantly in Montana, Wyoming and South Dakota. Because of the concentration of loans and deposits in these states, existing or future adverse economic conditions in Montana, Wyoming or South Dakota could cause us to experience higher rates of loss and delinquency on our loans than if the loans were more geographically diversified. Adverse economic conditions, including inflation, recession and unemployment, and other factors, such as political or business developments, natural disasters, wide-spread disease, terrorist activity, environmental contamination and other unfavorable conditions and events that affect these states, could reduce demand for credit or fee-based products and may delay or prevent borrowers from repaying their loans. Adverse conditions and other factors identified above could also negatively affect real estate and other collateral values, interest rate levels, and the availability of credit to refinance loans at or prior to maturity. These results could adversely impact our business, financial condition, results of operations and prospects.

**If we experience loan losses in excess of estimated amounts, our earnings will be adversely affected.**

The risk of credit losses on loans varies with, among other things, general economic conditions, the type of loan being made, the creditworthiness of the borrower over the term of the loan and, in the case of a collateralized loan, the value and marketability of the collateral for the loan. We maintain an allowance for loan losses based upon, among other things, historical experience, an evaluation of economic conditions and regular reviews of loan portfolio quality. Based upon such factors, our management makes various assumptions and judgments about the ultimate collectibility of our loan portfolio and provides an allowance for loan losses. These assumptions and judgments are even more complex and difficult to determine given recent market developments, the potential for continued market turmoil and the significant uncertainty of future conditions in the general economy and banking industry. If management's assumptions and judgments prove to be incorrect and the allowance for loan losses is inadequate to absorb future losses, or if the banking authorities or regulations require us to increase the allowance for loan losses, our earnings and financial condition could be significantly and adversely affected.

As of February 28, 2009, our allowance for loan losses was \$90 million, which represented 1.88% of total outstanding loans. Our allowance for loan losses may not be sufficient to cover future loan losses. Future adjustments to the allowance for loan losses may be necessary if economic conditions differ substantially from the assumptions used or further adverse developments arise with respect to our non-performing or performing loans. Material additions to our allowance for loan losses could have a material adverse effect on our financial condition, results of operations and prospects.

**We may be adversely affected by the soundness of other financial institutions.**

The financial services industry as a whole, as well as the securities markets generally, have been materially and adversely affected by significant declines in the values of nearly all asset classes and a serious lack of liquidity. Our credit risk is exacerbated when the collateral we hold cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit exposure due to us. Any such losses could harm our financial condition, results of operations and prospects.



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Financial institutions in particular have been subject to increased volatility and an overall loss of investor confidence. Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as a result of trading, clearing and counterparty or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more financial services companies, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. Many of these transactions expose us to increased credit risk in the event of default of a counterparty or client.

### **(2) Market Risks:**

**Recent market developments have affected our business and will continue to have an effect in ways that are not predictable or that we may fail to anticipate.**

The recent market developments and turmoil and the potential for increased and continuing disruptions present considerable risks and challenges to us. These risks and challenges have reached unprecedented levels and have significantly diminished overall confidence in the national economy, the financial markets and many financial institutions. This reduced confidence could further compound the overall market disruptions and risks to banks and bank holding companies, including us. Our business is affected by economic conditions, political uncertainties, volatility, illiquidity and other developments impacting the financial markets. Such factors have affected, and may further adversely affect, both credit and financial markets and future economic growth, resulting in adverse effects on us and other financial institutions in ways that are not predictable or that we may fail to anticipate.

**The effects of recent legislative and regulatory efforts to provide financial market stability are uncertain.**

In response to recent market disruptions, legislators and financial regulators have implemented a number of mechanisms designed to address the financial market turmoil, including the provision of direct and indirect assistance to distressed financial institutions, assistance by the banking authorities in arranging acquisitions of weakened banks and broker-dealers, and implementation of programs by the Federal Reserve to provide liquidity to the commercial paper markets. On October 3, 2008, the EESA was enacted which, among other things, empowers the Treasury to provide up to \$700 billion of funding to stabilize and provide liquidity to the financial markets. On October 14, 2008, the Secretary of the Treasury announced the TARP Capital Purchase Program, a program in which \$250 billion of the funds under EESA are made available for the purchase of preferred equity interests in qualifying financial institutions. On February 17, 2009, the American Recovery and Reinvestment Act of 2009 was enacted which amended, in certain respects, EESA and provided an additional \$787 billion in economic stimulus funding.

The overall effects of these and other legislative and regulatory efforts on the financial markets are uncertain, and they may not have the intended stabilization results. These efforts may even have unintended harmful consequences on the U.S. financial system and our business. Should these or other legislative or regulatory initiatives fail to stabilize and add sufficient liquidity to the financial markets, our business, financial condition, results of operations and prospects could be materially and adversely affected.

Even if legislative or regulatory efforts successfully stabilize and add liquidity to the financial markets, we may need to modify our strategies and business operations. We may also incur increased capital requirements and constraints or additional costs in order to satisfy new regulatory requirements. Given the volatile nature of the current market disruption and the uncertainties underlying efforts to mitigate or reverse the disruption, we may not timely anticipate or manage existing, new or additional risks, contingencies or developments in the current or future environment. Our failure to do so could materially and adversely affect our business, financial condition, results of operations and prospects.

**Changes in interest rates could negatively impact our net interest income, may weaken demand for our products and services and harm our results of operations and cash flows.**

Our earnings and cash flows are largely dependent upon net interest income, which is the difference between interest income earned on interest-earning assets such as loans and securities and interest expense paid on interest-bearing liabilities such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory

agencies, particularly the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and securities and the amount of interest we pay on deposits and

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borrowings, but such changes could also adversely affect (i) our ability to originate loans and obtain deposits, (ii) the fair value of our financial assets and liabilities, including mortgage servicing rights, (iii) our ability to realize gains on the sale of assets and (iv) the average duration of our mortgage-backed investment securities portfolio. An increase in interest rates that adversely affects the ability of borrowers to pay the principal or interest on loans may lead to an increase in non-performing assets and a reduction of income recognized, which could harm our results of operations and cash flows. In contrast, decreasing interest rates have the effect of causing customers to refinance mortgage loans faster than anticipated. This causes the value of assets related to the servicing rights on mortgage loans sold to be lower than originally recognized. If this happens, we may need to write down our mortgage servicing rights asset faster, which would accelerate expense and lower our earnings. Any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on our results of operations, cash flows and financial condition.

### ***(3) Liquidity Risks:***

**We may not be able to meet the cash flow requirements of our depositors and borrowers unless we maintain sufficient liquidity.**

Liquidity is the ability to meet current and future cash flow needs on a timely basis at a reasonable cost. Our liquidity is used to make loans and to repay deposit liabilities as they become due or are demanded by customers. Potential alternative sources of liquidity include Federal funds purchased and securities sold under repurchase agreements. We maintain a portfolio of investment securities that may be used as a secondary source of liquidity to the extent the securities are not pledged for collateral. We believe there are other potential sources of liquidity available to us should they be needed. These sources may include the drawing of additional funds on our revolving term loan, the sale of loans, the utilization of available government and regulatory assistance programs, the ability to acquire national market, non-core deposits, the issuance of additional collateralized borrowings such as Federal Home Loan Bank, or FHLB, advances, the issuance of debt securities, issuance of equity securities and borrowings through the Federal Reserve's discount window. Without sufficient liquidity from these potential sources, we may not be able to meet the cash flow requirements of our depositors and borrowers.

#### **Recent market disruptions have caused increased liquidity risks.**

The recent disruption and illiquidity in the credit markets are continuing challenges that have generally made potential funding sources more difficult to access, less reliable and more expensive. In addition, liquidity in the inter-bank market, as well as the markets for commercial paper and other short-term instruments, have significantly contracted. Reflecting concern about the stability of the financial markets generally and the strength of counterparties, many lenders and institutional investors have reduced, and in some cases, ceased to provide funding to borrowers, including other financial institutions. These market conditions have made the management of our own and our customers' liquidity significantly more challenging. A further deterioration in the credit markets or a prolonged period without improvement of market liquidity could adversely affect our liquidity and financial position, including our regulatory capital ratios, and could adversely affect our business, results of operations and prospects.

**The inability of our bank subsidiaries to pay dividends due to legal or regulatory limitations could adversely affect our liquidity and operations and our ability to service debt, redeem stock and pay dividends.**

We, as a holding company, are a separate and distinct legal entity from our subsidiaries. We receive all of our revenue from management fees and dividends paid by our bank subsidiaries. These dividends are our principal source of funds to pay dividends on our stock and interest and principal on our debt. Various federal and/or state laws and regulations limit the amount of dividends that our bank subsidiaries may pay. Limitations on our ability to receive dividends from our subsidiaries could have a material adverse effect on our liquidity and operations and our ability to service debt, redeem stock and pay dividends.

The Federal Reserve, the State of Montana, Division of Banking and Financial Institutions, and the State of South Dakota, Department of Revenue & Regulation, Division of Banking, are the primary regulatory agencies that examine us and our activities. Under certain circumstances, including any determination that the activities of our bank subsidiaries constitute an unsafe and unsound banking practice, the regulatory agencies have the authority by statute to restrict our subsidiaries' ability to transfer assets and make distributions to us as the holding company. Under applicable statutes and regulations, dividends may be paid out of current or retained net profits, but prior approval of

the regulatory agencies is generally required for the payment of a dividend if the total of all dividends declared by a bank subsidiary in any calendar year would exceed the total of its net profits for the year combined with its undistributed net profits for the two preceding years.

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Payment of dividends could also be subject to regulatory limitations if a bank subsidiary became under-capitalized for purposes of regulatory guidelines. Under-capitalized is currently defined as having a total risk-based capital ratio of less than 8.0%, a tier 1 risk-based capital ratio of less than 4.0%, or a core capital, or leverage, ratio of less than 4.0%. In addition, our right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of that subsidiary's creditors.

### **Failure to meet our debt covenants could result in our debt becoming immediately due and payable, which could adversely impact our results from operations, cash flows and financial condition.**

In conjunction with the First Western acquisition in January 2008, we incurred debt of \$159 million payable to various lenders under various debt agreements. The debt agreements contain covenants that, among other things, establish minimum capital and financial performance ratios, and place restrictions on indebtedness, non-performing assets, the allowance for loan losses, the redemption and issuance of common stock and the amount of dividends payable to shareholders. Failure to comply with the debt covenants could result in, among other remedies, the debt becoming immediately due and payable and the subsequent liquidation of our assets in satisfaction of the debt.

As discussed above, we experienced deterioration in credit quality during 2008 which resulted in higher levels of non-performing loans and caused us to be in default under our syndicated credit agreement as of June 30, 2008. Although we entered into an amendment to our syndicated credit agreement that waived such default, the amendment reduced the maximum amount that can be advanced on revolving notes under the syndicated credit agreement, increased the interest rate and commitment fee with respect to the revolving notes, and revised certain debt covenants related to non-performing assets. Although we have been in compliance with all existing and amended debt covenants since the amendment, we cannot predict the full impact market developments will have on our business. Given the current economic conditions and trends, management believes we will continue to experience credit deterioration and higher levels of non-performing loans in the near-term, which could cause us to be in default under some of the financial covenants contained in our syndicated credit agreement. Consequently, it is possible we will be required to pursue waivers or amendments with respect to such covenants, which waivers or amendments, if available, will likely contain terms that are unfavorable to us.

### ***(4) Operational Risks:***

#### **We face significant competition.**

We face substantial competition in all areas of our operations from a variety of different competitors, many of which are larger and may have more financial resources. Such competitors primarily include national, regional, and community banks within the various markets we serve. We also face competition from many other types of financial institutions, including, without limitation, savings and loans, credit unions, finance companies, brokerage firms, insurance companies, factoring companies and other financial intermediaries. The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Additionally, we expect competition to intensify among financial services companies due to the recent consolidation of certain competing financial institutions and the conversion of certain investment banks to bank holding companies. Also, technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic funds transfer and automatic payment systems. Many of our competitors have fewer regulatory constraints and may have lower cost structures. Additionally, due to their size, many competitors may offer a broader range of products and services as well as better pricing for those products and services than we can.

Our ability to compete successfully depends on a number of factors, including, among other things, the ability to develop, maintain and build upon long-term customer relationships based on quality service, high ethical standards and safe, sound assets; the ability to expand our market position; the scope, relevance and pricing of products and services offered to meet customer needs and demands; the rate at which we introduce new products and services relative to our competitors; customer satisfaction with our level of service; and, industry and general economic trends. Failure to perform in any of these areas could significantly weaken our competitive position, which could adversely affect our growth and profitability, which, in turn, could harm our financial condition, results of operations and

prospects.

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**We may not be able to manage risks inherent in our business, particularly given the recent turbulent and dynamic market conditions.**

A comprehensive and well-integrated risk management function is essential for our business. We have adopted various policies, procedures and systems to monitor and manage risk. These policies, procedures and systems may be inadequate to identify and mitigate all risks inherent in our business. In addition, our business and the markets and industry in which we operate are continuously evolving. We may fail to understand fully the implications of changes in our business or the financial markets and fail to adequately or timely enhance our risk framework to address those changes, particularly given the recent turbulent and dynamic market conditions. If our risk framework is ineffective, either because it fails to keep pace with changes in the financial markets or in our business or for other reasons, we could incur losses and otherwise experience harm to our business.

**We may not be able to continue growing our business.**

Our total assets have grown from \$4.2 billion as of December 31, 2004 to \$6.6 billion as of December 31, 2008. Our ability to grow depends, in part, upon our ability to successfully attract deposits, identify favorable loan and investment opportunities, open new branch banking offices and expand into new and complementary markets when appropriate opportunities arise. In the event we do not continue to grow, our results of operations could be adversely impacted.

Our ability to grow successfully depends on our capital resources and whether we can continue to fund growth while maintaining cost controls and asset quality, as well as on other factors beyond our control, such as national and regional economic conditions and interest rate trends. If we are not able to make loans, attract deposits and maintain asset quality due to constrained capital resources or other reasons, we may not be able to continue growing our business, which could adversely impact our earnings, financial condition and prospects.

**We may become liable for environmental remediation and other costs on repossessed properties, which could adversely impact our results of operations, cash flows and financial condition.**

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. If hazardous or toxic substances are found on these properties, we may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require us to incur substantial expenses and may materially reduce the affected property's value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although we have policies and procedures to perform an environmental review before initiating any foreclosure actions on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our results of operations, cash flows and financial condition.

**Our information systems may experience a breach in security.**

We rely heavily on communications and information systems to conduct our business. A breach in the security of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan, investment, credit card and other information systems. A breach of the security of our information systems could damage our reputation, result in a loss of customer business, subject us to additional regulatory scrutiny and expose us to civil litigation and possible financial liability.

**A failure of the technology we use could harm our business.**

We depend heavily upon data processing, software, communication and information exchange on a variety of computing platforms and networks and over the internet. Despite instituted safeguards, we cannot be certain that all of our systems are entirely free from vulnerability to breaches of security or other technological difficulties or failures. . We rely on the services of a variety of vendors to meet our data processing and communication needs. If information security is breached or other technology difficulties or failures occur, information may be lost or misappropriated, services and operations may be interrupted, and we could be exposed to claims from customers and related legal actions. Any of these results could harm our business.

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**We may not effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers.**

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to use technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on our business and, in turn, on our financial condition, results of operations and prospects.

**Our systems of internal operating controls may not be effective.**

We establish and maintain systems of internal operational controls that provide us with critical information used to manage our business. These systems are not foolproof, and are subject to various inherent limitations, including cost, judgments used in decision-making, assumptions about the likelihood of future events, the soundness of our systems, the possibility of human error, and the risk of fraud. Moreover, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions and the risk that the degree of compliance with policies or procedures may deteriorate over time. Because of these limitations, any system of internal operating controls may not be successful in preventing all errors or fraud or in making all material information known in a timely manner to the appropriate levels of management. From time to time, losses from operational malfunctions or fraud may occur. These losses are recorded as non-interest expense. Any future losses related to internal operating control systems could have an adverse effect on our business.

**We are dependent upon the services of our management team.**

Our future success and profitability is substantially dependent upon the management skills of our executive officers and directors, many of whom have held officer and director positions with us for many years. The loss or unavailability of key executives, including Lyle R. Knight, President and Chief Executive Officer, Terrill R. Moore, Executive Vice President and Chief Financial Officer, Edward Garding, Executive Vice President and Chief Credit Officer, Gregory A. Duncan, Executive Vice President and Chief Banking Officer, or Julie A. Castle, President First Interstate Bank Wealth Management, could harm our ability to operate our business or execute our business strategy.

**Our goodwill may become impaired.**

The excess purchase price over the fair value of net assets from acquisitions, or goodwill, is evaluated for impairment at least annually, and on an interim basis if an event or circumstance indicates that it is likely an impairment has occurred. In testing for impairment, the fair value of a reporting unit is estimated based on an analysis of market-based trading and transaction multiples of selected peer banks; and, if required, the estimated fair value is allocated to the assets and liabilities of the reporting unit. Consequently, the determination of goodwill is sensitive to market-based trading and transaction multiples. As such, variability in the market conditions could result in impairment of goodwill, which is recorded as a noncash adjustment to income. As of February 28, 2009, we had goodwill of \$184 million. An impairment of goodwill could have a material adverse effect on our business, results of operations and financial condition.

**We may not be able to attract and retain qualified employees to operate our business effectively.**

There is substantial competition for qualified personnel in our markets. Although unemployment rates have been migrating upward in Montana, Wyoming, South Dakota and the surrounding region, it may still be difficult to attract and retain qualified employees at all management and staffing levels. Failure to attract and retain employees and maintain adequate staffing of qualified personnel could adversely impact our operations and our ability to execute our business strategy. Furthermore, relatively low unemployment rates in our markets may lead to significant increases in salaries, wages and employee benefits expenses as we compete for qualified, skilled employees.

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### **An extended disruption of vital infrastructure and other business interruptions could negatively impact our business.**

Our operations depend upon vital infrastructure components including, among other things, transportation systems, power grids and telecommunication systems. A disruption in our operations resulting from failure of transportation and telecommunication systems, loss of power, interruption of other utilities, natural disaster, fire, global climate changes, computer hacking or viruses, failure of technology, terrorist activity or the domestic and foreign response to such activity, or other events outside of our control could have an adverse impact on the financial services industry as a whole and/or on our business. Our business recovery plan may not be adequate and may not prevent significant interruptions of our operations or substantial losses.

### **We are subject to claims and litigation pertaining to our fiduciary responsibilities.**

Some of the services we provide, such as trust and investment services, require us to act as fiduciaries for our customers and others. From time to time, third parties make claims and take legal action against us pertaining to the performance of our fiduciary responsibilities. If these claims and legal actions are not resolved in a manner favorable to us, we may be exposed to significant financial liability and/or our reputation could be damaged. Either of these results may adversely impact demand for our products and services or otherwise have a harmful effect on our business.

### **New or changes in existing tax, accounting, and regulatory rules and interpretations could significantly harm our business.**

The financial services industry is extensively regulated. Federal and state banking regulations are designed primarily to protect the deposit insurance funds and consumers, not to benefit a financial company's shareholders. These regulations may impose significant limitations on operations. The significant federal and state banking regulations that affect us are described in this report under the heading **Business Regulation and Supervision** above. These regulations, along with the currently existing tax, accounting, securities, insurance and monetary laws, and regulations, rules, standards, policies, and interpretations control the methods by which we conduct business, implement strategic initiatives and tax compliance, and govern financial reporting and disclosures. These laws, regulations, rules, standards, policies, and interpretations are undergoing significant review, are constantly evolving and may change significantly, particularly given the recent market developments in the banking and financial services industries.

Recent events have resulted in legislators, regulators and authoritative bodies, such as the Financial Accounting Standards Board, the SEC, the Public Company Accounting Oversight Board, and various taxing authorities responding by adopting and/or proposing substantive revisions to laws, regulations, rules, standards, policies and interpretations. Further, federal monetary policy as implemented through the Federal Reserve System can significantly affect credit conditions in our markets.

The nature, extent, and timing of the adoption of significant new laws, regulations, rules, standards, policies and interpretations, or changes in or repeal of these items or specific actions of regulators, may increase our costs of compliance and harm our business. For example, potential increases in or other modifications affecting regulatory capital thresholds could impact our status as well capitalized. It is impossible for us to predict accurately at this time the extent of any impact from changes in existing laws, regulations, rules, standards, policies and interpretations.

### **Non-compliance with laws and regulations could result in fines, sanctions and other enforcement actions.**

Federal and state regulators have broad enforcement powers. If we fail to comply with any laws, regulations, rules, standards, policies or interpretations applicable to us, we could face various sanctions and enforcement actions, which include the appointment of a conservator or receiver for us; the issuance of a cease and desist order that can be judicially enforced; the termination of our deposit insurance; the imposition of civil monetary fines and penalties; the issuance of directives to increase capital; the issuance of formal and informal agreements; the issuance of removal and prohibition orders against officers, directors, and other institution-affiliated parties; and the enforcement of such actions through injunctions or restraining orders.

### **The Federal Reserve may require us to commit capital resources to support our bank subsidiaries.**

The Federal Reserve, which examines us and our subsidiaries, has a policy stating that a bank holding company is expected to act as a source of financial and managerial strength to a subsidiary bank and to commit resources to

support such subsidiary bank. Under the source of strength doctrine, the Federal Reserve may require a bank holding company to make capital injections into a troubled subsidiary bank, and may charge the bank holding company with engaging in unsafe and unsound practices for failure to commit resources to such a subsidiary bank. A capital injection may be required at

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times when the holding company may not have the resources to provide it, and therefore may be required to borrow the funds. Any loans by a holding company to its subsidiary bank are subordinate in right of payment to deposits and to certain other indebtedness of such subsidiary bank. In the event of a bank holding company's bankruptcy, the bankruptcy trustee will assume any commitment by the holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank. Moreover, bankruptcy law provides that claims based on any such commitment will be entitled to a priority of payment over the claims of the institution's general unsecured creditors, including the holders of its note obligations. Thus, any borrowing that must be done by the holding company in order to make the required capital injection becomes more difficult and expensive and will adversely impact the holding company's financial condition, results of operations and cash flows.

### **Our deposit insurance premiums could be substantially higher in the future, which could have a material adverse effect on our future earnings.**

The FDIC insures deposits at FDIC insured financial institutions, including the Banks. The FDIC charges insured financial institutions premiums to maintain the DIF at a certain level. Recent bank failures and expectations for further failures in 2009 have reduced insurance reserve funds to their lowest level since 1993. On October 16, 2008, the FDIC published a restoration plan designed to replenish the DIF over a period of five years and to increase the deposit insurance reserve ratio to 1.15% of insured deposits by December 31, 2013. In order to implement the restoration plan, the FDIC proposes to change both its risk-based assessment system and its base assessment rates. For the first quarter of 2009 only, the FDIC increased all FDIC deposit assessment rates by 7 basis points. On February 27, 2009, the FDIC amended the restoration plan to extend the restoration plan horizon to seven years. The amended restoration plan was accompanied by a final rule setting assessment rates and making adjustments to improve how the assessment system differentiates for risk. Under the final rule, the base assessment rates would range from 12-16 basis points for Risk Category I institutions, such as our bank subsidiaries, beginning April 1, 2009. Changes to the risk-based assessment system include increasing premiums for institutions that rely on excessive amounts of brokered deposits, including CDARS, increasing premiums for excessive use of secured liabilities, including FHLB advances, lowering premiums for smaller institutions with high capital levels, and reductions in assessment rates for institutions holding long-term unsecured debt.

In addition, on February 27, 2009, the FDIC adopted an interim rule proposing a 20 basis point special assessment for all FDIC insured financial institutions. This proposed assessment, to be collected on September 30, 2009, is based on deposits as of June 30, 2009. Based on our current level and mix of deposit accounts, we estimate that a 20 basis point special assessment, should it occur, would result in an increase our deposit insurance premiums of approximately \$10.4 million. The interim rule also proposes to permit the FDIC to impose an additional special assessment after June 30, 2009 of up to 10 basis points if necessary to maintain public confidence in federal deposit insurance. This interim rule is subject to modification by the FDIC.

A change in the risk categories assigned to our bank subsidiaries, adjustments to base assessment rates and special assessments could have a material adverse effect on our earnings and financial condition.

### **(5) Investment Risks:**

#### **Our common stock is not publicly traded.**

Shares of our common stock are not publicly traded. Our common stock is not listed, quoted or traded on any securities exchange, market, bulletin board, quotation system or listing service. Because there is no established market for our common stock, there are limited opportunities for shareholders to resell their shares. In the event shareholders desire to sell or otherwise dispose of their shares, they may not be able to do so.

#### **Shares of our common stock are subject to contractual transfer restrictions.**

With respect to our outstanding common stock, approximately 91% of the shares are subject to contractual transfer restrictions set forth in shareholder agreements. Except as described below, purchasers of our common stock are required to enter into shareholder agreements. We have a right of first refusal to repurchase the restricted stock at fair market value currently determined as the minority appraised value per share based upon the most recent quarterly appraisal. Additionally, restricted stock held by our officers, directors and employees may be called by us under certain conditions. All stock not subject to such restrictions may be sold at a price per share that is negotiated between the shareholder and a prospective buyer, which may vary substantially from our appraised minority value.



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Shares of our stock held by participants in the savings and profit sharing plan, or Savings Plan, established for our employees are not subject to contractual transfer restrictions set forth in shareholder agreements. Since the Savings Plan does not allow distributions in kind, distributions from participants Savings Plan accounts require First Interstate Bank, as trustee for the Savings Plan, to sell our stock. In the event we do not elect to purchase the unrestricted stock, First Interstate Bank will be obligated to seek alternative purchasers.

**We have no obligation to repurchase outstanding shares of common stock and we are subject to limitations on the amount of common stock we may repurchase.**

We have no obligation, by contract, policy or otherwise, to purchase restricted or unrestricted shares of our outstanding common stock held by shareholders. Our debt covenants limit the repurchase of common shares, net of proceeds from the sale of capital securities, to a percentage of our consolidated net worth as of the end of the immediately preceding fiscal year. These covenants, unless amended or waived, restrict us in the number of shares we may repurchase from existing shareholders, thereby limiting the future liquidity for such shares. Moreover, during any period in which we may be in default under such covenants, we will be precluded from repurchasing any shares. Furthermore, we have made and adopted, and will continue to make and adopt, capital management decisions and policies that could limit the repurchase of outstanding common stock held by shareholders given regulatory limitations, strategic plans, growth initiatives, capital availability, projected liquidity needs and other factors. We have recently announced we will only receive requests for the repurchase of common shares during a two-week period commencing two days following the quarterly announcement of the minority appraised value of our common stock and that the number of shares repurchased during any window period may be limited at the discretion of our board of directors. Any limitations on the number of shares repurchased could cause a decrease in the value of our stock.

Shares we may repurchase will be priced at fair market value determined in good faith by our board of directors. The board of directors may, in their sole discretion, utilize an independent party to assist with the determination of fair value of the shares. Historically, shares repurchased have been priced at the most recent minority appraised value at the repurchase date. The appraised minority value of our common stock represents the estimated fair market valuation of a minority ownership interest, taking into account adjustments for the lack of marketability of the stock and other factors. This value does not represent an actual trading price between a willing buyer and seller of our shares in an informed, arms-length transaction. As such, the appraised minority value is only an estimate as of a specific date, and such appraisal may not be an indication of the actual value owners may realize with respect to shares they hold. Moreover, the estimated fair market value of our common stock may be materially different at any date other than the valuation dates.

**We are subject to limitations on the amount of dividends we may pay to our shareholders.**

Although we have historically paid dividends to our shareholders, we have no obligation to do so. Our debt covenants limit the payment of dividends to our shareholders to a percentage of our consolidated net income for the immediately preceding fiscal year. Furthermore, consistent with our strategic plans, growth initiatives, capital availability, projected liquidity needs and other factors, we have made and adopted, and will continue to make and adopt, capital management decisions and policies that could adversely impact the amount of dividends paid to our shareholders.

**Both participation and nonparticipation in recently announced assistance programs and initiatives for financial institutions have the potential to result in an adverse effect on our common stock.**

Various assistance programs and initiatives for financial institutions have been recently announced, including the Treasury's TARP Capital Purchase Program and Public-Private Investment Fund, the Federal Reserve Board of Governors Commercial Paper Funding Facility and Money Market Investor Funding Facility, the FDIC Temporary Liquidity Guarantee Program and various other initiatives. To date, we have only made application for participation in one of these programs, the Capital Purchase Program. In connection with the application, we have requested certain exceptions to the Treasury's standard terms and conditions applicable to the program. We cannot predict whether our requested exceptions will be considered or whether our application will be accepted. If we are accepted and decide to participate in the Capital Purchase Program, we will issue shares of preferred stock mandatorily convertible into common stock that will have rights and preferences over our common stock and that are expected to rank on a parity with our existing series A preferred stock as to dividends and liquidation rights. Any shares of preferred stock issued

pursuant to the Capital Purchase Program could cause a decrease in the value of our outstanding common stock and in the amount of cash dividends per common share.

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We are evaluating participation in the various government and regulatory assistance programs. While each of these programs is intended to assist financial institutions, there may be potential disadvantages to participating institutions. Conversely, financial institutions that do not participate in a particular program may fail to realize the intended benefits and be at a competitive disadvantage. It is impossible for us to predict accurately at this time the extent of our participation or nonparticipation in recently announced government and regulatory programs and initiatives. Consequences and effects associated with our participation or lack thereof have the potential to result in an adverse effect on our common stock.

### **Existing shareholders will be diluted by future issuances of common or preferred stock, and the valuation of our common stock could decrease.**

In addition to the possible issuance of preferred stock under the Treasury's Capital Purchase Program, future issuances of stock, including issuances pursuant to our equity incentive plans or in connection with other future financings or acquisitions, such as with the issuance of our series A preferred stock in the First Western acquisition, could cause dilution to our existing shareholders. This dilution could cause the valuation of our common stock to decline and also decrease the per share amount of any cash dividends. Furthermore, a variety of other factors discussed in this report could have a negative impact on our business, thereby resulting in a decrease in the value of our common stock.

### **Affiliates of our company own a controlling interest and are able to control the election of directors and future direction of our business.**

The directors and executive officers beneficially own approximately 51% of our outstanding common stock. Many of these directors and executive officers are members of the Scott family, which collectively owns approximately 78% of our common stock. By virtue of such ownership, these affiliates are able to control the election of directors and the determination of our business, including transactions involving dividends, stock repurchases, and any potential acquisition, merger or other business combination.

### **Item 1B. Unresolved Staff Comments**

We are not an accelerated filer or a large accelerated filer, as defined in Rule 12b-2 of the Exchange Act, or a well-known seasoned issuer as defined in Rule 405 of the Securities Act. We have not received any written comments from the SEC staff regarding our periodic or current reports filed under the Exchange Act.

### **Item 2. Properties**

Our principal executive offices and a banking office are anchor tenants in an eighteen story commercial building located in Billings, Montana. The building is owned by a joint venture partnership in which First Interstate Bank is one of two partners, owning a 50% interest in the partnership. We lease approximately 104,632 square feet of office space in the building. We also lease approximately 45,554 square feet of office space for our operations center, located in two buildings in Billings, Montana. We are currently constructing a new operations center in Billings, Montana. The facility, scheduled for completion in 2009, will provide 65,226 square feet of office space and will replace our existing space leased for operations. We provide banking services at 69 additional locations in Montana, Wyoming and South Dakota, of which 18 properties are leased from independent third parties and 51 properties are owned by us. We believe each of our facilities is suitable and adequate to meet our current operational needs.

### **Item 3. Legal Proceedings**

In the normal course of business, we are named or threatened to be named as a defendant in various lawsuits. Management, following consultation with legal counsel, does not expect the ultimate disposition of these matters to have a material adverse effect on our business.

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

No matters were submitted to a vote of security holders during the fourth quarter of 2008.

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**PART II**

**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters  
and Issuer Purchases of Equity Securities**

**Description of Our Capital Stock**

Our authorized capital stock consists of 20,000,000 shares of common stock without par value, of which 7,881,259 shares were outstanding as of February 28, 2009, and 100,000 shares of preferred stock without par value, of which 5,000 shares have been designated as 6.75% Series A noncumulative redeemable preferred stock, or Series A Preferred Stock. As of February 28, 2009, all 5,000 shares of authorized Series A Preferred Stock were outstanding.

*Preferred Stock*

Our board of directors is authorized, without approval of the holders of common stock, to provide for the issuance of preferred stock from time to time in one or more series in such number and with such designations, preferences, powers and other special rights as may be stated in the resolution or resolutions providing for such preferred stock. Our board of directors may cause us to issue preferred stock with voting, conversion and other rights that could adversely affect the holders of the common stock or make it more difficult to effect a change in control.

In connection with the First Western acquisition in January 2008, our board of directors authorized the issuance of the Series A Preferred Stock, which ranks senior to our common stock and to all equity securities issued by us with respect to dividend and liquidation rights. The Series A Preferred Stock has no voting rights. Holders of the Series A Preferred Stock are entitled to receive, when and if declared by the board of directors, noncumulative cash dividends at an annual rate of \$675 per share (based on a 360 day year). In the event dividends are not paid for three consecutive quarters, the Series A Preferred Stock holders are entitled to elect two members to our board of directors. The Series A Preferred Stock is subject to indemnification obligations and set-off rights pursuant to the purchase agreement entered into at the time of the First Western acquisition. We may, at our option, redeem all or any part of the outstanding Series A Preferred Stock at any time after January 10, 2013, subject to certain conditions, at a price of \$10 thousand per share plus accrued but unpaid dividends at the date fixed for redemption. The Series A Preferred Stock may be redeemed prior to January 10, 2013 only in the event we are entitled to exercise our set-off rights pursuant to the First Western purchase agreement. After January 10, 2018, the Series A Preferred Stock may be converted, at the option of the holder, into shares of our common stock at a ratio of 80 shares of common stock for every one share of Series A Preferred Stock. Prior to conversion of the Series A Preferred Stock, holders are required to enter into shareholder agreements that contain transfer restrictions with respect to the common stock.

*Common Stock*

Each share of the common stock is entitled to one vote in the election of directors and in all other matters submitted to a vote of shareholders. Accordingly, holders of a majority of the shares of common stock entitled to vote in any election of directors may elect all of the directors standing for election if they choose to do so, subject to the rights, if any, of the holders of the preferred stock. Voting for directors is noncumulative.

Subject to the preferential rights of the Series A Preferred Stock and any other preferred stock that may at the time be outstanding, each share of common stock has an equal and ratable right to receive dividends when, if and as declared by the board of directors out of assets legally available. In the event of our liquidation, dissolution or winding up, the holders of common stock will be entitled to share equally and ratably in the assets available for distribution after payments to creditors and to the holders of the Series A Preferred Stock and any other preferred stock that may at the time be outstanding. Holders of common stock have no conversion rights or preemptive or other rights to subscribe for any additional shares of common stock or for other securities. All outstanding common stock is fully paid and non-assessable.

Our common stock is not actively traded, and there is no established trading market for the stock. There is only one class of common stock. As of February 28, 2009, 91% of our shares of common stock were subject to contractual transfer restrictions set forth in shareholder agreements and approximately 9% were held by 17 shareholders without such restrictions, including our 401(k) plan, or Savings Plan, which holds 78% of the unrestricted shares. See also Part I, Item 1, Risk Factors Liquidity Risks.

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Minority appraisal values as of each calendar quarter end for the past two years, determined by an independent valuation expert, follow:

| Valuation Based on<br>Financial Data As of | Valuation Effective Date | Appraised<br>Minority Value |
|--------------------------------------------|--------------------------|-----------------------------|
| December 31, 2006                          | February 15, 2007        | \$ 89.00                    |
| March 31, 2007                             | May 10, 2007             | 89.00                       |
| June 30, 2007                              | August 13, 2007          | 86.75                       |
| September 30, 2007                         | November 13, 2007        | 87.75                       |
| December 31, 2007                          | February 15, 2008        | 83.50                       |
| March 31, 2008                             | May 15, 2008             | 84.75                       |
| June 30, 2008                              | August 13, 2008          | 77.00                       |
| September 30, 2008                         | November 14, 2008        | 79.75                       |
| December 31, 2008                          | March 2, 2009            | 74.50                       |

Resale of our stock may be restricted pursuant to the Securities Act and applicable state securities laws. In addition, most shares of our stock are subject to shareholder s agreements:

Members of the Scott family, as majority shareholders, are subject to a shareholder s agreement.

Under this agreement, the Scott family has agreed to limit the transfer of shares owned by members of the Scott family to family members or charities, or with our approval, to our officers, directors, advisory directors or to our Savings Plan.

Shareholders who are not Scott family members, with the exception of 17 shareholders who own an aggregate of 706,472 shares of unrestricted stock, are subject to shareholder s agreements. Stock subject to these agreements may not be sold or transferred without triggering our option to acquire the stock in accordance with the terms of these agreements. In addition, the agreements grant us the right to repurchase all or some of the stock under certain conditions.

Purchases of our common stock made through our Savings Plan are not restricted by shareholder agreements. Since the Savings Plan does not allow distributions in kind, however, any distribution from an employee s account in the Savings Plan will require the Savings Plan administrator to authorize a sale of the stock.

As of February 28, 2009, we had 740 record shareholders, including the Wealth Management division of First Interstate Bank as trustee for 554,080 shares held on behalf of 1,268 individual participants in the Savings Plan. Of such participants, 352 individuals also own shares of our stock outside of the Savings Plan. The Savings Plan Trustee votes the shares based on the instructions of each participant. In the event the participant does not provide the Savings Plan Trustee with instructions, the Savings Plan Trustee votes those shares in accordance with voting instructions received from a majority of the participants in the plan.

***Dividends***

It is our policy to pay a dividend to all common shareholders quarterly. Dividends are declared and paid in the month following the calendar quarter. The board may change or eliminate the payment of future dividends.

Recent quarterly and special dividends follow:

| Month Declared and Paid       | Amount<br>Per Share | Total Cash<br>Dividend |
|-------------------------------|---------------------|------------------------|
| January 2007                  | 0.61                | \$5,007,153            |
| January 2007 special dividend | 0.41                | 3,363,708              |
| April 2007                    | 0.65                | 5,319,599              |
| July 2007                     | 0.65                | 5,299,394              |
| October 2007                  | 0.65                | 5,265,375              |
| January 2008                  | 0.65                | 5,207,192              |
| April 2008                    | 0.65                | 5,124,399              |
| July 2008                     | 0.65                | 5,090,168              |

|              |      |           |
|--------------|------|-----------|
| October 2008 | 0.65 | 5,157,034 |
| January 2009 | 0.65 | 5,127,714 |

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**Table of Contents***Dividend Restrictions*

For a description of restrictions on the payment of dividends, see Part I, Item 1, Business Regulation and Supervision Restrictions on Transfers of Funds to Us and the Bank, and Management's Discussion and Analysis of Financial Condition and Results of Operations Capital Resources and Liquidity Management and Management's Discussion and Analysis of Financial Condition and Results of Operations Financial Condition Long-Term Debt included in Item 7 herein.

**Sales of Unregistered Securities**

There were no issuances of unregistered securities during the fourth quarter of 2008.

**Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

The following table provides information with respect to purchases made by or on behalf of us or any affiliated purchasers (as defined in Rule 10b-18(a)(3) under the Exchange Act), of our common stock during the three months ended December 31, 2008.

**Purchases of Equity Securities by Issuer**

| Period        | Total<br>Number<br>of Shares<br>Purchased<br>(1) | Average<br>Price<br>Paid Per<br>Share | Total Number<br>of Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | Maximum<br>Number<br>of Shares That<br>May Yet Be<br>Purchased<br>Under the<br>Plans or<br>Programs |
|---------------|--------------------------------------------------|---------------------------------------|-------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------|
| October 2008  | 17,551                                           | \$ 77.00                              | Not<br>Applicable                                                                                     | Not<br>Applicable                                                                                   |
| November 2008 | 17,117                                           | 79.46                                 | Not<br>Applicable                                                                                     | Not<br>Applicable                                                                                   |
| December 2008 | 31,103                                           | 79.46                                 | Not<br>Applicable                                                                                     | Not<br>Applicable                                                                                   |
| Total         | 65,771                                           | \$ 78.80                              | Not<br>Applicable                                                                                     | Not<br>Applicable                                                                                   |

- (1) Our common stock is not publicly traded, and there is no established trading market for the stock. There is only one class of common stock. As of December 31, 2008, approximately 91% of our common stock was subject to contractual transfer restrictions set forth in shareholder agreements. We have a right of first refusal to repurchase the restricted stock. Additionally, under certain conditions we may call restricted stock held by our officers, directors and employees. We have no obligation to purchase restricted or unrestricted stock, but have historically purchased such stock. All purchases indicated in the table above were effected pursuant to private transactions.

**Table of Contents****Performance Graph**

The performance graph below compares the cumulative total shareholder return of our common stock with the cumulative total return on equity securities of companies included in the Nasdaq Composite Index and the Nasdaq Bank Index. The Nasdaq Bank Index is a comparative peer index comprised of financial companies, including banks, savings institutions and related holding companies that perform banking-related functions, listed on the Nasdaq Stock Market. The Nasdaq Composite Index is a comparative broad market index comprised of all domestic and international common stocks listed on the Nasdaq Stock Market. The graph assumes an investment of \$100 on December 31, 2003 and reinvestment of dividends on the date of payment without commissions. The plot points on the graph were provided by SNL Financial LC, Charlottesville, VA.

Our common stock is not publicly traded, and there is no established trading market for our stock. The cumulative total shareholder return for our common stock is based on the minority appraised value of the common stock, which represents the estimated fair market valuation of a minority interest, taking into account adjustments for the lack of marketability and other factors, as of December 31<sup>st</sup> of each year. The performance graph represents past performance, which may not be indicative of the future performance of our common stock.

| <i>Index</i>                       | <i>Period Ending</i> |                 |                 |                 |                 |                 |
|------------------------------------|----------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
|                                    | <b>12/31/03</b>      | <b>12/31/04</b> | <b>12/31/05</b> | <b>12/31/06</b> | <b>12/31/07</b> | <b>12/31/08</b> |
| First Interstate BancSystems, Inc. | \$ 100.00            | \$ 127.18       | \$ 147.51       | \$ 190.68       | \$ 185.00       | \$ 170.42       |
| NASDAQ Composite                   | 100.00               | 108.59          | 110.08          | 120.56          | 132.39          | 78.72           |
| NASDAQ Bank                        | 100.00               | 110.99          | 106.18          | 117.87          | 91.85           | 69.88           |

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**Table of Contents****Item 6. Selected Consolidated Financial Data**

The following selected consolidated financial data with respect to our consolidated financial position as of December 31, 2008 and 2007, and the results of our operations for the fiscal years ended December 31, 2008, 2007 and 2006, has been derived from our audited consolidated financial statements included in Part IV, Item 15. This data should be read in conjunction with Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and such consolidated financial statements, including the notes thereto. The selected consolidated financial data with respect to our consolidated financial position as of December 31, 2006, 2005 and 2004, and the results of our operations for the fiscal years ended December 31, 2005 and 2004, has been derived from our audited consolidated financial statements not included herein.

**Five Year Summary**

*(Dollars in thousands except share and per share data)*

| Year ended December 31,                             | 2008       | 2007       | 2006       | 2005       | 2004       |
|-----------------------------------------------------|------------|------------|------------|------------|------------|
| <i>Operating Data:</i>                              |            |            |            |            |            |
| Interest income                                     | \$ 355,919 | \$ 325,557 | \$ 293,423 | \$ 233,857 | \$ 192,840 |
| Interest expense                                    | 120,542    | 125,954    | 105,960    | 63,549     | 42,421     |
| Net interest income                                 | 235,377    | 199,603    | 187,463    | 170,308    | 150,419    |
| Provision for loan losses                           | 33,356     | 7,750      | 7,761      | 5,847      | 8,733      |
| Net interest income after provision for loan losses | 202,021    | 191,853    | 179,702    | 164,461    | 141,686    |
| Non-interest income                                 | 128,382    | 92,448     | 102,119    | 70,882     | 70,644     |
| Non-interest expense                                | 222,326    | 178,867    | 164,713    | 151,318    | 142,980    |
| Income before income taxes                          | 108,077    | 105,434    | 117,108    | 84,025     | 69,350     |
| Income tax expense                                  | 37,429     | 36,793     | 41,499     | 29,310     | 23,929     |
| Net income                                          | 70,648     | 68,641     | 75,609     | 54,715     | 45,421     |
| Preferred stock dividends                           | 3,347      |            |            |            |            |
| Net income available to common shareholders         | \$ 67,301  | \$ 68,641  | \$ 75,609  | \$ 54,715  | \$ 45,421  |
| Basic earnings per common share                     | \$ 8.55    | \$ 8.45    | \$ 9.32    | \$ 6.84    | \$ 5.74    |
| Diluted earnings per common share                   | 8.38       | 8.25       | 9.11       | 6.71       | 5.68       |
| Dividends per common share                          | 2.60       | 2.97       | 2.27       | 1.88       | 1.56       |
| Weighted average common shares outstanding diluted  | 8,028,168  | 8,322,480  | 8,303,990  | 8,149,337  | 7,997,579  |
| <i>Ratios:</i>                                      |            |            |            |            |            |
| Return on average assets                            | 1.12%      | 1.37%      | 1.60%      | 1.26%      | 1.14%      |
|                                                     | 14.73      | 16.14      | 20.38      | 16.79      | 15.75      |

Return on average common  
stockholders' equity

Average stockholders' equity to

average assets

7.98

8.52

7.85

7.52

7.22

Net interest margin

4.25

4.46

4.47

4.48

4.34

Net interest spread

3.87

3.78

3.89

4.13

4.12

Common stock dividend payout

ratio (1)

30.41

35.15

24.36

27.49

27.18

*Balance Sheet Data at Year**End:*

Total assets

\$6,628,347

\$5,216,797

\$4,974,134

\$4,562,313

\$4,217,293

Loans

4,772,813

3,558,980

3,310,363

3,034,354

2,739,509

Allowance for loan losses

87,316

52,355

47,452

42,450

42,141

Investment securities

1,072,276

1,128,657

1,124,598

1,019,901

867,315

Deposits

5,174,259

3,999,401

3,708,511

3,547,590

3,321,681

Other borrowed funds

79,216

8,730

5,694

7,495

7,995

Long-term debt

84,148

5,145

21,601

54,654

61,926

Subordinated debentures held

by subsidiary trusts

123,715

103,095

41,238

41,238

41,238

Stockholders' equity

539,062

444,443

410,375

349,847

308,326

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**Table of Contents****Five Year Summary (continued)***(Dollars in thousands except share and per share data)*

| Year ended December 31,                                                     | 2008  | 2007   | 2006   | 2005   | 2004   |
|-----------------------------------------------------------------------------|-------|--------|--------|--------|--------|
| <i>Asset Quality Ratios at Year End:</i>                                    |       |        |        |        |        |
| Non-performing assets to total loans and other real estate owned (OREO) (2) | 2.03% | 1.00%  | 0.55%  | 0.67%  | 0.79%  |
| Allowance for loan losses to total loans                                    | 1.83  | 1.47   | 1.43   | 1.40   | 1.54   |
| Allowance for loan losses to non-performing loans (3)                       | 96.03 | 150.66 | 269.72 | 236.17 | 212.04 |
| Net charge-offs to average loans                                            | 0.28  | 0.08   | 0.09   | 0.19   | 0.21   |
| <i>Regulatory Capital Ratios at Year End:</i>                               |       |        |        |        |        |
| Tier 1 risk-based capital                                                   | 8.57% | 12.39% | 10.71% | 10.07% | 9.67%  |
| Total risk-based capital                                                    | 10.49 | 13.64  | 11.93  | 11.27  | 10.95  |
| Leverage ratio                                                              | 7.13  | 9.92   | 8.61   | 7.91   | 7.49   |

- (1) Dividends per common share divided by basic earnings per common share.
- (2) For purposes of computing the ratio of non-performing assets to total loans and OREO, non-performing assets include nonaccrual loans, loans past due 90 days or more and still accruing interest, restructured loans and OREO.
- (3) For purposes of computing the ratio of allowance for loan losses to non-performing loans, non-performing loans include nonaccrual loans, loans past due 90 days or more and still accruing interest and restructured loans.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations****Cautionary Note Regarding Forward-Looking Statements and Factors that Could Affect Future Results**

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Rule 175 promulgated thereunder, and Section 21E of the Securities Exchange Act of 1934, as amended, and Rule 3b-6 promulgated thereunder, that involve inherent risks and uncertainties. Any statements about our plans, objectives, expectations, strategies, beliefs, or future performance or events constitute forward-looking statements. Such statements are identified as those that include words or phrases such as believes, expects, anticipates, plans, trend, objective, continue or similar expressions or future or conditional verbs such as will, would, should, could, might, may or similar expressions.

Forward-looking statements involve known and unknown risks, uncertainties, assumptions, estimates and other important factors that could cause actual results to differ materially from any results, performance or events expressed or implied by such forward-looking statements. All forward-looking statements are qualified in their entirety by reference to the factors discussed in this report including, among others, the following risk factors discussed more fully in Item 1A hereof:

credit losses

concentrations of real estate loans

commercial loan risk

adverse economic conditions affecting Montana, Wyoming and South Dakota

adequacy of the allowance for loan losses

soundness of other financial institutions

recent market developments

effects of recent legislative and regulatory efforts to stabilize financial markets

changes in interest rates

inability to meet liquidity requirements

disruptions and illiquidity in credit markets

inability of our bank subsidiaries to pay dividends

failure to meet debt covenants

competition

inability to manage risks in turbulent and dynamic market conditions

inability to grow our business

environmental remediation and other costs

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breach in information system security

failure of technology

failure to effectively implement technology-driven products and services

ineffective internal operational controls

dependence on our management team

impairment of goodwill

the ability to attract and retain qualified employees

disruption of vital infrastructure and other business interruptions

litigation pertaining to fiduciary responsibilities

changes in or noncompliance with governmental regulations

capital required to support our bank subsidiaries

increases in deposit insurance premiums

investment risks affecting holders of common stock

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

**Recent Developments**

In response to the financial crises affecting the banking system and financial markets, the EESA was signed into law on October 3, 2008. Pursuant to the EESA, the Treasury was given the authority, among other things, to purchase up to \$700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the financial markets. On February 17, 2009, the American Recovery and Reinvestment Act of 2009 was enacted which amended, in certain respects, the EESA and provided an additional \$787 billion in economic stimulus funding.

On October 14, 2008, the Secretary of the Treasury announced that the Treasury will purchase equity stakes in a wide variety of banks and thrifts. Under the program, known as the TARP Capital Purchase Program, from the \$700 billion authorized by the EESA, the Treasury made \$250 billion of capital available to U.S. financial institutions in the form of preferred stock. In conjunction with the purchase of preferred stock, the Treasury received, from participating financial institutions, warrants to purchase common stock with an aggregate market price equal to 5% of the preferred investment. Participating financial institutions are required to adopt the Treasury's standards for executive compensation and corporate governance for the period during which the Treasury holds equity issued under the TARP Capital Purchase Program. On December 4, 2008, we submitted an application for participation in the TARP Capital Purchase Program. In connection with the application, we requested certain exceptions to the Treasury's standard terms and conditions applicable to the program. As of the date of this report, we have not been notified whether our application has been accepted nor have we determined whether we will participate in the program if we are accepted.

On November 21, 2008, the FDIC adopted a final rule related to the TLG Program. The TLG Program was initiated to counter the system-wide crisis in the nation's financial sector. Under the TLG Program, the FDIC will (i) guarantee certain newly issued senior unsecured debt issued by participating institutions on or after October 14, 2008 and before June 30, 2009, and (ii) provide full FDIC deposit insurance coverage for non-interest bearing transaction deposit accounts, NOW accounts paying less than 0.5% per annum and IOLTA accounts held at participating FDIC-insured institutions through December 31, 2009. On March 17, 2009, the FDIC extended the debt guarantee program through October 31, 2009. We elected to participate in the deposit insurance coverage guarantee program. We have not elected to participate in the debt guarantee program because more cost-effective liquidity sources are available to us.

On February 27, 2009, the FDIC adopted an interim rule proposing a 20 basis point emergency special assessment for all FDIC insured financial institutions. This proposed assessment, to be collected on September 30, 2009, is based on deposits as of June 30, 2009. The interim rule also proposes to permit the FDIC to impose an additional emergency special assessment after June 30, 2009 of up to 10 basis points if necessary to maintain public confidence in federal deposit insurance.

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### **Executive Overview**

We are a financial and bank holding company with 70 banking offices in 42 communities throughout Montana, Wyoming and South Dakota. We offer a wide range of banking products and services through our bank subsidiaries. We differentiate ourselves from competitors by providing superior service to our customers and emphasizing community involvement to improve the communities we serve.

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

Our business strategy is to profitably grow our business through measured organic growth and through expansion into new and complementary markets through selective acquisitions. In January 2008, we completed the First Western acquisition by purchasing two banks and a data center located in western South Dakota. The acquired entities operate eighteen banking offices in twelve South Dakota communities and had combined total assets as of the acquisition date of approximately \$913 million. In recent years, we have focused on improving efficiency through control of operating expenses, implementation of new technologies, consolidation of like operational and administrative functions where appropriate, and identification and implementation of strategies to increase non-interest income. As we address current economic and banking challenges in the near-term, our focus is on building capital, improving liquidity, improving earnings, managing loan quality, completing the integration of the acquired First Western entities and addressing short-term and long-term succession issues.

Our success is highly dependent on economic conditions and market interest rates. Because we operate in Montana, Wyoming and South Dakota, the local economic conditions in each of these areas are particularly important. Our local economies have not been as severely impacted by the national economic and real estate downturn, sub-prime mortgage crisis and ongoing financial market turmoil as many areas of the United States. The overall economic outlook for Montana, Wyoming and South Dakota predicts little or no growth in 2009 as the effects of the national recession spread into sectors that are likely to impact our local economies. Although the continuing impact of the national recession and financial market turmoil is uncertain, these factors affect our business and could have a harmful effect on our results of operations, cash flows and financial condition.

During 2008, we reported net income to common shareholders of \$67.3 million, or \$8.38 per diluted share, as compared to \$68.6 million, or \$8.25 per diluted share, in 2007. During fourth quarter 2008, we recorded a one-time, after-tax gain of \$17.0 million, or \$2.11 per diluted share, from the sale of i\_Tech, our technology services subsidiary. Exclusive of this one-time gain, net income for 2008 decreased 26.7%, or \$1.98 per diluted share, from 2007.

Net interest income, on a fully taxable-equivalent, or FTE, basis, increased 18.2% to \$240.6 million in 2008, from \$203.7 million in 2007, primarily due to the net interest income of the acquired First Western entities. Our net FTE interest margin ratio decreased 21 basis points to 4.25% in 2008, from 4.46% in 2007. This decline was largely due to indebtedness incurred in late 2007 and early 2008 to finance the acquisition of nonearning assets, principally goodwill, recorded in conjunction with the First Western acquisition. Additionally, interest free funding sources, including non-interest bearing deposits and common equity, comprised a smaller percentage of our funding base during 2008, as compared to 2007, and reductions in target federal funds rates further compressed our net FTE interest margin ratio.

During 2008, we experienced deterioration in credit quality, particularly in real estate development loans. This deterioration resulted in higher levels of non-performing and internally risk classified loans. Our non-performing loans increased \$56.2 million, or 161.6%, to \$90.9 million, or 1.9% of total loans, as of December 31, 2008, compared to \$34.8 million, or 1.0% of total loans, as of December 31, 2007. Based on our assessment of the adequacy of our allowance for loan losses, we recorded provisions for loan losses of \$33.4 million in 2008, as compared to \$7.8 million in 2007.

We continue to experience adverse effects and earning pressure due to the recession and market turbulence. We believe the trends of deteriorating credit quality and increasing non-performing loans will continue in 2009. Higher levels of non-performing loans adversely impact our financial condition and operating results and may cause us to be in non-compliance with certain financial covenants contained in our senior debt instruments.

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Exclusive of the one-time gain on the sale of i\_Tech and the results of the acquired First Western entities, non-interest income was flat and non-interest expense increased \$16.4 million, or 9.2%, in 2008 as compared to 2007. During 2008, we recorded impairment of mortgage servicing rights of \$10.9 million, as compared to \$1.7 million in 2007. The remaining increase in non-interest expense in 2008, exclusive of the acquired First Western entities, was primarily due to increases in salaries, wages and benefits expense combined with one-time employee recruitment and relocation costs and higher group insurance costs.

The following discussion and analysis is intended to provide greater details of the results of our operations and financial condition. It should be read in conjunction with the information under Part II, Item 6, Selected Consolidated Financial Data and the consolidated financial statements, including the notes thereto, and other financial data appearing elsewhere in this document.

### **Critical Accounting Estimates and Significant Accounting Policies**

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

Notes to Consolidated Financial Statements Summary of Significant Accounting Policies included in Part IV, Item 15.

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

#### *Allowance for Loan Losses*

The allowance for loan losses represents management's estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of subjective measurements, including management's assessment of the internal risk classifications of loans, changes in the nature of the loan portfolio, industry concentrations and the impact of current local, regional and national economic factors on the quality of the loan portfolio. Changes in these estimates and assumptions are reasonably possible and may have a material impact on our consolidated financial statements, results of operations or liquidity. The allowance for loan losses is maintained at an amount we believe is sufficient to provide for estimated losses inherent in our loan portfolio at each balance sheet date. Management continuously monitors qualitative and quantitative trends in the loan portfolio, including changes in the levels of past due, internally classified and non-performing loans. As a result, our historical experience has provided for an adequate allowance for loan losses. For additional information regarding the allowance for loan losses, its relation to the provision for loan losses and risk related to asset quality, see Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Provision for Loan Losses and Management's Discussion and Analysis of Financial Condition and Results of Operations Financial Condition Allowance for Loan Losses below, and Notes to Consolidated Financial Statements Allowance for Loan Losses included in Part IV, Item 15. See also Part I, Item 1A, Risk Factors Credit Risks.

#### *Goodwill*

The excess purchase price over the fair value of net assets from acquisitions, or goodwill, is evaluated for impairment at the reporting unit level at least annually, or on an interim basis if an event or circumstance indicates that it is likely an impairment has occurred. In testing for impairment, the fair value of each reporting unit is estimated based on an analysis of market-based trading and transaction multiples of selected banks in the western and central regions of the United States; and, if required, the estimated fair value is allocated to the assets and liabilities of each reporting unit. Determining the fair value of goodwill is considered a critical accounting estimate because of its sensitivity to market-based trading and transaction multiples. In addition, any allocation of the fair value of goodwill to assets and liabilities requires significant management judgment and the use of subjective measurements. Variability

in the market and changes in assumptions or subjective measurements used to allocated fair value are reasonably possible and may have a material impact on our consolidated financial statements, results of operations or liquidity. For additional information regarding goodwill, see Notes to Consolidated Financial Statements Summary of Significant Accounting Policies, included in Part IV, Item 15. See also Part I, Item 1A, Risk Factors Operational Risks.

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*Valuation of Mortgage Servicing Rights*

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

Determining the fair value of mortgage servicing rights is considered a critical accounting estimate because of the assets' sensitivity to changes in estimates and assumptions used, particularly loan prepayment speeds and discount rates. Changes in these estimates and assumptions are reasonably possible and may have a material impact on our consolidated financial statements, results of operations or liquidity.

At December 31, 2008, the consultant's valuation model indicated that an immediate 25 basis point decrease in mortgage interest rates would result in a reduction in fair value of mortgage servicing rights of \$3.3 million and an immediate 50 basis point decrease in mortgage interest rates would result in a reduction in fair value of \$4.9 million.

For additional information regarding mortgage servicing rights, see Notes to Consolidated Financial Statements Mortgage Servicing Rights, included in Part IV, Item 15. See also Part I, Item 1A, Risk Factors Market Risks.

**Results of Operations**

*Net Interest Income*

Net interest income, the largest source of our operating income, is derived from interest, dividends and fees received on interest earning assets, less interest expense incurred on interest bearing liabilities. Interest earning assets primarily include loans and investment securities. Interest bearing liabilities include deposits and various forms of indebtedness. Net interest income is affected by the level of interest rates, changes in interest rates and changes in the composition of interest earning assets and interest bearing liabilities.

The most significant impact on our net interest income between periods is derived from the interaction of changes in the volume of and rates earned or paid on interest earning assets and interest bearing liabilities. The volume of loans, investment securities and other interest earning assets, compared to the volume of interest bearing deposits and indebtedness, combined with the interest rate spread, produces changes in the net interest income between periods.

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

**Average Balance Sheets, Yields and Rates**

(Dollars in thousands)

|                                                       | Year Ended December 31, |           |                 |                    |           |                 |                    |           |                 |
|-------------------------------------------------------|-------------------------|-----------|-----------------|--------------------|-----------|-----------------|--------------------|-----------|-----------------|
|                                                       | 2008                    |           |                 | 2007               |           |                 | 2006               |           |                 |
|                                                       | Average<br>Balance      | Interest  | Average<br>Rate | Average<br>Balance | Interest  | Average<br>Rate | Average<br>Balance | Interest  | Average<br>Rate |
| <i>Interest earning assets:</i>                       |                         |           |                 |                    |           |                 |                    |           |                 |
| Loans (1)(2)                                          | \$4,527,987             | \$306,976 | 6.78%           | \$3,449,809        | \$274,020 | 7.94%           | \$3,208,102        | \$246,861 | 7.69%           |
| U.S. government agency and mortgage-backed securities | 923,912                 | 43,336    | 4.69            | 892,850            | 42,650    | 4.78            | 915,844            | 40,985    | 4.48            |
| Federal funds sold                                    | 55,205                  | 1,080     | 1.96            | 87,460             | 4,422     | 5.06            | 43,726             | 2,196     | 5.02            |
| Other securities                                      | 5,020                   | 214       | 4.26            | 857                | 3         | 0.35            | 1,059              | 6         | 0.57            |
| Tax exempt securities (2)                             | 147,812                 | 9,382     | 6.35            | 111,732            | 7,216     | 6.46            | 105,209            | 6,832     | 6.49            |
| Interest bearing deposits in banks                    | 5,946                   | 191       | 3.21            | 26,165             | 1,307     | 5.00            | 8,190              | 360       | 4.40            |
| Total interest earnings assets                        | 5,665,882               | 361,179   | 6.37            | 4,568,873          | 329,618   | 7.21            | 4,282,130          | 297,240   | 6.94            |
| Non-earning assets                                    | 667,206                 |           |                 | 423,893            |           |                 | 444,702            |           |                 |
| Total assets                                          | \$6,333,088             |           |                 | \$4,992,766        |           |                 | \$4,726,832        |           |                 |
| <i>Interest bearing liabilities:</i>                  |                         |           |                 |                    |           |                 |                    |           |                 |
| Demand deposits                                       | 1,120,807               | 12,966    | 1.16%           | 1,004,019          | 23,631    | 2.35%           | 850,925            | 15,852    | 1.86%           |
| Savings deposits                                      | 1,144,553               | 18,454    | 1.61            | 940,521            | 24,103    | 2.56            | 845,967            | 17,424    | 2.06            |
| Time deposits                                         | 1,688,859               | 65,443    | 3.87            | 1,105,959          | 51,815    | 4.69            | 1,010,820          | 39,991    | 3.96            |
| Borrowings (3)                                        | 663,957                 | 10,823    | 1.63            | 566,984            | 21,640    | 3.82            | 683,776            | 27,636    | 4.04            |
| Long-term debt                                        | 86,909                  | 4,579     | 5.27            | 9,230              | 467       | 5.06            | 40,320             | 1,576     | 3.91            |
| Subordinated debentures held by by subsidiary trusts  | 123,327                 | 8,277     | 6.71            | 47,099             | 4,298     | 9.13            | 41,238             | 3,481     | 8.44            |
| Total interest bearing liabilities                    | 4,828,412               | 120,542   | 2.50            | 3,673,812          | 125,954   | 3.43            | 3,473,046          | 105,960   | 3.05            |
| Non-interest bearing deposits                         | 940,968                 |           |                 | 842,239            |           |                 | 837,909            |           |                 |
| Other liabilities                                     | 58,173                  |           |                 | 51,529             |           |                 | 44,860             |           |                 |
| Stockholders equity                                   | 505,535                 |           |                 | 425,186            |           |                 | 371,017            |           |                 |
| Total liabilities and stockholders equity             | \$6,333,088             |           |                 | \$4,992,766        |           |                 | \$4,726,832        |           |                 |

|                                                            |           |           |           |
|------------------------------------------------------------|-----------|-----------|-----------|
| Net FTE interest income                                    | \$240,637 | \$203,664 | \$191,280 |
| Less FTE adjustments (2)                                   | (5,260)   | (4,061)   | (3,817)   |
| Net interest income from consolidated statements of income | \$235,377 | \$199,603 | \$187,463 |
| Interest rate spread                                       | 3.87%     | 3.78%     | 3.89%     |
| Net FTE interest margin (4)                                | 4.25%     | 4.46%     | 4.47%     |

(1) Average loan balances include nonaccrual loans. Interest income on loans includes amortization of deferred loan fees net of deferred loan costs.

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

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

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

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Net FTE interest income increased \$37.0 million, or 18.2%, to \$240.6 million in 2008, from \$203.7 million in 2007, due to the net interest income of the acquired First Western entities. Average earning assets grew 24.0% in 2008, with approximately 78.0% of this growth attributable to the acquired First Western entities. Despite growth in earning assets and an increase in the interest rate spread, our net FTE interest margin decreased 21 basis points to 4.25% in 2008, as compared to 4.46% for 2007, largely due to the First Western acquisition. In conjunction with the acquisition, we incurred indebtedness to acquire nonearning assets, including goodwill, core deposit intangibles and premises and equipment. In addition, interest free funding sources, including non-interest bearing deposits and common equity comprised a smaller percentage of our funding base during 2008 as compared to 2007, and reductions in federal funds rates in 2008 further compressed our net FTE interest margin ratio.

Our fourth quarter 2008 net FTE interest margin ratio declined to 4.13%, compared to 4.30% for third quarter 2008 and 4.41% for fourth quarter 2007, primarily due to reductions in federal funds rates. During fourth quarter 2008, the federal funds rate fell 125 to 150 basis points, with the last decrease taking the rate to between 0 and 25 basis points.

Net FTE interest income increased \$12.4 million, or 6.5%, to \$203.7 million in 2007 from \$191.3 million in 2006, due to organic growth in earning assets, primarily loans. During 2007, the migration of customer deposits from traditional repurchase agreements, which are secured by pledged investment securities, into a new money market sweep deposit product increased funds available to support growth in earning assets. Further contributing to improvements in net FTE interest income in 2007 and 2006 were increases in earning assets as a percentage of total assets.

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

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

(Dollars in thousands)

|                                                       | Year Ended December 31, 2008<br>compared with<br>December 31, 2007 |            |           | Year Ended December 31,<br>2007<br>compared with<br>December 31, 2006 |          |          | Year Ended December 31,<br>2006<br>compared with<br>December 31, 2005 |          |          |
|-------------------------------------------------------|--------------------------------------------------------------------|------------|-----------|-----------------------------------------------------------------------|----------|----------|-----------------------------------------------------------------------|----------|----------|
|                                                       | Volume                                                             | Rate       | Net       | Volume                                                                | Rate     | Net      | Volume                                                                | Rate     | Net      |
| <i>Interest earning assets:</i>                       |                                                                    |            |           |                                                                       |          |          |                                                                       |          |          |
| Loans (1)                                             | \$85,640                                                           | \$(52,684) | \$ 32,956 | \$18,599                                                              | \$ 8,560 | \$27,159 | \$22,782                                                              | \$27,626 | \$50,408 |
| U.S. government agency and mortgage-backed securities | 1,484                                                              | (798)      | 686       | (1,029)                                                               | 2,694    | 1,665    | 5,263                                                                 | 5,668    | 10,931   |
| Federal funds sold                                    | (1,631)                                                            | (1,711)    | (3,342)   | 2,196                                                                 | 30       | 2,226    | (1,312)                                                               | 742      | (570)    |
| Other securities (2)                                  | 15                                                                 | 196        | 211       | (1)                                                                   | (2)      | (3)      | (173)                                                                 | (22)     | (195)    |
| Tax exempt securities (1)(2)                          | 2,330                                                              | (164)      | 2,166     | 424                                                                   | (40)     | 384      | 120                                                                   | (32)     | 88       |
| Interest bearing deposits in banks                    | (1,010)                                                            | (106)      | (1,116)   | 790                                                                   | 157      | 947      | (754)                                                                 | 93       | (661)    |
| Total change                                          | 86,828                                                             | (55,267)   | 31,561    | 20,979                                                                | 11,399   | 32,378   | 25,926                                                                | 34,075   | 60,001   |



*Interest bearing liabilities:*

|                                                   |        |          |          |         |         |         |       |        |        |
|---------------------------------------------------|--------|----------|----------|---------|---------|---------|-------|--------|--------|
| Demand deposits                                   | 2,749  | (13,414) | (10,665) | 2,852   | 4,927   | 7,779   | 1,316 | 9,741  | 11,057 |
| Savings deposits                                  | 5,229  | (10,878) | (5,649)  | 1,947   | 4,732   | 6,679   | (701) | 6,974  | 6,273  |
| Time deposits                                     | 27,309 | (13,681) | 13,628   | 3,764   | 8,060   | 11,824  | (68)  | 10,418 | 10,350 |
| Borrowings (3)                                    | 3,701  | (14,518) | (10,817) | (4,720) | (1,276) | (5,996) | 4,441 | 10,445 | 14,886 |
| Long-term debt                                    | 3,930  | 182      | 4,112    | (1,215) | 106     | (1,109) | (842) | (62)   | (904)  |
| Subordinated debentures held by subsidiary trusts | 6,956  | (2,977)  | 3,979    | 495     | 322     | 817     |       | 749    | 749    |
| Total change                                      | 49,874 | (55,286) | (5,412)  | 3,123   | 16,871  | 19,994  | 4,146 | 38,265 | 42,411 |

Increase  
(decrease) in FTE  
net interest

|            |          |       |           |          |            |          |          |            |          |
|------------|----------|-------|-----------|----------|------------|----------|----------|------------|----------|
| income (1) | \$36,954 | \$ 19 | \$ 36,973 | \$17,856 | \$ (5,472) | \$12,384 | \$21,780 | \$ (4,190) | \$17,590 |
|------------|----------|-------|-----------|----------|------------|----------|----------|------------|----------|

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

(2) Held-to-maturity investment securities are presented at amortized cost.

(3) Includes interest on federal funds purchased, securities sold under repurchase agreements and other borrowed funds.

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### *Provision for Loan Losses*

The provision for loan losses creates an allowance for loan losses known and inherent in the loan portfolio at each balance sheet date. We perform a quarterly assessment of the risks inherent in our loan portfolio, as well as a detailed review of each significant asset with identified weaknesses. Based on this analysis, we record a provision for loan losses in order to maintain the allowance for loan losses at appropriate levels. In determining the allowance for loan losses, we estimate losses on specific loans, or groups of loans, where the probable loss can be identified and reasonably determined. The balance of the allowance for loan losses is based on internally assigned risk classifications of loans, historical loan loss rates, changes in the nature of the loan portfolio, overall portfolio quality, industry concentrations, delinquency trends, current economic factors and the estimated impact of current economic conditions on certain historical loan loss rates. Fluctuations in the provision for loan losses result from management's assessment of the adequacy of the allowance for loan losses. Ultimate loan losses may vary from current estimates. For additional information concerning the provision for loan losses, see *Critical Accounting Estimates and Significant Accounting Policies* above.

The provision for loan losses increased \$25.6 million, or 330.4%, to \$33.4 million in 2008, as compared to \$7.8 million in 2007. During fourth quarter 2008, we recorded provisions of \$20.0 million, as compared to \$5.6 million recorded in third quarter 2008 and \$2.1 million recorded in fourth quarter 2007. Significant increases in provisions for loan losses, particularly during fourth quarter 2008, reflect our assessment of the estimated effect of current economic conditions on our loan portfolio. Effects of the broad recession impacted our market areas in 2008 resulting in higher levels of non-performing assets, particularly real estate development loans. We determined that the provisions for loan losses made during 2008 were necessary to maintain our allowance for loan losses at a level, which in our estimate, is necessary to absorb probable loan losses within our existing loan portfolio. For additional information concerning non-performing assets, see *Non-Performing Assets* herein.

The provision for loan losses decreased less than 1% to \$7.8 million in 2007, as compared to 2006; however, during fourth quarter 2007, the provision for loan losses increased \$724 thousand, or 51.7%, to \$2.1 million, as compared to \$1.4 million for the same period in 2006. The fourth quarter 2007 increase was primarily due to higher levels of non-performing loans.

### *Non-interest Income*

Principal sources of non-interest income include other service charges, commissions and fees; technology services revenues; service charges on deposit accounts; wealth management revenues; and, income from the origination and sale of loans. Non-interest income increased \$35.9 million, or 38.9%, to \$128.4 million in 2008 from \$92.4 million in 2007. Non-interest income decreased \$9.7 million, or 9.5%, to \$92.4 million in 2007 from \$102.1 million in 2006. Fluctuations in non-interest income are a function of changes in each of the principal categories discussed below.

Other service charges, commissions and fees primarily include debit and credit card interchange income; mortgage servicing fees; investment services revenues; and, ATM service charge revenues. Other service charges, commissions and fees increased \$4.0 million, or 16.4%, to \$28.2 million in 2008 from \$24.2 million in 2007. Other service charges, commissions and fees increased 10.6% to \$24.2 million in 2007, from \$21.9 million in 2006. Approximately \$1.8 million of the 2008 increase was attributable to the acquired First Western entities. The remaining increase in 2008 and 2007 was primarily due to additional fee income from higher volumes of credit and debit card transactions and increases in insurance commissions.

Service charges on deposit accounts increased \$2.9 million, or 16.4%, to \$20.7 million in 2008, from \$17.8 million in 2007. Service charges on deposit accounts increased \$206 thousand, or 1.2%, to \$17.8 million in 2007, from \$17.6 million in 2006. Substantially all of the 2008 increase was attributable to the acquired First Western entities.

Technology services revenues decreased \$1.4 million, or 7.2%, to \$17.7 million in 2008, from \$19.1 million in 2007. This decrease was primarily due to a \$2.0 million contract termination fee recorded during third quarter 2007. In addition, item processing income decreased \$718 thousand in 2008, as compared to 2007, primarily due to the introduction of imaging technology that permits items to be captured electronically rather than through physical processing and transporting of the items. These decreases were offset by an increase of \$1.8 million in core data processing revenues resulting from increases in the number of core data processing customers and the volume of core data transactions processed. Technology services revenues increased 20.4% to \$19.1 million in 2007, from \$15.8 million in 2006, primarily due to a \$2.0 million nonrecurring contract termination fee recorded during third

quarter 2007 and an increase in the volume of core data and debit card transactions processed.

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Wealth management revenues, comprised principally of fees earned for management of trust assets and investment services, increased 5.3% to \$12.4 million in 2008, from \$11.7 million in 2007, due to the addition of new trust and investment services customers in 2008. Wealth management revenues increased 5.0% to \$11.7 million in 2007, from \$11.2 million in 2006, primarily due to higher asset management fees resulting from the improved market performance of underlying trust account assets and the addition of new trust and investment services customers.

Income from the origination and sale of loans includes origination and processing fees on residential real estate loans held for sale and gains on residential real estate loans sold to third parties. Fluctuations in market interest rates have a significant impact on the level of income generated from the origination and sale of loans. Higher interest rates can substantially reduce the demand for home loans and loans to refinance existing mortgages. Conversely, lower interest rates generally stimulate refinancing and home loan origination. Income from the origination and sale of loans increased 9.3% to \$12.3 million in 2008, from \$11.2 million in 2007, and 17.0% to \$11.2 million in 2007, from \$9.6 million in 2006. Approximately \$224 thousand of the 2008 increase is attributable to the acquired First Western entities.

During fourth quarter 2008, we recorded a one-time gain of \$27.1 million on the sale of i\_Tech, our technology services subsidiary. i\_Tech represented all of our technology services operating segment. Due to the sale, no technology services revenues will be recorded in 2009 or future periods. For additional information concerning this sale and the resulting gain, see Notes to Consolidated Financial Statements Disposals included in Part IV, Item 15.

Other income primarily includes company-owned life insurance revenues, check printing income, agency stock dividends and gains on sales of assets other than investment securities. Other income increased \$1.6 million, or 19.4%, to \$9.9 million in 2008, from \$8.3 million in 2007. Exclusive of the acquired First Western entities, non-interest income decreased \$1.7 million, or 20.2%, in 2008, as compared to 2007. During first quarter 2008, we recorded a gain of \$1.6 million resulting from the mandatory redemption of our class B shares of Visa, Inc. The net gain was split between our community banking and technology services operating segments. In addition, during first quarter 2008, we recorded a nonrecurring gain of \$1.1 million due to the release of funds escrowed in conjunction with the December 2006 sale of our interest in iPay Technologies, LLC. These gains were offset by decreases in earnings of securities held under deferred compensation plans and one-time gains recorded in 2007 of \$986 thousand on the sale of mortgage servicing rights and \$737 thousand from the conversion and subsequent sale of our MasterCard stock.

Other income increased 20.2% to \$8.3 million in 2007, from \$6.9 million in 2006, primarily due to nonrecurring gains of \$737 thousand from the conversion and subsequent sale of MasterCard stock and \$986 thousand on the sale of mortgage servicing rights recorded during 2007.

*Non-interest Expense*

Non-interest expense increased \$43.5 million, or 24.3%, to \$222.3 million in 2008, from \$178.9 million in 2007, and 8.6% to \$178.9 million in 2007, from \$164.7 million in 2006. Significant components of these increases are discussed below.

Salaries, wages and employee benefits expense increased \$15.9 million, or 16.2%, to \$114.0 million in 2008, from \$98.1 million in 2007. Approximately \$12.2 million of the 2008 increase was attributable to the acquired First Western entities. The remaining increase was primarily due to higher group health insurance costs and wage increases. These increases were partially offset by decreases in incentive bonus and profit sharing accruals to reflect 2008 performance results.

Salaries, wages and employee benefits expense increased 10.4% to \$98.1 million in 2007, from \$88.9 million in 2006, primarily due to the combined effects of wage increases, higher staffing levels, higher incentive compensation accruals and increased group medical insurance costs.

Furniture and equipment expense increased \$2.7 million, or 16.3%, to \$18.9 million in 2008, from \$16.2 million in 2007. Approximately \$1.2 million of the increase was attributable to the acquired First Western entities. The remaining increase was primarily due to higher depreciation and maintenance expenses resulting from the addition, replacement and repair of equipment in the ordinary course of business. Furniture and equipment expense decreased slightly to \$16.2 million in 2007, as compared to \$16.3 million in 2006.

Occupancy expense increased \$1.6 million, or 11.0%, to \$16.3 million in 2008, from \$14.7 million in 2007, due to the acquired First Western entities. Occupancy expense increased 10.8% to \$14.7 million in 2007, from \$13.3 million in 2006, primarily due to increases in rental expense and higher depreciation expense resulting from adjustment of the useful lives of two buildings and related leasehold improvements.

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Mortgage servicing rights are evaluated quarterly for impairment by discounting the expected future cash flows, taking into consideration the estimated level of prepayments based on current industry expectations and the predominant risk characteristics of the underlying loans. Impairment adjustments are recorded through a valuation allowance. The valuation allowance is adjusted for changes in impairment through a charge to current period earnings. We recorded impairment charges of \$10.9 million in 2008 and \$1.7 million in each of 2007 and 2006.

Mortgage servicing rights are amortized in proportion to and over the period of estimated net servicing income. Changes in estimated servicing period and growth in the serviced loan portfolio cause amortization expense to vary between periods. Mortgage servicing rights amortization increased \$1.5 million, or 33.3%, to \$5.9 million in 2008, from \$4.4 million in 2007, and \$417 thousand, or 10.4%, to \$4.4 million in 2007, from \$4.0 million in 2006.

FDIC insurance premiums increased \$2.5 million, or 555.9%, to \$2.9 million in 2008, from \$444 thousand in 2007. During the first half of 2008, we fully utilized a one-time credit provided by the FDIC to offset the cost of FDIC insurance premiums for well-managed banks. In addition, we elected to participate in the deposit insurance coverage guarantee program during fourth quarter 2008. The fee assessment for deposit insurance coverage on deposits insured under this program is 10 basis points per annum. For the first quarter of 2009 only, the FDIC increased all FDIC deposit assessment rates by 7 basis points and on February 27, 2009 the FDIC issued a final rule setting base assessment rates for Risk Category I institutions at 12 to 16 basis points, beginning April 1, 2009. While we cannot provide any assurance as to the actual amount of any increase in our FDIC insurance premiums, as such changes are dependent upon a variety of factors, some of which are beyond our control, we expect our base premiums will increase to approximately \$7.0 million in 2009.

In addition, on February 27, 2009, the FDIC adopted an interim rule proposing a 20 basis point special assessment for all FDIC insured financial institutions. This proposed assessment, which would be collected on September 30, 2009, is based on deposits as of June 30, 2009. Based on our current level and mix of deposit accounts, we estimate that a 20 basis point special assessment in 2009, should it occur, would increase our deposit insurance premiums by approximately \$10.4 million. A final rule related to the special assessment is expected in the near term.

Core deposit intangibles represent the intangible value of depositor relationships resulting from deposit liabilities assumed and are amortized based on the estimated useful lives of the related deposits. We recorded core deposit intangibles of \$14.9 million in conjunction with the acquisition of the First Western entities. These intangibles are being amortized using an accelerated method over their weighted average expected useful lives of 9.2 years. Core deposit intangible amortization expense was \$2.5 million in 2008, as compared to \$174 thousand in 2007 and \$772 thousand in 2006. Core deposit intangible amortization expense is expected to decrease 14.9% to \$2.1 million in 2009. For additional information regarding core deposit intangibles, see Notes to Consolidated Financial Statements Summary of Significant Accounting Policies, included in Part IV, Item 15.

Other expenses primarily include professional fees, outsource technology service costs, advertising and public relations costs; office supply, postage, freight, telephone and travel expenses; donations expense; board of director fees; and, other losses. Other expenses increased \$7.8 million, or 18.1%, to \$50.8 million in 2008, from \$43.0 million in 2007. Exclusive of other expenses of the acquired First Western entities, which included a \$1.3 million other than temporary impairment charge on one investment security, other expenses decreased \$1.1 million, or 2.3%, in 2008, as compared to 2007. During fourth quarter 2007, we recorded loss contingency accruals of \$1.5 million related to an indemnification agreement with Visa USA and two potential operational losses incurred in the ordinary course of business. During first quarter 2008, we reversed \$625 thousand of the loss contingency accrual related to our indemnification agreement with Visa USA. In addition, during 2008 we recorded expenses of \$450 thousand related to employee recruitment and relocation and \$708 thousand related to nonrecurring fraud losses.

Other expenses increased 9.5% to \$43.0 million in 2007, from \$39.3 million in 2006, primarily due to fourth quarter 2007 loss contingency accruals of \$1.5 million related to an indemnification agreement with Visa USA and two potential operational losses incurred in the ordinary course of business and increases in consulting fees related to the evaluation of a company-wide data warehousing system.

### *Income Tax Expense*

Our effective federal tax rate was 30.3% for the year ended December 31, 2008; 31.0% for the year ended December 31, 2007; and 31.6% for the year ended December 31, 2006. Fluctuations in federal income tax rates are

primarily due to fluctuations in tax exempt interest income as a percentage of total income. State income tax applies primarily to pretax earnings generated within Montana, South Dakota, Colorado, Idaho and Oregon. Our effective state tax rate was 4.4% for the year ended December 31, 2008; 3.9% for the year ended December 31, 2007; and 3.8% for the year ended December 31, 2006.

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**Table of Contents***Operating Segment Results*

The following table summarizes net income (loss) for each of our operating segments for the years indicated.

**Operating Segment Results**

(Dollars in thousands)

| Year ended December 31,   | Net Income (Loss) |           |           |
|---------------------------|-------------------|-----------|-----------|
|                           | 2008              | 2007      | 2006      |
| Community Banking         | \$ 63,364         | \$ 71,244 | \$ 66,691 |
| Technology Services       | 2,911             | 3,706     | 3,761     |
| Other                     | 70,312            | 68,400    | 75,642    |
| Intersegment eliminations | (65,939)          | (74,709)  | (70,485)  |
| Consolidated              | \$ 70,648         | \$ 68,641 | \$ 75,609 |

Our principal operating segment is community banking, which encompasses commercial and consumer banking services offered to individuals, businesses, municipalities and other entities. The community banking segment represented over 87% of our combined revenues and income during 2008, 2007 and 2006, and over 97% of our consolidated assets as of December 31, 2008 and 2007. Components of the changes in community banking net income in 2008 as compared to 2007, and in 2007 as compared to 2006, are discussed above.

The technology services operating segment encompasses services provided through i\_Tech to affiliated and non-affiliated customers including core application data processing; ATM and debit card processing; item proof, capture and imaging; wide area network services; and, system support. On December 31, 2008, we sold all of the outstanding stock of i\_Tech to Fiserv. For additional information regarding the sale of i\_Tech, see Notes to Consolidated Financial Statements - Disposals included in Part IV, Item 15.

Technology services net income decreased \$795 thousand, or 21.5%, to \$2.9 million in 2008, from \$3.7 million in 2007. This decrease was primarily due to a \$2.0 million nonrecurring contract termination fee recorded in 2007. In addition, item processing income decreased \$718 thousand in 2008, as compared to 2007, primarily due to the introduction of imaging technology that permits items to be captured electronically rather than through physical processing and transporting of the items. These decreases were partially offset by a one-time gain of \$894 thousand from the mandatory redemption of our class B shares of Visa, Inc. recorded during first quarter 2008 and increases in core data processing revenues due to higher transaction volumes.

Technology services net income decreased 1.5% to \$3.7 million in 2007, from \$3.8 million in 2006. Increases in net income resulting from a \$2.0 million contract termination fee and higher revenues from increases in the number of customers using core data processing services and the volume of core data and debit card transactions processed in 2007 were offset by increases in salary and benefits expenses due to higher staffing levels and increases in equipment maintenance and repair expense.

The Other category includes the net funding cost and other expenses of the parent holding company and the operational results of consolidated nonbank subsidiaries (except i\_Tech). Other net income increased 2.8% to \$70.3 million in 2008, as compared to \$68.4 million in 2007. Improvements in net income were primarily the result of increases of \$1.7 million in intercompany management fees; and, nonrecurring gains, including a \$1.1 million gain resulting from the release of funds escrowed in conjunction with the December 2006 sale of our equity interest in iPay, an unconsolidated joint venture also recorded during first quarter 2008, and a \$27.1 million gain on the sale of i\_Tech recorded during fourth quarter 2008. These contributions to net income were partially offset by increases in interest expense of \$7.5 million due to additional indebtedness incurred in conjunction with the First Western acquisition and decreases in earnings of subsidiaries.

During fourth quarter 2006, the parent holding company recorded a one-time after tax gain of \$12.3 million on the sale of its equity interest in an unconsolidated joint venture. Exclusive of this one-time gain, Other net income



increased 8.1% to \$68.4 million in 2007, from \$63.3 million in 2006. The increase in net income in 2007, as compared to 2006, was principally due to investment of proceeds received from the sale of the unconsolidated joint venture in 2006.

For additional information regarding the our operating segments, see **Business Operating Segments** included in Part I, Item 1, and **Notes to Consolidated Financial Statements Segment Reporting** included in Part IV, Item 15.

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**Table of Contents****Summary of Quarterly Results**

The following table presents unaudited quarterly results of operations for the fiscal years ended December 31, 2008 and 2007.

**Quarterly Results**

*(Dollars in thousands except per share data)*

|                                                        | First<br>Quarter | Second<br>Quarter | Third<br>Quarter | Fourth<br>Quarter | Total     |
|--------------------------------------------------------|------------------|-------------------|------------------|-------------------|-----------|
| <i>Year Ended December 31, 2008:</i>                   |                  |                   |                  |                   |           |
| Interest income                                        | \$91,109         | \$88,068          | \$89,928         | \$86,814          | \$355,919 |
| Interest expense                                       | 34,306           | 29,697            | 29,234           | 27,305            | 120,542   |
| Net interest income                                    | 56,803           | 58,371            | 60,694           | 59,509            | 235,377   |
| Provision for loan losses                              | 2,363            | 5,321             | 5,636            | 20,036            | 33,356    |
| Net interest income after provision<br>for loan losses | 54,440           | 53,050            | 55,058           | 39,473            | 202,021   |
| Non-interest income                                    | 26,369           | 25,225            | 24,310           | 52,478            | 128,382   |
| Non-interest expense                                   | 53,155           | 49,662            | 55,111           | 64,398            | 222,326   |
|                                                        |                  |                   |                  |                   |           |
| Income before income taxes                             | 27,654           | 28,613            | 24,257           | 27,553            | 108,077   |
| Income tax expense                                     | 9,578            | 9,988             | 8,362            | 9,501             | 37,429    |
|                                                        |                  |                   |                  |                   |           |
| Net income                                             | \$18,076         | \$18,625          | \$15,895         | \$18,052          | \$ 70,648 |
| Preferred stock dividends                              | 768              | 853               | 863              | 863               | 3,347     |
|                                                        |                  |                   |                  |                   |           |
| Net income available to common<br>shareholders         | \$17,308         | \$17,772          | \$15,032         | \$17,189          | \$ 67,301 |
|                                                        |                  |                   |                  |                   |           |
| Basic earnings per common share                        | \$ 2.19          | \$ 2.27           | \$ 1.93          | \$ 2.17           | \$ 8.55   |
| Diluted earnings per common<br>share                   | 2.14             | 2.22              | 1.89             | 2.13              | 8.38      |
| Dividends per common share                             | 0.65             | 0.65              | 0.65             | 0.65              | 2.60      |
|                                                        |                  |                   |                  |                   |           |
| <i>Year Ended December 31, 2007:</i>                   |                  |                   |                  |                   |           |
| Interest income                                        | \$78,636         | \$80,834          | \$83,314         | \$82,773          | \$325,557 |
| Interest expense                                       | 30,492           | 31,656            | 32,471           | 31,335            | 125,954   |
| Net interest income                                    | 48,144           | 49,178            | 50,843           | 51,438            | 199,603   |
| Provision for loan losses                              | 1,875            | 1,875             | 1,875            | 2,125             | 7,750     |
| Net interest income after provision<br>for loan losses | 46,269           | 47,303            | 48,968           | 49,313            | 191,853   |
| Non-interest income                                    | 21,697           | 22,306            | 25,390           | 23,055            | 92,448    |
| Non-interest expense                                   | 42,770           | 42,586            | 44,581           | 48,930            | 178,867   |

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|                                   |          |          |          |          |           |
|-----------------------------------|----------|----------|----------|----------|-----------|
| Income before income taxes        | 25,196   | 27,023   | 29,777   | 23,438   | 105,434   |
| Income tax expense                | 8,700    | 9,398    | 10,528   | 8,167    | 36,793    |
| Net income                        | \$16,496 | \$17,625 | \$19,249 | \$15,271 | \$ 68,641 |
| Basic earnings per common share   | \$ 2.01  | \$ 2.16  | \$ 2.37  | \$ 1.91  | \$ 8.45   |
| Diluted earnings per common share | 1.97     | 2.11     | 2.32     | 1.86     | 8.25      |
| Dividends per common share        | 1.02     | 0.65     | 0.65     | 0.65     | 2.97      |

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### **Financial Condition**

Total assets increased \$1,412 million, or 27.1%, to \$6,628 million as of December 31, 2008, from \$5,217 million as of December 31, 2007, primarily due to the First Western acquisition in January 2008. As of the date of acquisition, the acquired entities had combined total assets of \$913 million, combined total loans of \$727 million, combined premises and equipment of \$27 million and combined total deposits of \$814 million. In connection with the acquisition, we recorded goodwill of \$146 million and core deposit intangibles of \$15 million. For additional information regarding the First Western acquisition, see Notes to Consolidated Financial Statements - Acquisitions included in Part IV, Item 15.

#### *Loans*

Our loan portfolio consists of a mix of real estate, consumer, commercial, agricultural and other loans, including fixed and variable rate loans. Fluctuations in the loan portfolio are directly related to the economies of the communities we serve. While each loan originated generally must meet minimum underwriting standards established in our credit policies, lending officers are granted certain levels of autonomy in approving and pricing loans to assure that the banking offices are responsive to competitive issues and community needs in each market area.

*Real Estate Loans.* We provide interim construction and permanent financing for both single-family and multi-unit properties, medium-term loans for commercial, agricultural and industrial property and/or buildings and equity lines of credit secured by real estate. Residential real estate loans are typically sold in the secondary market. Those residential real estate loans not sold are typically secured by first liens on the financed property and generally mature in less than 10 years. Commercial, agricultural and industrial loans are generally secured by first liens on income-producing real estate and generally mature in less than five years. Approximately 53% of our commercial real estate loans as of December 31, 2008, were owner occupied, which typically involves less risk than loans on investment property.

*Consumer Loans.* Our consumer loans include direct personal loans, credit card loans and lines of credit; and, indirect loans created when we purchase consumer loan contracts advanced for the purchase of automobiles, boats and other consumer goods from consumer product dealers. Personal loans and indirect dealer loans are generally secured by automobiles, boats and other types of personal property and are made on an installment basis. Credit cards are offered to individual and business customers in our market areas. Lines of credit are generally floating rate loans that are unsecured or secured by personal property. Approximately 61% of our consumer loans as of December 31, 2008, were indirect dealer loans.

*Commercial Loans.* We provide a mix of variable and fixed rate commercial loans. The loans are typically made to small and medium-sized manufacturing, wholesale, retail and service businesses for working capital needs and business expansions. Commercial loans generally include lines of credit and loans with maturities of five years or less. The loans are generally made with business operations as the primary source of repayment, but also include collateralization by inventory, accounts receivable, equipment and/or personal guarantees.

*Agricultural Loans.* Our agricultural loans generally consist of short and medium-term loans and lines of credit that are primarily used for crops, livestock, equipment and general operations. Agricultural loans are ordinarily secured by assets such as livestock or equipment and are repaid from the operations of the farm or ranch. Agricultural loans generally have maturities of five years or less, with operating lines for one production season.

Total loans increased 34.1% to \$4,773 million as of December 31, 2008, from \$3,559 million as of December 31, 2007, and 7.5% to \$3,559 million as of December 31, 2007, from \$3,310 as of December 31, 2006. Approximately \$723 million of the 2008 increase was attributable to the acquired First Western entities. Excluding loans of the acquired entities, total loans increased \$491 million, or 13.8%, in 2008, with the most significant growth occurring in commercial, commercial real estate, construction and residential real estate loans.

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

**Loans Outstanding**

(Dollars in thousands)

|                                   | 2008        | Percent | 2007        | Percent | As of December 31,<br>2006 | Percent | 2005        | Percent | 2004        | Percent |
|-----------------------------------|-------------|---------|-------------|---------|----------------------------|---------|-------------|---------|-------------|---------|
| <i>Loans</i>                      |             |         |             |         |                            |         |             |         |             |         |
| Real estate:                      |             |         |             |         |                            |         |             |         |             |         |
| Commercial                        | \$1,483,967 | 31.1%   | \$1,018,831 | 28.6%   | \$ 937,695                 | 28.3%   | \$ 926,190  | 30.5%   | \$ 855,711  | 31.2%   |
| Construction                      | 790,177     | 16.5    | 664,272     | 18.7    | 579,603                    | 17.5    | 403,751     | 13.3    | 296,773     | 10.8    |
| Residential                       | 587,464     | 12.3    | 419,001     | 11.8    | 402,468                    | 12.2    | 408,659     | 13.4    | 363,145     | 13.3    |
| Agricultural                      | 191,831     | 4.0     | 142,256     | 4.0     | 137,659                    | 4.1     | 116,402     | 3.9     | 108,345     | 4.0     |
| Other                             | 47,076      | 1.0     | 26,080      | 0.7     | 25,360                     | 0.8     | 19,067      | 0.6     | 21,255      | 0.7     |
| Consumer                          | 689,635     | 14.4    | 608,002     | 17.1    | 605,858                    | 18.3    | 587,895     | 19.4    | 514,045     | 18.8    |
| Commercial                        | 833,894     | 17.5    | 593,669     | 16.7    | 542,325                    | 16.4    | 494,848     | 16.3    | 500,611     | 18.3    |
| Agricultural                      | 145,876     | 3.1     | 81,890      | 2.3     | 76,644                     | 2.3     | 74,561      | 2.5     | 74,303      | 2.7     |
| Other loans                       | 2,893       | 0.1     | 4,979       | 0.1     | 2,751                      | 0.1     | 2,981       | 0.1     | 5,321       | 0.2     |
| Total loans                       | 4,772,813   | 100.0%  | 3,558,980   | 100.0%  | 3,310,363                  | 100.0%  | 3,034,354   | 100.0%  | 2,739,509   | 100.0%  |
| Less allowance for loan losses    | 87,316      |         | 52,355      |         | 47,452                     |         | 42,450      |         | 42,141      |         |
| Net loans                         | \$4,685,497 |         | \$3,506,625 |         | \$3,262,911                |         | \$2,991,904 |         | \$2,697,368 |         |
| Ratio of allowance to total loans | 1.83%       |         | 1.47%       |         | 1.43%                      |         | 1.40%       |         | 1.54%       |         |

Commercial real estate loans increased 45.7% to \$1,484 million as of December 31, 2008, from \$1,019 million as of December 31, 2007 and 8.7% to \$1,019 million as of December 31, 2007, from \$938 million as of December 31, 2006. Excluding increases attributable to the acquired First Western entities, commercial real estate loans increased 15.3% as of December 31, 2008, as compared to December 31, 2007, primarily due to real estate development loans. Demand for improved lots declined in 2008 reducing the cash flow of real estate developers, which resulted in increases in outstanding loan balances. As of December 31, 2008, we had no interest reserves related to real estate development loans. The increase in commercial real estate loans in 2007 was primarily due to strong demand for housing and overall growth in our market areas.

Construction loans increased 19.0% to \$790 million as of December 31, 2008, from \$664 million as of December 31, 2007 and 14.6% to \$664 million as of December 31, 2007, from \$580 million as of December 31, 2006. Excluding increases attributable to the acquired First Western entities, construction loans increased 2.9% as of December 31, 2008, as compared to December 31, 2007. Construction loans are primarily to commercial builders for residential lot development and the construction of single-family residences and commercial real estate properties. Construction loans are generally underwritten pursuant to the same guidelines used for originating permanent commercial and residential mortgage loans. Terms and rates typically match those of permanent commercial and

residential mortgage loans, except that during the construction phase the borrower pays interest only. Growth in construction loans in 2008 and 2007 was primarily the result of demand for housing and overall growth in our market areas.

Residential real estate loans increased 40.2% to \$587 million as of December 31, 2008, from \$419 million as of December 31, 2007. Excluding increases attributable to the acquired First Western entities, residential real estate loans increased 25.4% as of December 31, 2008, as compared to December 31, 2007. Increase in residential real estate loans primarily occurred in equity loans and lines of credit. Equity loans and lines of credit are typically secured by first or second liens on residential real estate and generally do not exceed a loan to value ratio of 90%. As of December 31, 2008, equity loans and lines of credit totaled \$381 million. We do not engage in sub-prime lending practices.

Commercial loans increased 40.5% to \$834 million as of December 31, 2008, from \$594 million as of December 31, 2007 and 9.5% to \$594 million as of December 31, 2007, from \$542 million as of December 31, 2006. Excluding increases attributable to the acquired First Western entities, commercial loans increased 15.3% as of December 31, 2008, as compared to December 31, 2007. Management attributes 2008 growth to an overall increase in borrowing activity during most of 2008 due to retail business expansion in our market areas. This expansion began to decline in late 2008 as retail businesses in our market areas were impacted by the effects the recession. The increase in 2007, as compared to 2006 was primarily due to a favorable economy, growth in our existing market areas and an increase in overall borrowing activity.

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The following table presents the maturity distribution of our loan portfolio and the sensitivity of the loans to changes in interest rates as of December 31, 2008:

**Maturities and Interest Rate Sensitivities**

(Dollars in thousands)

|                                   | Within<br>One Year | One Year to<br>Five Years | After<br>Five Years | Total           |
|-----------------------------------|--------------------|---------------------------|---------------------|-----------------|
| Real estate                       | \$2,026,031        | \$ 937,027                | \$ 137,457          | \$3,100,515     |
| Consumer                          | 369,911            | 299,034                   | 20,690              | 689,635         |
| Commercial                        | 659,026            | 166,080                   | 8,788               | 833,894         |
| Agricultural                      | 132,402            | 13,367                    | 107                 | 145,876         |
| Other loans                       | 2,893              |                           |                     | 2,893           |
| <br>Total loans                   | <br>\$3,190,263    | <br>\$1,415,508           | <br>\$ 167,042      | <br>\$4,772,813 |
| <br>Loans at fixed interest rates | <br>\$ 946,036     | <br>\$1,401,612           | <br>\$ 153,125      | <br>\$2,500,773 |
| Loans at variable interest rates  | 2,158,595          | 13,896                    | 13,917              | 2,186,408       |
| Nonaccrual loans                  | 85,632             |                           |                     | 85,632          |
| <br>Total loans                   | <br>\$3,190,263    | <br>\$1,415,508           | <br>\$ 167,042      | <br>\$4,772,813 |

***Investment Securities***

We manage our investment portfolio to obtain the highest yield possible, while meeting our risk tolerance and liquidity guidelines and satisfying the pledging requirements for deposits of state and political subdivisions and securities sold under repurchase agreements. The portfolio is comprised of mortgage-backed securities, U.S. government agency securities, tax exempt securities, corporate securities and mutual funds. Federal funds sold are additional investments that are classified as cash equivalents rather than as investment securities. Investment securities classified as available-for-sale are recorded at fair value, while investment securities classified as held-to-maturity are recorded at amortized cost. Unrealized gains or losses, net of the deferred tax effect, on available-for-sale securities are reported as increases or decreases in accumulated other comprehensive income or loss, a component of stockholders' equity.

Investment securities decreased 5.0% to \$1,072 million as of December 31, 2008, from \$1,129 million as of December 31, 2007. Excluding investment securities of the acquired First Western entities, our investment securities decreased 11.5% as of December 31, 2008, compared to December 31, 2007. During 2008, proceeds from maturities, calls and principal paydowns of investment securities were used to fund loan growth. Investment securities increased less than 1.0% to \$1,129 million as of December 31, 2007, from \$1,125 million as of December 31, 2006. During first quarter 2007, we introduced a money market sweep deposit product that does not require the pledging of investment securities as collateral. The migration of customers from traditional repurchase agreements, which typically require the pledging of investment securities as collateral, to the new money market sweep deposit product allowed us to deploy available funds into earning assets other than short-term investment securities.

As of December 31, 2008, our investments in corporate securities, non-agency mortgage-backed securities and Federal National Mortgage Association, or Fannie Mae, common stock totaled \$5.4 million, or less than 1% of our total investment portfolio. We did not invest in Federal Home Loan Mortgage Corporation, or Freddie Mac, preferred stock. As of December 31, 2008, investment securities with amortized costs and fair values of \$894 million and \$907 million, respectively, were pledged to secure public deposits and securities sold under repurchase agreements, as

compared to \$909 million and \$907 million, respectively, as of December 31, 2007. The weighted average yield on investment securities decreased 4 basis points to 4.92% in 2008, from 4.96% in 2007, and increased 28 basis points to 4.96% in 2007, from 4.68% in 2006. For additional information concerning securities sold under repurchase agreements, see Federal Funds Purchased and Securities Sold Under Repurchase Agreements included herein.

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The following table sets forth the book value, percentage of total investment securities and average yield on investment securities as of December 31, 2008:

**Securities Maturities and Yield**

(Dollars in thousands)

|                                                             | Book<br>Value | % of Total<br>Investment<br>Securities | Weighted<br>Average<br>Yield (1) |
|-------------------------------------------------------------|---------------|----------------------------------------|----------------------------------|
| <i>U.S. Government agency securities</i>                    |               |                                        |                                  |
| Maturing within one year                                    | \$ 84,165     | 7.9%                                   | 3.73%                            |
| Maturing in one to five years                               | 179,843       | 16.8                                   | 4.40                             |
| Mark-to-market adjustments on securities available-for-sale | 6,371         |                                        |                                  |
| Total                                                       | 270,379       | 25.2                                   | 4.19                             |
| <i>Mortgage-backed securities</i>                           |               |                                        |                                  |
| Maturing within one year                                    | 226,270       | 21.1                                   | 4.93                             |
| Maturing in one to five years                               | 271,519       | 25.3                                   | 4.81                             |
| Maturing in five to ten years                               | 84,029        | 7.8                                    | 5.00                             |
| Maturing after ten years                                    | 64,638        | 6.0                                    | 5.19                             |
| Mark-to-market adjustments on securities available-for-sale | 8,803         |                                        |                                  |
| Total                                                       | 655,259       | 61.1                                   | 4.92                             |
| <i>Tax exempt securities</i>                                |               |                                        |                                  |
| Maturing within one year                                    | 13,873        | 1.3                                    | 6.04                             |
| Maturing in one to five years                               | 41,122        | 3.8                                    | 6.24                             |
| Maturing in five to ten years                               | 37,085        | 3.5                                    | 6.19                             |
| Maturing after ten years                                    | 50,951        | 4.8                                    | 6.30                             |
| Mark-to-market adjustments on securities available-for-sale | 99            |                                        |                                  |
| Total                                                       | 143,130       | 13.4                                   | 6.23                             |
| <i>Other securities (2)</i>                                 |               |                                        |                                  |
| No stated maturity                                          | 618           | 0.1                                    |                                  |
| Maturing within one year                                    | 2,891         | 0.3                                    | 5.27                             |
| Mark-to-market adjustments on securities available-for-sale | (5)           |                                        |                                  |
| Total                                                       | 3,504         | 0.3                                    | 4.34                             |

|                                      |              |              |
|--------------------------------------|--------------|--------------|
| Mutual funds with no stated maturity | 4            | 1.15         |
| Total                                | 4            | 1.15         |
| Total                                | \$ 1,072,276 | 100.0% 4.92% |

(1) Average yields have been calculated on a FTE basis.

(2) Investment in community development entities. Investment income is in the form of credits that reduce income tax expense.

The maturities noted above reflect \$97 million of investment securities at their final maturities although they have call provisions within the next year. Mortgage-backed securities, and to a limited extent other securities, have uncertain cash flow characteristics that present additional interest rate risk in the form of prepayment or extension risk primarily caused by changes in market interest rates. This additional risk is generally rewarded in the form of higher yields. Maturities of mortgage-backed securities presented above are based on prepayment assumptions at December 31, 2008.

There were no significant concentrations of investments at December 31, 2008 (greater than 10% of stockholders equity) in any individual security issuer, except for U.S. government or agency-backed securities.

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As of December 31, 2007, we had U.S. government agency securities with carrying values of \$453 million and a weighted average yield of 4.54%; mortgage-backed securities with carrying values of \$562 million and a weighted average yield of 4.87%; tax exempt securities with carrying values of \$114 million and a weighted average yield of 6.44%; other securities with carrying values of \$767 thousand and a weighted average yield of 0.00%; and, mutual funds with carrying values of \$3 thousand and a weighted average yield of 3.62%.

As of December 31, 2006, we had U.S. government agency securities with carrying values of \$564 million and a weighted average yield of 4.81%; mortgage-backed securities with carrying values of \$448 million and a weighted average yield of 4.63%; tax exempt securities with carrying values of \$111 million and a weighted average yield of 6.49%; other securities with carrying values of \$918 thousand and a weighted average yield of 0.00%; and, mutual funds with carrying values of \$40 thousand and a weighted average yield of 4.77%.

We evaluate our investment portfolio quarterly for other-than-temporary declines in the market value of individual investment securities. This evaluation includes monitoring credit ratings; market, industry and corporate news; volatility in market prices; and, determining whether the market value of a security has been below its cost for an extended period of time. As of December 31, 2008, we had investment securities with fair values of \$73 million that had been in a continuous loss position more than twelve months. Gross unrealized losses on these securities totaled \$796 thousand as of December 31, 2008, and were primarily attributable to changes in interest rates. We recorded impairment losses of \$1.3 million in 2008, all of which was related to one corporate bond. Subsequent to the impairment loss, the carrying value of this bond was zero. No impairment losses were recorded during 2007 or 2006.

For additional information concerning investment securities, see Notes to Consolidated Financial Statements Investment Securities included in Part IV, Item 15.

### *Mortgage Servicing Rights*

We recognize the rights to service mortgage loans for others whether acquired or originated internally. Net mortgage servicing rights decreased 49.3% to \$11 million as of December 31, 2008, from \$22 million as of December 31, 2007, primarily due to increases in impairment reserves. Impairment reserves increased \$11 million, or 187.1%, to \$17 million as of December 31, 2008, compared to \$6 million as of December 31, 2007, primarily due to increases in the estimated level of expected prepayments. For additional information regarding mortgage servicing rights, see Notes to Consolidated Financial Statements Mortgage Servicing Rights included in Part IV, Item 15.

### *Other Assets*

Other assets increased 30.2% to \$56 million as of December 31, 2008, from \$43 million as of December 31, 2007, primarily due to increases in other real estate owned and the acquisition of \$7 million of Federal Reserve Bank stock in conjunction with obtaining Federal Reserve membership for the acquired First Western entities. Other assets decreased 7.2% to \$43 million as of December 31, 2007, from \$46 million as of December 31, 2006.

### *Deposits*

We emphasize developing total client relationships with our customers in order to increase our core deposit base, which is our primary funding source. Our deposits consist of non-interest bearing and interest bearing demand, savings, individual retirement and time deposit accounts.

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The following table summarizes our deposits as of the dates indicated:

**Deposits**

(Dollars in thousands)

|                             | 2008        | Percent | 2007        | Percent | As of December 31, |        | 2005        | Percent | 2004        | Percent |
|-----------------------------|-------------|---------|-------------|---------|--------------------|--------|-------------|---------|-------------|---------|
|                             | 2006        | Percent |             |         |                    |        |             |         |             |         |
| <i>Deposits</i>             |             |         |             |         |                    |        |             |         |             |         |
| Non-interest bearing demand | \$ 985,155  | 19.0%   | \$ 836,753  | 20.9%   | \$ 888,694         | 24.0%  | \$ 864,128  | 24.4%   | \$ 756,687  | 22.8%   |
| Interest bearing:           |             |         |             |         |                    |        |             |         |             |         |
| Demand                      | 1,059,818   | 20.5    | 1,019,208   | 25.5    | 964,312            | 26.0   | 792,263     | 22.3    | 623,082     | 18.8    |
| Savings                     | 1,198,783   | 23.2    | 992,571     | 24.8    | 798,497            | 21.5   | 879,586     | 24.8    | 921,176     | 27.7    |
| Time, \$100 and over        | 821,437     | 15.9    | 464,560     | 11.6    | 408,813            | 11.0   | 352,324     | 9.9     | 364,744     | 11.0    |
| Time, other                 | 1,109,066   | 21.4    | 686,309     | 17.2    | 648,195            | 17.5   | 659,289     | 18.6    | 655,992     | 19.7    |
|                             |             |         |             |         |                    |        |             |         |             |         |
| Total interest bearing      | 4,189,104   | 81.0    | 3,162,648   | 79.1    | 2,819,817          | 76.0   | 2,683,462   | 75.6    | 2,564,994   | 77.2    |
|                             |             |         |             |         |                    |        |             |         |             |         |
| Total deposits              | \$5,174,259 | 100.0%  | \$3,999,401 | 100.0%  | \$3,708,511        | 100.0% | \$3,547,590 | 100.0%  | \$3,321,681 | 100.0%  |

Total deposits increased 29.4% to \$5,174 million as of December 31, 2008, from \$3,999 million as of December 31, 2007. Excluding increases attributable to the acquired First Western entities, total deposits increased 9.1% as of December 31, 2008, as compared to December 31, 2007. All deposit categories demonstrated growth in 2008, as compared to 2007, and there was a shift in the mix of deposits, with interest bearing demand deposits decreasing to 20.5% of total deposits in 2008, as compared to 25.5% in 2007, and time deposits increasing to 37.3% of total deposits in 2008, as compared to 28.8% in 2007.

Time deposits of \$100 thousand or more increased 76.8% to \$821 million as of December 31, 2008, from \$465 million as of December 31, 2007. Excluding increases attributable to the acquired First Western entities, time deposits of \$100 thousand or more increased 42.2% as of December 31, 2008, as compared to December 31, 2007. During third quarter 2008, we issued an aggregate of \$100 million of certificates of deposit in brokered transactions. These certificates, which are included in time deposits of \$100 thousand or more, generally mature within four months and were issued to customers outside of our market areas. As of December 31, 2008, \$24 million of these deposits were outstanding. The remaining increase in time deposits of \$100 thousand or more was primarily due to internal growth, the result of management's focus to increase deposits combined with increases in deposit insurance coverage to \$250 thousand per account.

Other time deposits increased 61.6% to \$1,109 million as of December 31, 2008, from \$686 million as of December 31, 2007. Excluding increases attributable to the acquired First Western entities, other time deposits increased 24.1% as of December 31, 2008, as compared to December 31, 2007, primarily due increases in CDARS deposits. Under the CDARS program, large certificates of deposit are exchanged through a network of banks in smaller increments to ensure they are eligible for full FDIC insurance coverage. As of December 31, 2008, we had CDARS deposits of \$141 million compared to \$15 million as of December 31, 2007.

Total deposits increased 7.8% to \$3,999 million as of December 31, 2007, from \$3,709 million as of December 31, 2006. All deposit categories demonstrated growth with the exception of non-interest bearing demand deposits, which decreased 5.8% in 2007, as compared to 2006. In addition, there was a shift in the mix of deposits, with non-interest bearing demand deposits decreasing to 20.9% of total deposits in 2007, as compared to 24.0% in 2006, and savings deposits increasing to 24.8% of total deposits in 2007, as compared to 21.5% in 2006. Approximately half of the increase in total deposits and the shift from non-interest bearing demand deposits to savings deposits was due to the first quarter 2007 introduction of a new money market cash sweep deposit product as an alternative to traditional repurchase agreements. The money market cash sweep product allows commercial customers to invest on a daily basis excess non-interest bearing and interest bearing demand deposit funds into a higher-yielding money market savings account held by First Interstate Bank. The remaining increase in total deposits in 2007, as compared to 2006, was due to organic growth.

For additional information concerning customer deposits, including the use of repurchase agreements, see Part I, Item 1, Business Deposit Products and Notes to Consolidated Financial Statements Deposits included in Part IV, Item 15.

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**Table of Contents***Federal Funds Purchased and Securities Sold Under Repurchase Agreements*

The following table sets forth certain information regarding federal funds purchased and repurchase agreements as of the dates indicated:

**Federal Funds Purchased and Securities Sold Under Repurchase Agreements**

(Dollars in thousands)

| As of and for the year ended December 31,    | 2008      | 2007      | 2006      |
|----------------------------------------------|-----------|-----------|-----------|
| Federal funds purchased:                     |           |           |           |
| Balance at period end                        | \$ 30,625 | \$        | \$        |
| Average balance                              | 64,994    | 5,172     | 31,579    |
| Maximum amount outstanding at any month-end  | 121,390   | 29,470    | 87,810    |
| Average interest rate:                       |           |           |           |
| During the year                              | 2.14%     | 5.17%     | 5.22%     |
| At period end                                | 0.22      |           |           |
| Securities sold under repurchase agreements: |           |           |           |
| Balance at period end                        | \$525,501 | \$604,762 | \$731,548 |
| Average balance                              | 537,267   | 558,469   | 638,686   |
| Maximum amount outstanding at any month-end  | 576,845   | 679,247   | 731,548   |
| Average interest rate:                       |           |           |           |
| During the year                              | 1.43%     | 3.80%     | 3.96%     |
| At period end                                | 0.34      | 3.09      | 4.15      |

*Other Borrowed Funds*

Other borrowed funds increased \$70 million to \$79 million as of December 31, 2008, from \$9 million as of December 31, 2007, primarily due to short-term borrowings from the FHLB. On September 11, 2008, we borrowed \$25 million on a note bearing interest of 2.96% that matured and was repaid on March 11, 2009 and on September 22, 2008, we borrowed \$50 million on a note maturing September 22, 2009 bearing interest of 3.57%. Proceeds from these borrowings were used to fund growth in earning assets.

Other borrowed funds increased 53.3% to \$9 million as of December 31, 2007, from \$6 million as of December 31, 2006, primarily due to fluctuations in the timing of tax deposits made by customers and the subsequent withdrawal of funds by the federal government.

For additional information on other borrowed funds as of December 31, 2007 and 2006, see Notes to Consolidated Financial Statements Long-Term Debt and Other Borrowed Funds included in Part IV, Item 15.

*Long-Term Debt*

Long term debt increased \$79 million to \$84 million as of December 31, 2008, from \$5 million as of December 31, 2007, due to indebtedness incurred to finance the First Western acquisition. In conjunction with the First Western acquisition, on January 10, 2008 we entered into a credit agreement with four syndicated banks. The credit agreement is secured by all of the outstanding stock of First Interstate Bank. Under the terms of the credit agreement, we borrowed \$50 million on variable rate term notes maturing January 10, 2013. The term notes are payable in equal quarterly principal installments of \$1.8 million beginning March 31, 2008, with one final installment of \$14.3 million due at maturity. Interest on the term notes is payable quarterly. As of December 31, 2008, \$43 million was outstanding on the term notes bearing interest at a weighted average interest rate of 2.51%. Included under the terms of the credit agreement is a \$15 million revolving credit facility that matures January 10, 2011. As of December 31, 2008, no amounts were outstanding on the revolving credit facility. Also in conjunction with the First Western acquisition, on January 10, 2008 we entered into a subordinated credit agreement and borrowed \$20 million on a 6.81% unsecured subordinated term loan maturing January 9, 2018. Interest on the subordinated term loan is payable quarterly and principal is due at maturity.

Unrelated to the First Western acquisition, in February 2008 we borrowed \$15 million on a variable rate unsecured subordinated term loan maturing February 28, 2018, with interest payable quarterly and principal due at maturity. The interest rate on the subordinated term loan was 4.20% as of December 31, 2008.

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As of December 31, 2007, our long-term debt was comprised principally of a fixed rate note with the FHLB, an unsecured revolving term loan and a capital lease obligation. Long-term debt decreased 76.2% to \$5 million as of December 31, 2007, from \$22 million as of December 31, 2006, due to scheduled debt repayments.

Our long-term debt agreements, including the syndicated credit agreement and unsecured subordinated credit agreements, contain various covenants that, among other things, establish minimum capital and financial performance ratios; and, place certain restrictions on capital expenditures, indebtedness, redemptions or repurchases of common stock, and the amount of dividends payable to shareholders. As of June 30, 2008, we were in violation of two financial performance covenants related to non-performing assets included in the syndicated credit agreement. On October 3, 2008, the syndicated credit agreement was amended to revise certain debt covenants related to non-performing assets and waive all debt covenant defaults resulting from breaches existing as of June 30, 2008. As of December 31, 2008, we were in compliance with all existing and amended debt covenants. Trends and effects associated with the recession and market turmoil may cause us to be in non-compliance with certain financial covenants in the near-term.

For additional information regarding long-term debt, see Notes to Consolidated Financial Statements Long Term Debt and Other Borrowed Funds, included in Part IV, Item 15.

### *Subordinated Debentures Held by Subsidiary Trusts*

Subordinated debentures held by subsidiary trusts increased \$21 million to \$124 million as of December 31, 2008, from \$103 million as of December 31, 2007, and 150.0% to \$103 million as of December 31, 2007, from \$41 million as of December 31, 2006. During fourth quarter 2007, we completed a series of four financings involving the sale of Trust Preferred Securities to third-party investors and the issuance of 30-year junior subordinated deferrable interest debentures, or Subordinated Debentures, in the aggregate amount of \$62 million to wholly-owned business trusts. During January 2008, we completed two additional financings involving the sale of Trust Preferred Securities to third-party investors and the issuance of Subordinated Debentures in the aggregate amount of \$21 million to wholly-owned business trusts. All of the Subordinated Debentures are unsecured with interest payable quarterly at various interest rates and may be redeemed, subject to approval of the Federal Reserve Bank, at our option on or after five years from the date of issue, or at any time in the event of unfavorable changes in laws or regulations. Proceeds from these issuances, together with the financing obtained under the syndicated credit agreement and unsecured subordinated term loan agreement described above, were used to fund the First Western acquisition. For additional information regarding the Subordinated Debentures, see Notes to Consolidated Financial Statements Subordinated Debentures Held by Subsidiary Trusts included in Part IV, Item 15. For additional information regarding the First Western acquisition see Notes to Consolidated Financial Statements Acquisitions included in Part IV, Item 15.

### *Accounts Payable and Accrued Expenses*

Accounts payable and accrued expenses increased 70.3% to \$51 million as of December 31, 2008, from \$30 million as of December 31, 2007. Excluding increases attributable to the acquired First Western entities, accounts payable and accrued expenses increased 51.2% as of December 31, 2008, compared to December 31, 2007, primarily due to the timing of corporate income tax payments and the deferral of a portion of the gain recognized on the sale of i\_Tech. Accounts payable and accrued expenses decreased 17.0% to \$30 million as of December 31, 2007, from \$36 million as of December 31, 2006, primarily due to timing of corporate income tax payments.

### *Non-Performing Assets*

Non-performing assets include loans past due 90 days or more and still accruing interest, nonaccrual loans, loans renegotiated in troubled debt restructurings and OREO. Restructured loans are loans on which we have granted a concession on the interest rate or original repayment terms due to financial difficulties of the borrower. OREO consists of real property acquired through foreclosure on the collateral underlying defaulted loans. We initially record OREO at the lower of carrying value or fair value less estimated costs to sell by a charge against the allowance for loan losses, if necessary. Estimated losses that result from the ongoing periodic valuation of these properties are charged to earnings in the period in which they are identified.

We generally place loans on nonaccrual when they become 90 days past due, unless they are well secured and in the process of collection. When a loan is placed on nonaccrual status, any interest previously accrued but not collected is reversed from income. Approximately \$4.6 million and \$1.7 million of gross interest income would have been accrued if all loans on nonaccrual had been current in accordance with their original terms for the years ended



December 31, 2008 and 2007, respectively.

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

**Non-Performing Assets**

(Dollars in thousands)

| As of December 31,                            | 2008     | 2007     | 2006     | 2005     | 2004     |
|-----------------------------------------------|----------|----------|----------|----------|----------|
| Non-performing loans:                         |          |          |          |          |          |
| Nonaccrual loans                              | \$85,632 | \$31,552 | \$14,764 | \$17,142 | \$17,585 |
| Accruing loans past due 90 days or more       | 3,828    | 2,171    | 1,769    | 1,001    | 905      |
| Restructured loans                            | 1,462    | 1,027    | 1,060    | 1,089    | 1,384    |
| Total non-performing loans                    | 90,922   | 34,750   | 17,593   | 19,232   | 19,874   |
| OREO                                          | 6,025    | 928      | 529      | 1,091    | 1,828    |
| Total non-performing assets                   | \$96,947 | \$35,678 | \$18,122 | \$20,323 | \$21,702 |
| Non-performing assets to total loans and OREO | 2.03%    | 1.00%    | 0.55%    | 0.67%    | 0.79%    |

Non-performing assets increased \$61 million, or 171.7%, to \$97 million as of December 31, 2008, from \$36 million as of December 31, 2007. This increase in non-performing assets was primarily related to land development loans and was reflective of deterioration of economic conditions in certain of our market areas during 2008, as well as overall growth in our loan portfolio. Non-performing assets increased \$18 million, or 96.9% to \$36 million as of December 31, 2007, from \$18 million as of December 31, 2006, primarily due to the loans of four commercial real estate borrowers placed on nonaccrual during third and fourth quarter 2007.

Nonaccrual loans of \$86 million as of December 31, 2008 included residential real estate development loans of \$39 million, other commercial real estate loans of \$33 million, commercial loans of \$8 million, agricultural loans of \$3 million and consumer loans of \$3 million. Nonaccrual loans increased \$54 million, or 171.4%, to \$86 million as of December 31, 2008, from \$32 million as of December 31, 2007. Approximately 50.0% of this increase was related to the loans of six borrowers adversely affected by weakening demand for residential real estate lots.

OREO increased \$5 million to \$6 million as of December 31, 2008, as compared to \$928 thousand as of December 31, 2007. This increase was due to foreclosure on the collateral underlying the land development loans of two commercial borrowers during the second and fourth quarters of 2008. During first quarter 2009, we expect to transfer approximately \$6 million of non-performing land development loans to OREO.

Potential problem loans consist of performing loans that have been internally risk classified due to uncertainties regarding the borrowers' ability to continue to comply with the contractual repayment terms of the loans. These loans are not included in the non-performing assets table above. There can be no assurance that we have identified and internally risk classified all of our potential non-performing loans. Furthermore, we cannot predict the extent to which economic conditions in our market areas may continue or worsen or the full impact such conditions may have on our loan portfolio. Accordingly, there may be other loans that will become 90 days or more past due, be placed on nonaccrual, be renegotiated or become OREO in the future. Given the current economic environment, we expect higher levels of problem loans in 2009.

**Allowance for Loan Losses**

The allowance for loan losses is established through a provision for loan losses based on our evaluation of known and inherent risk in our loan portfolio at each balance sheet date. See the discussion under **Provision for Loan Losses**

above. The allowance for loan losses is increased by provisions charged against earnings and reduced by net loan charge-offs. Loans are charged-off when we determine that collection has become unlikely. Consumer loans are generally charged off when they become 120 days past due. Other loans, or portions thereof, are charged off when they become 180 days past due unless they are well-secured and in the process of collection. Recoveries are recorded only when cash payments are received.

The allowance for loan losses consists of three elements: (i) historical valuation allowances based on loan loss experience for similar loans with similar characteristics and trends; (ii) specific valuation allowances based on probable losses on specific loans; and, (iii) general valuation allowances determined based on general economic conditions and other qualitative risk factors both internal and external to us. Historical valuation allowances are determined by applying percentage loss factors to the credit exposures from outstanding loans. For commercial, agricultural and real estate loans, loss factors are applied based on the internal risk classifications of these loans. For consumer loans, loss factors are applied on a portfolio basis. Loss factor percentages are based on a migration analysis of our historical loss experience over a

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seven year period, designed to account for credit deterioration. Specific allowances are established for loans where we have determined that probability of a loss exists and will exceed the historical loss factors applied based on internal risk classification of the loans. General valuation allowances are determined by evaluating, on a quarterly basis, changes in the nature and volume of the loan portfolio, overall portfolio quality, industry concentrations, current economic, political and regulatory factors and the estimated impact of current economic, political, environmental and regulatory conditions on historical loss rates.

The following table sets forth information concerning our allowance for loan losses as of the dates and for the years indicated.

**Allowance for Loan Losses**

*(Dollars in thousands)*

| As of and for the year ended December 31, | 2008        | 2007        | 2006        | 2005        | 2004        |
|-------------------------------------------|-------------|-------------|-------------|-------------|-------------|
| Balance at the beginning of period        | \$ 52,355   | \$ 47,452   | \$ 42,450   | \$ 42,141   | \$ 38,940   |
| Allowance of acquired banking offices     | 14,463      |             |             |             |             |
| Charge-offs:                              |             |             |             |             |             |
| Real estate                               | 4,997       | 671         | 86          | 382         | 475         |
| Consumer                                  | 5,527       | 3,778       | 4,030       | 4,133       | 5,304       |
| Commercial                                | 3,523       | 643         | 1,014       | 2,803       | 1,583       |
| Agricultural                              | 648         | 116         | 80          | 133         | 438         |
| Total charge-offs                         | 14,695      | 5,208       | 5,210       | 7,451       | 7,800       |
| Recoveries:                               |             |             |             |             |             |
| Real estate                               | 156         | 87          | 63          | 13          | 182         |
| Consumer                                  | 1,404       | 1,390       | 1,568       | 1,297       | 1,424       |
| Commercial                                | 211         | 854         | 699         | 596         | 511         |
| Agricultural                              | 66          | 30          | 121         | 7           | 151         |
| Total recoveries                          | 1,837       | 2,361       | 2,451       | 1,913       | 2,268       |
| Net charge-offs                           | 12,858      | 2,847       | 2,759       | 5,538       | 5,532       |
| Provision for loan losses                 | 33,356      | 7,750       | 7,761       | 5,847       | 8,733       |
| Balance at end of period                  | \$ 87,316   | \$ 52,355   | \$ 47,452   | \$ 42,450   | \$ 42,141   |
| Period end loans                          | \$4,772,813 | \$3,558,980 | \$3,310,363 | \$3,034,354 | \$2,739,509 |
| Average loans                             | 4,527,987   | 3,449,809   | 3,208,102   | 2,874,723   | 2,629,474   |
| Net charge-offs to average loans          | 0.28%       | 0.08%       | 0.09%       | 0.19%       | 0.21%       |
| Allowance to period-end loans             | 1.83%       | 1.47%       | 1.43%       | 1.40%       | 1.54%       |

The allowance for loan losses was \$87 million, or 1.83% of period-end loans, at December 31, 2008, compared to \$52 million, or 1.47% of period-end loans, at December 31 2007, and \$47 million, or 1.43% of period-end loans, at

December 31, 2006.

Net charge-offs in 2008 increased \$10 million to \$13 million, or 0.28% of average loans in 2008, from \$3 million, or 0.08% of average loans in 2007, and remained flat in 2007 as compared to 2006. The increase in net charge-offs in 2008, as compared to 2007, was primarily due to the loans of one commercial real estate borrower and two commercial borrowers and was reflective of the increase in internally classified loans related to the deterioration of economic conditions in 2008, as well as overall loan growth.

Although we believe that we have established our allowance for loan losses in accordance with accounting principles generally accepted in the United States and that the allowance for loan losses was adequate to provide for known and inherent losses in the portfolio at all times during the five-year period ended December 31, 2008, future provisions will be subject to on-going evaluations of the risks in the loan portfolio. If the economy continues to decline or asset quality continues to deteriorate, material additional provisions could be required.

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The allowance for loan losses is allocated to loan categories based on the relative risk characteristics, asset classifications and actual loss experience of the loan portfolio. The following table provides a summary of the allocation of the allowance for loan losses for specific loan categories as of the dates indicated. The allocations presented should not be interpreted as an indication that charges to the allowance for loan losses will be incurred in these amounts or proportions, or that the portion of the allowance allocated to each loan category represents the total amount available for future losses that may occur within these categories. The unallocated portion of the allowance for loan losses and the total allowance are applicable to the entire loan portfolio.

**Allocation of the Allowance for Loan Losses**

*(Dollars in thousands)*

| As of December 31, | 2008      |          | 2007      |          | 2006      |          | 2005      |          | 2004      |          |
|--------------------|-----------|----------|-----------|----------|-----------|----------|-----------|----------|-----------|----------|
|                    | % of      |          | % of      |          | % of      |          | % of      |          | % of      |          |
|                    | Loan      |          | Loan      |          | Loan      |          | Loan      |          | Loan      |          |
|                    | Category  |          | Category  |          | Category  |          | Category  |          | Category  |          |
|                    | Allocated | to Total | Allocated | to Total | Allocated | to Total | Allocated | to Total | Allocated | to Total |
|                    | Reserves  | Loans    | Reserves  | Loans    | Reserves  | Loans    | Reserves  | Loans    | Reserves  | Loans    |
| Real estate        | \$69,280  | 64.9%    | \$39,420  | 63.8%    | \$33,532  | 62.9%    | \$22,622  | 61.7%    | \$19,469  | 60.0%    |
| Consumer           | 5,092     | 14.4     | 4,838     | 17.1     | 5,794     | 18.3     | 7,544     | 19.4     | 7,492     | 18.8     |
| Commercial         | 11,021    | 17.5     | 7,170     | 16.7     | 6,746     | 16.4     | 7,607     | 16.3     | 8,952     | 18.3     |
| Agricultural       | 1,923     | 3.1      | 779       | 2.3      | 908       | 2.3      | 1,147     | 2.5      | 2,200     | 2.7      |
| Other loans        |           | 0.1      |           | 0.1      | 14        | 0.1      | 15        | 0.1      | 27        | 0.2      |
| Unallocated (1)    |           | N/A      | 148       | N/A      | 458       | N/A      | 3,515     | N/A      | 4,001     | N/A      |
| Totals             | \$87,316  | 100.0%   | \$52,355  | 100.0%   | \$47,452  | 100.0%   | \$42,450  | 100.0%   | \$42,141  | 100.0%   |

(1) During 2006, we refined the methodology for determining the allocated components of the allowance for loan losses. This refinement included improved evaluation of qualitative risk factors internal and external to us and use of a migration analysis of historical loan losses. This refinement resulted in a

reallocation  
among specific  
loan categories  
and the  
allocation of  
previously  
unallocated  
allowance  
amounts to  
specific loan  
categories. As a  
result, allocation  
of the allowance  
for loan losses  
in periods prior  
to 2006 is not  
directly  
comparable to  
the 2006, 2007  
and 2008  
presentation.

During 2008, the allocated reserve for loan losses on real estate loans increased 75.7% to \$69 million as of December 31, 2008, from \$39 million as of December 31, 2007, and 17.6% to \$39 million as of December 31, 2007, from \$34 million as of December 31, 2006. Increases in reserve for loan losses allocated to real estate loans were primarily the result of weakening demand for residential lots, particularly in four of the communities we serve, a general slow down in housing across our market areas, the effect of increases in net charge-offs on our historical loss factors and the application of historical loss factors to higher levels of internally risk classified real estate loans, including land development loans and loans secured by commercial real estate.

The allocated reserve for loan losses on commercial loans increased 53.7% to \$11 million as of December 31, 2008, from \$7 million as of December 31, 2007, primarily due to the application of historical loss factors to higher levels of internally risk classified commercial loans, the effect of increases in net charge-offs on our historical loss factors and the growing concerns over the impact of the current recession on our commercial loan portfolio. Increases in the allocated reserve for loan losses on commercial loans in 2007, as compared to 2006, were not significant.

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**Table of Contents***Contractual Obligations*

Contractual obligations as of December 31, 2008 are summarized in the following table.

**Contractual Obligations**

(Dollars in thousands)

|                                                       | Within<br>One Year | One Year to<br>Three Years | Payments Due<br>Three Years<br>to Five<br>Years | After<br>Five Years | Total       |
|-------------------------------------------------------|--------------------|----------------------------|-------------------------------------------------|---------------------|-------------|
| Deposits without a stated maturity                    | \$3,243,756        | \$                         | \$                                              | \$                  | \$3,243,756 |
| Time deposits                                         | 1,548,851          | 304,450                    | 77,175                                          | 27                  | 1,930,503   |
| Securities sold under repurchase agreements           | 525,501            |                            |                                                 |                     | 525,501     |
| Other borrowed funds(1)                               | 79,216             |                            |                                                 |                     | 79,216      |
| Long-term debt obligations (2)                        | 8,978              | 16,382                     | 21,645                                          | 35,265              | 82,270      |
| Capital lease obligations                             | 32                 | 71                         | 84                                              | 1,691               | 1,878       |
| Operating lease obligations                           | 3,094              | 6,002                      | 4,599                                           | 9,612               | 23,307      |
| Purchase obligations (3)                              | 40,602             |                            |                                                 |                     | 40,602      |
| Subordinated debentures held by subsidiary trusts (4) |                    |                            |                                                 | 123,715             | 123,715     |
| Total contractual obligations                         | \$5,450,030        | \$326,905                  | \$103,503                                       | \$170,310           | \$6,050,748 |

(1) Included in other borrowed funds are tax deposits made by customers pending subsequent withdrawal by the federal government and borrowings with original maturities of less than one year. For additional information concerning other borrowed funds, see Notes to Consolidated Financial Statements



Long Term  
Debt and Other  
Borrowed Funds  
included in  
Part IV,  
Item 15.

- (2) Long-term debt consists of various notes payable to FHLB at various rates with maturities through October 31, 2017; variable rate term notes maturing on January 10, 2103; a fixed rate subordinated term loan bearing interest of 6.81% and maturing January 9, 2018; and a variable rate subordinated term loan maturing February 28, 2018. For additional information concerning long-term debt, see Notes to Consolidated Financial Statements Long Term Debt and Other Borrowed Funds included in Part IV, Item 15.

(3)

Purchase obligations relate to obligations under construction contracts to build or renovate banking offices and obligations to purchase investment securities.

- (4) The subordinated debentures are unsecured, with various interest rates and maturities from March 26, 2033 through April 1, 2038. Interest distributions are payable quarterly; however, we may defer interest payments at any time for a period not exceeding 20 consecutive quarters. For additional information concerning the subordinated debentures, see Notes to Consolidated Financial Statements Subordinated Debentures held by Subsidiary Trusts included in Part IV, Item 15.

We also have obligations under a postretirement healthcare benefit plan. These obligations represent actuarially determined future benefit payments to eligible plan participants. See Notes to Consolidated Financial Statements Employee Benefit Plans included in Part IV, Item 15.

In addition, on December 31, 2008 we entered into a contractual obligation pursuant to a technology services agreement maturing December 31, 2015. Amounts payable under the service agreement are primarily based on the number of transactions or accounts processed. We estimate payments made under the service agreement in 2009 will be approximately \$13 million.

*Off-Balance Sheet Arrangements*

We have entered into various arrangements not reflected on the consolidated balance sheet that have or are reasonably likely to have a current or future effect on our financial condition, results of operations or liquidity. These include guarantees, commitments to extend credit and standby letters of credit.

We guarantee the distributions and payments for redemption or liquidation of capital trust preferred securities issued by our wholly-owned subsidiary business trusts to the extent of funds held by the trusts. Although the guarantees are not separately recorded, the obligations underlying the guarantees are fully reflected on our consolidated balance sheets as subordinated debentures held by subsidiary trusts. The subordinated debentures currently qualify as tier 1 capital under the Federal Reserve capital adequacy guidelines. For additional information regarding the subordinated debentures, see Notes to Consolidated Financial Statements Subordinated Debentures Held by Subsidiary Trusts included in Part IV, Item 15.

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We are a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit and standby letters of credit. For additional information regarding our off-balance sheet arrangements, see Notes to Consolidated Financial Statements Financial Instruments with Off-Balance Sheet Risk included in Part IV, Item 15.

### **Capital Resources and Liquidity Management**

#### *Capital Resources*

Stockholders' equity is influenced primarily by earnings, dividends, sales and redemptions of common stock and, to a lesser extent, changes in the unrealized holding gains or losses, net of taxes, on available-for-sale investment securities. Stockholders' equity increased 21.3% to \$539 million as of December 31, 2008, from \$444 million as of December 31, 2007, and 8.3% to \$444 million as of December 31, 2007, from \$410 million as of December 31, 2006, primarily due to retention of earnings and the issuance of capital stock. In January 2008, we issued 5,000 shares of 6.75% Series A noncumulative redeemable preferred stock, or Series A Preferred Stock, with an aggregate value of \$50 million in partial consideration for the First Western acquisition. For more information regarding the Series A Preferred Stock, see Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities Description of Our Capital Stock, included in Part II, Item 5. In addition, during third quarter 2008 we raised additional capital of \$11.8 million through the sale of 153,662 shares of our common stock, including 58,799 shares sold in a private placement to members or affiliates of the Scott family and 94,863 shares sold to our employees and directors pursuant to our employee benefit plans. The remaining increase in stockholders' equity was primarily due to the retention of earnings, net of stock redemptions and dividends.

Pursuant to FDICIA, the Federal Reserve and FDIC have adopted regulations setting forth a five-tier system for measuring the capital adequacy of the financial institutions they supervise. At December 31, 2008 and 2007, the Banks each had capital levels that, in all cases, exceeded the well-capitalized guidelines. For additional information concerning our capital levels, see Notes to Consolidated Financial Statements Regulatory Capital contained in Part IV, Item 15.

In recent years, we have experienced significant growth in earning assets through a combination of organic loan and deposit growth in our existing market areas and expansion into new market areas through acquisition. To support this growth and preserve our well-capitalized status with the federal banking agencies, our board of directors, with the assistance of management, is evaluating alternative sources of additional capital including, among other things, possible participation in TARP Capital Purchase Program and/or other government sponsored plans.

Approximately 91% of our common shares are subject to shareholder agreements that give us a right of first refusal to repurchase the restricted stock. We purchased 275,683 shares of common stock from restricted shareholders with an aggregate value of \$23 million in 2008, as compared to 257,827 shares of common stock with an aggregate value of \$23 million in 2007 and 107,074 shares with an aggregate value of \$8 million in 2006. Our ability to repurchase common shares is limited by our liquidity, capital resources and debt covenants. In 2009, we announced we will receive requests for stock redemptions only during a two-week window period each calendar quarter commencing two days following the quarterly announcement of the appraised value of a minority interest in our stock by our independent valuation firm and that the number of shares repurchased during any window period may be limited at the discretion of our board of directors.

#### *Liquidity*

Liquidity measures our ability to meet current and future cash flow needs on a timely basis and at a reasonable cost. We manage our liquidity position to meet the daily cash flow needs of customers, while maintaining an appropriate balance between assets and liabilities to meet the return on investment objectives of our shareholders. Our liquidity position is supported by management of liquid assets and liabilities and access to alternative sources of funds. Liquid assets include cash, interest bearing deposits in banks, federal funds sold, available-for-sale investment securities and maturing or prepaying balances in our held-to-maturity investment and loan portfolios. Liquid liabilities include core deposits, federal funds purchased, securities sold under repurchase agreements and borrowings. Other sources of liquidity include the drawing of additional funds on our revolving credit facility, the sale of loans, the ability to acquire additional national market, non-core deposits, the issuance of additional collateralized borrowings such as FHLB advances, the issuance of debt securities, additional borrowings through the Federal Reserve's discount

window and the issuance of preferred or common securities. We do not engage in derivatives or hedging activities to support our liquidity position. For additional information regarding our available lines of credit, see Notes to Consolidated Financial Statements Long-Term Debt included in Part IV, Item 15.

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Our short-term and long-term liquidity requirements are primarily to fund on-going operations, including payment of interest on deposits and debt, extensions of credit to borrowers, capital expenditures and shareholder dividends. These liquidity requirements are met primarily through cash flow from operations, redeployment of prepaying and maturing balances in our loan and investment portfolios, debt financing and increases in customer deposits. For additional information regarding our operating, investing and financing cash flows, see Consolidated Financial Statements Consolidated Statements of Cash Flows, included in Part IV, Item 15.

As a holding company, we are a corporation separate and apart from our subsidiary Banks and, therefore, we provide for our own liquidity. Our main sources of funding include management fees and dividends declared and paid by our subsidiaries and access to capital markets. There are statutory, regulatory and debt covenant limitations that affect the ability of our Bank subsidiaries to pay dividends to us. Management believes that such limitations will not impact our ability to meet our ongoing short-term cash obligations. For additional information regarding dividend restrictions, see Long-Term Debt and Capital Resources included herein and Business Regulation and Supervision included in Part I, Item 1.

**Asset Liability Management**

The goal of asset liability management is the prudent control of market risk, liquidity and capital. Asset liability management is governed by policies, goals and objectives adopted and reviewed by each Bank's board of directors. The board delegates its responsibility for development of asset liability management strategies to achieve these goals and objectives to the Asset Liability Committee, or ALCO, which is comprised of members of senior management.

*Interest Rate Risk*

Interest rate risk is the risk of loss of future earnings or long-term value due to changes in interest rates. Our primary source of earnings is the net interest margin, which is affected by changes in interest rates, the relationship between rates on interest bearing assets and liabilities, the impact of interest rate fluctuations on asset prepayments and the mix of interest bearing assets and liabilities.

The ability to optimize the net interest margin is largely dependent upon the achievement of an interest rate spread that can be managed during periods of fluctuating interest rates. Interest sensitivity is a measure of the extent to which net interest income will be affected by market interest rates over a period of time. Interest rate sensitivity is related to the difference between amounts of interest earning assets and interest bearing liabilities which either reprice or mature within a given period of time. The difference is known as interest rate sensitivity gap.

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The following table shows interest rate sensitivity gaps and the earnings sensitivity ratio for different intervals as of December 31, 2008. The information presented in the table is based on our mix of interest earning assets and interest bearing liabilities and historical experience regarding their interest rate sensitivity.

**Interest Rate Sensitivity Gaps**

(Dollars in thousands)

|                                                                            | Projected Maturity or Repricing |                                |                              |                     |                 |
|----------------------------------------------------------------------------|---------------------------------|--------------------------------|------------------------------|---------------------|-----------------|
|                                                                            | Three<br>Months<br>or Less      | Three<br>Months to<br>One Year | One<br>Year to<br>Five Years | After<br>Five Years | Total           |
| <i>Interest earning assets:</i>                                            |                                 |                                |                              |                     |                 |
| Loans (1)                                                                  | \$1,981,576                     | \$ 752,748                     | \$1,781,700                  | \$171,157           | \$4,687,181     |
| Investment securities (2)                                                  | 168,675                         | 272,251                        | 401,751                      | 229,599             | 1,072,276       |
| Interest bearing deposits in<br>banks                                      | 1,458                           |                                |                              |                     | 1,458           |
| Federal funds sold                                                         | 107,502                         |                                |                              |                     | 107,502         |
| <br>Total interest earning assets                                          | <br>\$2,259,211                 | <br>\$1,024,999                | <br>\$2,183,451              | <br>\$400,756       | <br>\$5,868,417 |
| <i>Interest bearing liabilities:</i>                                       |                                 |                                |                              |                     |                 |
| Interest bearing demand<br>accounts (3)                                    | \$ 79,486                       | \$ 238,459                     | \$ 741,873                   | \$                  | \$1,059,818     |
| Savings deposits (3)                                                       | 975,839                         | 54,230                         | 168,714                      |                     | 1,198,783       |
| Time deposits, \$100 or<br>more (4)                                        | 276,821                         | 414,464                        | 130,152                      |                     | 821,437         |
| Other time deposits                                                        | 308,980                         | 548,254                        | 251,805                      | 27                  | 1,109,066       |
| Securities sold under<br>repurchase agreements                             | 525,501                         |                                |                              |                     | 525,501         |
| Other borrowed funds                                                       | 29,216                          | 50,000                         |                              |                     | 79,216          |
| Long-term debt                                                             | 58,224                          | 1,500                          | 2,468                        | 21,956              | 84,148          |
| Subordinated debentures<br>held by subsidiary trusts                       | 77,322                          |                                | 46,393                       |                     | 123,715         |
| <br>Total interest bearing<br>liabilities                                  | <br>\$2,331,389                 | <br>\$1,306,907                | <br>\$1,341,405              | <br>\$ 21,983       | <br>\$5,001,684 |
| <br>Rate gap                                                               | <br>\$ (72,178)                 | <br>\$ (281,908)               | <br>\$ 842,046               | <br>\$378,773       | <br>\$ 866,733  |
| Cumulative rate gap                                                        | (72,178)                        | (354,086)                      | 487,960                      | 866,733             |                 |
| Cumulative rate gap as a<br>percentage of total interest<br>earning assets | -1.23%                          | -6.03%                         | 8.32%                        | 14.77%              | 14.77%          |

(1) Does not  
include

nonaccrual  
loans of  
\$85,632.

- (2) Adjusted to reflect:  
(a) expected shorter maturities based upon our historical experience of early prepayments of principal, and  
(b) the redemption of callable securities on their next call date.

- (3) Includes savings deposits paying interest at market rates in the three month or less category. All other deposit categories, while technically subject to immediate withdrawal, actually display sensitivity characteristics that generally fall within one to five years. Their allocation is presented based on that historical analysis. If these deposits were included in the three month or less category,



the above table would reflect a negative three month gap of \$1,275 million, a negative cumulative one year gap of \$1,265 million and a positive cumulative one to five year gap of \$488 million.

- (4) Included in the three month to one year category are deposits of \$171 million maturing in three to six months.

*Net Interest Income Sensitivity*

The view presented in the preceding interest rate sensitivity gap table illustrates a static view of the effect on our net interest margin of changing interest rate scenarios. We believe net interest income sensitivity provides the best perspective of how day-to-day decisions affect our interest rate risk profile. We monitor net interest margin sensitivity by utilizing an income simulation model to subject twelve month net interest income to various rate movements. Simulations modeled quarterly include scenarios where market rates change suddenly up or down in a parallel manner and scenarios where market rates gradually change up or down at nonparallel rates resulting in a change in the slope of the yield curve. Estimates produced by our income simulation model are based on numerous assumptions including, but not limited to, the nature and timing of changes in interest rates, prepayments of loans and investment securities, volume of loans originated, level and composition of deposits, ability of borrowers to repay adjustable or variable rate loans and reinvestment opportunities for cash flows. Given these various assumptions, the actual effect of interest rate changes on our net interest margin may be materially different than estimated.

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We target a mix of interest earning assets and interest bearing liabilities such that no more than 5% of the net interest margin will be at risk over a one-year period should short-term interest rates shift up or down 2%. As of December 31, 2008, our income simulation model predicted net interest income would decrease \$1.9 million, or less than 1%, assuming a 2% increase in short-term market interest rates and 1.0% increase in long-term interest rates. This scenario predicts that our funding sources will reprice faster than our interest earning assets.

We did not simulate a decrease in interest rates due to the extremely low rate environment as of December 31, 2008. Prime rate has historically been set at a rate of 300 basis points over the targeted federal funds rate, which is currently set between 0 and 25 basis points. Our income simulation model has an assumption that prime will continue to be set at a rate of 300 basis points over the targeted federal funds rate. Additionally, rates that are currently below 2% are modeled not to fall below 0% with an overall decrease of 2% in interest rates. In a declining rate environment, our income simulation model predicts our net interest income and net interest rate spread will decrease and our net interest margin will compress because interest expense will not decrease in direct proportion to a simulated downward shift in interest rates.

The preceding interest rate sensitivity analysis does not represent a forecast and should not be relied upon as being indicative of expected operating results. In addition, if the actual prime rate falls below a 300 basis point spread to targeted federal funds rates, we could experience a continued decrease in net interest income as a result of falling yields on earning assets tied to prime rate.

### **Recent Accounting Pronouncements**

The expected impact of accounting standards recently issued but not yet adopted are discussed in Notes to Consolidated Financial Statements Recent Accounting Pronouncements included in Part IV, Item 15.

### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Our primary market risk exposure is interest rate risk. Our business and the composition of our balance sheet consists of investments in interest earning assets (principally loans and investment securities) which are primarily funded by interest bearing liabilities (deposits and indebtedness). Such financial instruments have varying levels of sensitivity to changes in market interest rates. Interest rate risk results when, due to different maturity dates and repricing intervals, interest rate indices for interest earning assets decrease relative to interest bearing liabilities, thereby creating a risk of decreased net earnings and cash flow.

Although we characterize some of our interest-sensitive assets as securities available-for-sale, such securities are not purchased with a view to sell in the near term. Rather, such securities may be sold in response to or in anticipation of changes in interest rates and resulting prepayment risk. See Notes to Consolidated Financial Statements Summary of Significant Accounting Policies included in Part IV, Item 15.

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The following table provides information about our market sensitive financial instruments, categorized by expected maturity, principal repayment or repricing and fair value at December 31, 2008. The table constitutes a forward-looking statement. For a description of our policies for managing risks associated with changing interest rates, see Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations Asset Liability Management Interest Rate Risk.

**Market Sensitive Financial Instruments Maturities***(Dollars in thousands)*

|                                                   | December 31, 2008 Expected Maturity, Principal Repayment or Repricing |           |           |           |           |            |             |
|---------------------------------------------------|-----------------------------------------------------------------------|-----------|-----------|-----------|-----------|------------|-------------|
|                                                   | 2009                                                                  | 2010      | 2011      | 2012      | 2013      | Thereafter | Total       |
| <i>Interest-sensitive assets:</i>                 |                                                                       |           |           |           |           |            |             |
| Cash and short-term investments                   | \$ 314,030                                                            | \$        | \$        | \$        | \$        | \$         | \$ 314,030  |
| Net loans                                         | 3,257,666                                                             | 550,969   | 383,355   | 214,314   | 217,686   | 72,297     | 4,696,287   |
| Securities available for sale                     | 333,576                                                               | 149,890   | 56,179    | 107,524   | 132,915   | 181,830    | 961,914     |
| Securities held to maturity                       | 10,832                                                                | 7,722     | 6,803     | 5,954     | 2,630     | 75,868     | 109,809     |
| Accrued interest receivable                       | 38,694                                                                |           |           |           |           |            | 38,694      |
| Mortgage servicing rights                         | 3,767                                                                 | 2,889     | 1,875     | 1,130     | 712       | 1,459      | 11,832      |
| Total interest-sensitive assets                   | \$3,958,565                                                           | \$711,470 | \$448,212 | \$328,922 | \$353,943 | \$331,454  | \$6,132,566 |
| <i>Interest-sensitive liabilities:</i>            |                                                                       |           |           |           |           |            |             |
| Deposits, excluding time                          | \$1,643,560                                                           | \$342,899 | \$342,899 | \$914,398 | \$        | \$         | \$3,243,756 |
| Time deposits                                     | 1,564,482                                                             | 256,849   | 44,272    | 39,653    | 29,017    | 23         | 1,934,296   |
| Federal funds purchased                           | 30,625                                                                |           |           |           |           |            | 30,625      |
| Repurchase agreements                             | 525,501                                                               |           |           |           |           |            | 525,501     |
| Accrued interest payable                          | 20,531                                                                |           |           |           |           |            | 20,531      |
| Other borrowed funds                              | 79,216                                                                |           |           |           |           |            | 79,216      |
| Long-term debt                                    | 9,240                                                                 | 9,213     | 7,515     | 7,309     | 14,629    | 40,349     | 88,255      |
| Subordinated debentures held by subsidiary trusts |                                                                       |           |           |           |           | 119,608    | 119,608     |

|                                            |             |           |           |           |           |           |             |
|--------------------------------------------|-------------|-----------|-----------|-----------|-----------|-----------|-------------|
| Total<br>interest-sensitive<br>liabilities | \$3,873,155 | \$608,961 | \$394,686 | \$961,360 | \$ 43,646 | \$159,980 | \$6,041,788 |
|--------------------------------------------|-------------|-----------|-----------|-----------|-----------|-----------|-------------|

The prepayment projections for net loans are based upon experience and do not take into account any allowance for loan losses. The expected maturities of securities are based upon contractual maturities adjusted for projected prepayments of principal, assuming no reinvestment of proceeds. Actual maturities of these instruments could vary substantially if future prepayments differ from our historical experience. All other financial instruments are stated at contractual maturities.

#### **Item 8. Financial Statements and Supplementary Data**

The following consolidated financial statements of FIBS and subsidiaries are contained elsewhere herein [see Item 15(a)1]:

Report of McGladrey & Pullen LLP, Independent Registered Public Accounting Firm  
 Consolidated Balance Sheets December 31, 2008 and 2007  
 Consolidated Statements of Income Years Ended December 31, 2008, 2007 and 2006  
 Consolidated Statements of Stockholders Equity and Comprehensive Income Years Ended  
 December 31, 2008, 2007 and 2006  
 Consolidated Statements of Cash Flows Years Ended December 31, 2008, 2007 and 2006  
 Notes to Consolidated Financial Statements

#### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

There have been no disagreements with accountants on accounting and financial disclosure.

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**Item 9A(T). Controls and Procedures**

**Disclosure Controls and Procedures**

Our management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined under Rules 13a-15(e) and 15d-15(e) of the Exchange Act. As of December 31, 2008, an evaluation was performed, under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures, as of December 31, 2008, were effective in ensuring that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the time periods required by the SEC's rules and forms.

**Management's Annual Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our system of internal control over financial reporting within the meaning of Rules 13a-15(f) and 15d-15(f) of the Exchange Act is designed to provide reasonable assurance to our management and board of directors regarding the preparation and fair presentation of our published financial statements in accordance with U.S. generally accepted accounting principles. Our management, including the Chief Executive Officer and the Chief Financial Officer, assessed the effectiveness of our system of internal control over financial reporting as of December 31, 2008. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework. Based on our assessment, we believe that, as of December 31, 2008, our system of internal control over financial reporting was effective to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of our financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the SEC that permit us to provide only management's report in this annual report.

**Changes in Internal Control Over Financial Reporting**

There were no changes in our system of internal control over financial reporting for the quarter ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, such system of control.

**Limitations on Controls and Procedures**

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

**Item 9B. Other Information**

There were no items required to be disclosed in a report on Form 8-K during the fourth quarter of 2008 that were not reported.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance.**

Information concerning Directors, Executive Officers and Corporate Governance is set forth under the heading Directors and Executive Officers in our Proxy Statement and is herein incorporated by reference.

Information concerning Compliance With Section 16(a) of the Securities Exchange Act of 1934 is set forth under the heading

Section 16(a) Beneficial Ownership Reporting Compliance in our Proxy Statement and is herein incorporated by reference.



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**Item 11. Executive Compensation**

Information concerning Executive Compensation is set forth under the headings Compensation of Executive Officers Compensation Discussion and Analysis and Compensation of Executive Officers and Directors in our Proxy Statement and is herein incorporated by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Information concerning Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters is set forth under the heading Security Ownership of Certain Beneficial Owners and Management and Securities Authorized for Issuance under Equity Compensation Plans in our Proxy Statement and is herein incorporated by reference.

**Item 13. Certain Relationships and Related Transactions and Director Independence**

Information concerning Certain Relationships and Related Transactions and Director Independence is set forth under the headings Directors and Executive Officers and Certain Relationships and Related Transactions in our Proxy Statement and is herein incorporated by reference. In addition, see Notes to Consolidated Financial Statements Related Party Transactions included in Part IV, Item 15.

**Item 14. Principal Accountant Fees and Services**

Information concerning Principal Accountant Fees and Services is set forth under the heading Directors and Executive Officers Principal Accounting Fees and Services in our Proxy Statement and is herein incorporated by reference.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

(a) 1. Our audited consolidated financial statements follow.

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders  
First Interstate BancSystem, Inc.

We have audited the accompanying consolidated balance sheets of First Interstate BancSystem, Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of First Interstate BancSystem, Inc. and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

We were not engaged to examine management's assessment of the effectiveness of First Interstate BancSystem's internal control over financial reporting as of December 31, 2008 included in Management's Report on Internal Control Over Financial Reporting and, accordingly, we do not express an opinion thereon.

/s/ MCGLADREY & PULLEN LLP

Des Moines, Iowa

March 23, 2009

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries**  
**Consolidated Balance Sheets***(In thousands, except share data)*

| December 31,                                                                                                    | 2008        | 2007        |
|-----------------------------------------------------------------------------------------------------------------|-------------|-------------|
| <i>Assets</i>                                                                                                   |             |             |
| Cash and due from banks                                                                                         | \$ 205,070  | \$ 181,743  |
| Federal funds sold                                                                                              | 107,502     | 60,635      |
| Interest bearing deposits in banks                                                                              | 1,458       | 6,868       |
| Total cash and cash equivalents                                                                                 | 314,030     | 249,246     |
| Investment securities:                                                                                          |             |             |
| Available-for-sale                                                                                              | 961,914     | 1,014,280   |
| Held-to-maturity (estimated fair values of \$109,809 and \$114,613 at December 31, 2008 and 2007, respectively) | 110,362     | 114,377     |
| Total investment securities                                                                                     | 1,072,276   | 1,128,657   |
| Loans                                                                                                           | 4,772,813   | 3,558,980   |
| Less allowance for loan losses                                                                                  | 87,316      | 52,355      |
| Net loans                                                                                                       | 4,685,497   | 3,506,625   |
| Premises and equipment, net                                                                                     | 177,799     | 124,041     |
| Accrued interest receivable                                                                                     | 38,694      | 32,215      |
| Company owned life insurance                                                                                    | 69,515      | 67,076      |
| Mortgage servicing rights, net of accumulated amortization and impairment reserve                               | 11,002      | 21,715      |
| Goodwill                                                                                                        | 183,673     | 37,380      |
| Core deposit intangibles, net of accumulated amortization                                                       | 12,682      | 257         |
| Net deferred tax asset                                                                                          | 7,401       | 6,741       |
| Other assets                                                                                                    | 55,778      | 42,844      |
| Total assets                                                                                                    | \$6,628,347 | \$5,216,797 |
| <i>Liabilities and Stockholders' Equity</i>                                                                     |             |             |
| Deposits:                                                                                                       |             |             |
| Non-interest bearing                                                                                            | \$ 985,155  | \$ 836,753  |
| Interest bearing                                                                                                | 4,189,104   | 3,162,648   |
| Total deposits                                                                                                  | 5,174,259   | 3,999,401   |
| Federal funds purchased                                                                                         | 30,625      |             |
| Securities sold under repurchase agreements                                                                     | 525,501     | 604,762     |
| Accrued interest payable                                                                                        | 20,531      | 21,104      |
| Accounts payable and accrued expenses                                                                           | 51,290      | 30,117      |

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|                                                                                                                                                                                                         |             |             |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|-------------|
| Other borrowed funds                                                                                                                                                                                    | 79,216      | 8,730       |
| Long-term debt                                                                                                                                                                                          | 84,148      | 5,145       |
| Subordinated debentures held by subsidiary trusts                                                                                                                                                       | 123,715     | 103,095     |
| Total liabilities                                                                                                                                                                                       | 6,089,285   | 4,772,354   |
| Stockholders' equity:                                                                                                                                                                                   |             |             |
| Nonvoting noncumulative preferred stock without par value; authorized 100,000 shares; issued and outstanding 5,000 as of December 31, 2008 and no shares issued and outstanding as of December 31, 2007 | 50,000      |             |
| Common stock without par value; authorized 20,000,000 shares; issued and outstanding 7,887,519 shares and 8,006,041 shares as of December 31, 2008 and 2007, respectively                               | 117,613     | 29,773      |
| Retained earnings                                                                                                                                                                                       | 362,477     | 416,425     |
| Accumulated other comprehensive income (loss), net                                                                                                                                                      | 8,972       | (1,755)     |
| Total stockholders' equity                                                                                                                                                                              | 539,062     | 444,443     |
| Total liabilities and stockholders' equity                                                                                                                                                              | \$6,628,347 | \$5,216,797 |

*See accompanying notes to consolidated financial statements.*

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries**  
**Consolidated Statements of Income***(In thousands, except per share data)*

| Year Ended December 31,                                       | 2008       | 2007       | 2006       |
|---------------------------------------------------------------|------------|------------|------------|
| Interest income:                                              |            |            |            |
| Interest and fees on loans                                    | \$ 305,152 | \$ 272,482 | \$ 245,435 |
| Interest and dividends on investment securities:              |            |            |            |
| Taxable                                                       | 43,583     | 42,660     | 40,991     |
| Exempt from federal taxes                                     | 5,913      | 4,686      | 4,441      |
| Interest on deposits in banks                                 | 191        | 1,307      | 360        |
| Interest on federal funds sold                                | 1,080      | 4,422      | 2,196      |
| Total interest income                                         | 355,919    | 325,557    | 293,423    |
| Interest expense:                                             |            |            |            |
| Interest on deposits                                          | 96,863     | 99,549     | 73,267     |
| Interest on federal funds purchased                           | 1,389      | 267        | 1,649      |
| Interest on securities sold under repurchase agreements       | 7,694      | 21,212     | 25,278     |
| Interest on other borrowed funds                              | 1,741      | 161        | 709        |
| Interest on long-term debt                                    | 4,578      | 467        | 1,576      |
| Interest on subordinated debentures held by subsidiary trusts | 8,277      | 4,298      | 3,481      |
| Total interest expense                                        | 120,542    | 125,954    | 105,960    |
| Net interest income                                           | 235,377    | 199,603    | 187,463    |
| Provision for loan losses                                     | 33,356     | 7,750      | 7,761      |
| Net interest income after provision for loan losses           | 202,021    | 191,853    | 179,702    |
| Non-interest income:                                          |            |            |            |
| Other service charges, commissions and fees                   | 28,193     | 24,221     | 21,906     |
| Service charges on deposit accounts                           | 20,712     | 17,787     | 17,581     |
| Technology services revenues                                  | 17,699     | 19,080     | 15,845     |
| Wealth management revenues                                    | 12,352     | 11,734     | 11,176     |
| Income from the origination and sale of loans                 | 12,290     | 11,245     | 9,611      |
| Investment securities gains (losses), net                     | 101        | 59         | (722)      |
| Gain on sale of equity method investee                        |            |            | 19,801     |
| Gain on sale of nonbank subsidiary                            | 27,096     |            |            |
| Other income                                                  | 9,939      | 8,322      | 6,921      |
| Total non-interest income                                     | 128,382    | 92,448     | 102,119    |
| Non-interest expense:                                         |            |            |            |
| Salaries, wages and employee benefits                         | 114,024    | 98,134     | 88,889     |
| Furniture and equipment                                       | 18,880     | 16,229     | 16,333     |
| Occupancy, net                                                | 16,361     | 14,741     | 13,300     |
| Mortgage servicing rights impairment expense                  | 10,940     | 1,702      | 1,694      |

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|                                             |           |           |           |
|---------------------------------------------|-----------|-----------|-----------|
| Mortgage servicing rights amortization      | 5,918     | 4,441     | 4,024     |
| FDIC insurance premiums                     | 2,912     | 444       | 435       |
| Core deposit intangible amortization        | 2,503     | 174       | 772       |
| Other expenses                              | 50,788    | 43,002    | 39,266    |
| Total non-interest expense                  | 222,326   | 178,867   | 164,713   |
| Income before income tax expense            | 108,077   | 105,434   | 117,108   |
| Income tax expense                          | 37,429    | 36,793    | 41,499    |
| Net income                                  | 70,648    | 68,641    | 75,609    |
| Preferred stock dividends                   | 3,347     |           |           |
| Net income available to common shareholders | \$ 67,301 | \$ 68,641 | \$ 75,609 |
| Basic earnings per common share             | \$ 8.55   | \$ 8.45   | \$ 9.32   |
| Diluted earnings per common share           | 8.38      | 8.25      | 9.11      |

*See accompanying notes to consolidated financial statements.*

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Consolidated Statements of Stockholders' Equity and Comprehensive Income***(In thousands, except share and per share data)*

|                                                                                                                             | Preferred | Common    | Retained   | Unearned<br>Compensation<br>Restricted | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total<br>Stockholders'<br>Equity |
|-----------------------------------------------------------------------------------------------------------------------------|-----------|-----------|------------|----------------------------------------|-----------------------------------------------------------|----------------------------------|
|                                                                                                                             | Stock     | Stock     | Earnings   | Stock                                  |                                                           |                                  |
| Balance at December 31, 2005                                                                                                | \$        | \$ 43,569 | \$ 314,843 | \$ (330)                               | \$ (8,235)                                                | \$ 349,847                       |
| Comprehensive income:                                                                                                       |           |           |            |                                        |                                                           |                                  |
| Net income                                                                                                                  |           |           | 75,609     |                                        |                                                           | 75,609                           |
| Unrealized gains on available-for-sale investment securities, net of income tax expense of \$421                            |           |           |            |                                        | 648                                                       | 648                              |
| Less reclassification adjustment for losses included in net income, net of income tax benefit of \$290                      |           |           |            |                                        | 446                                                       | 446                              |
| Other comprehensive income                                                                                                  |           |           |            |                                        |                                                           | 1,094                            |
| Total comprehensive income                                                                                                  |           |           |            |                                        |                                                           | 76,703                           |
| Common stock transactions:                                                                                                  |           |           |            |                                        |                                                           |                                  |
| 128,305 common shares retired                                                                                               |           | (9,593)   |            |                                        |                                                           | (9,593)                          |
| 76,140 common shares issued                                                                                                 |           | 5,829     |            |                                        |                                                           | 5,829                            |
| 1,000 restricted shares issued                                                                                              |           |           |            |                                        |                                                           |                                  |
| 97,020 stock options exercised, net of 32,467 shares tendered in payment of option price and income tax withholding amounts |           | 3,306     |            |                                        |                                                           | 3,306                            |
| Tax benefit of stock options                                                                                                |           | 1,368     |            |                                        |                                                           | 1,368                            |
| Stock-based compensation expense                                                                                            |           | 1,328     |            |                                        |                                                           | 1,328                            |

|                                                                                                                              |          |          |         |          |
|------------------------------------------------------------------------------------------------------------------------------|----------|----------|---------|----------|
| Reclassification of unearned compensation upon adoption of SFAS No. 123(revised)                                             | (330)    | 330      |         |          |
| Cash dividends declared: Common (\$2.27 per share)                                                                           |          | (18,413) |         | (18,413) |
| Balance at December 31, 2006                                                                                                 | 45,477   | 372,039  | (7,141) | 410,375  |
| Comprehensive income:                                                                                                        |          |          |         |          |
| Net income                                                                                                                   |          | 68,641   |         | 68,641   |
| Unrealized gains on available-for-sale investment securities, net of income tax expense of \$3,759                           |          |          | 5,696   | 5,696    |
| Less reclassification adjustment for gains included in net income, net of income tax expense of \$23                         |          |          | (36)    | (36)     |
| Other comprehensive income                                                                                                   |          |          |         | 5,660    |
| Total comprehensive income                                                                                                   |          |          |         | 74,301   |
| Adjustment to initially apply SFAS No. 158, net of income tax benefit of \$164                                               |          |          | (274)   | (274)    |
| Common stock transactions:                                                                                                   |          |          |         |          |
| 294,760 common shares retired                                                                                                | (25,887) |          |         | (25,887) |
| 17,248 common shares issued                                                                                                  | 1,497    |          |         | 1,497    |
| 138,765 stock options exercised, net of 21,309 shares tendered in payment of option price and income tax withholding amounts | 5,074    |          |         | 5,074    |
| Tax benefit of stock-based compensation                                                                                      | 2,519    |          |         | 2,519    |
| Stock-based compensation expense                                                                                             | 1,093    |          |         | 1,093    |
| Cash dividends declared: Common (\$2.97 per share)                                                                           |          | (24,255) |         | (24,255) |



**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Consolidated Statements of Stockholders' Equity and Comprehensive Income (Continued)***(In thousands, except share and per share data)*

|                                                                                                                  | Preferred<br>Stock | Common<br>Stock | Retained<br>Earnings | Unearned<br>Compensation<br>Restricted<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total<br>Stockholders'<br>Equity |
|------------------------------------------------------------------------------------------------------------------|--------------------|-----------------|----------------------|-------------------------------------------------|-----------------------------------------------------------|----------------------------------|
| Balance at December 31,<br>2007                                                                                  | \$                 | \$ 29,773       | \$ 416,425           | \$                                              | \$ (1,755)                                                | \$ 444,443                       |
| Cumulative effect of<br>adoption of new<br>accounting principle (see<br>Note 26)                                 |                    |                 | (633)                |                                                 |                                                           | (633)                            |
| Comprehensive income:                                                                                            |                    |                 |                      |                                                 |                                                           |                                  |
| Net income                                                                                                       |                    |                 | 70,648               |                                                 |                                                           | 70,648                           |
| Post-retirement liability<br>adjustment, net of income<br>tax benefit of \$5                                     |                    |                 |                      |                                                 | (8)                                                       | (8)                              |
| Unrealized gains on<br>available-for-sale<br>investment securities, net<br>of income tax expense of<br>\$7,003   |                    |                 |                      |                                                 | 10,796                                                    | 10,796                           |
| Less reclassification<br>adjustment for gains<br>included in net income,<br>net of income tax expense<br>of \$40 |                    |                 |                      |                                                 | (61)                                                      | (61)                             |
| Other comprehensive<br>income                                                                                    |                    |                 |                      |                                                 |                                                           | 10,727                           |
| Total comprehensive<br>income                                                                                    |                    |                 |                      |                                                 |                                                           | 81,375                           |
| Preferred stock<br>transactions:                                                                                 |                    |                 |                      |                                                 |                                                           |                                  |
| 5,000 preferred shares<br>issued                                                                                 | 50,000             |                 |                      |                                                 |                                                           | 50,000                           |
| Preferred stock issuance<br>costs                                                                                |                    |                 | (38)                 |                                                 |                                                           | (38)                             |
| Common stock<br>transactions:                                                                                    |                    |                 |                      |                                                 |                                                           |                                  |



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|                                                                                                                             |           |            |            |    |          |            |
|-----------------------------------------------------------------------------------------------------------------------------|-----------|------------|------------|----|----------|------------|
| 333,393 common shares retired                                                                                               | (27,912)  |            |            |    |          | (27,912)   |
| 154,288 common shares issued                                                                                                | 11,884    |            |            |    |          | 11,884     |
| 60,583 stock options exercised, net of 32,510 shares tendered in payment of option price and income tax withholding amounts | 1,779     |            |            |    |          | 1,779      |
| Tax benefit of stock-based compensation                                                                                     | 1,178     |            |            |    |          | 1,178      |
| Stock-based compensation expense                                                                                            | 911       |            |            |    |          | 911        |
| Transfer from retained earnings to common stock                                                                             | 100,000   | (100,000)  |            |    |          |            |
| Cash dividends declared:                                                                                                    |           |            |            |    |          |            |
| Common (\$2.60 per share)                                                                                                   |           | (20,578)   |            |    |          | (20,578)   |
| Preferred (6.75% per share)                                                                                                 |           | (3,347)    |            |    |          | (3,347)    |
| Balance at December 31, 2008                                                                                                | \$ 50,000 | \$ 117,613 | \$ 362,477 | \$ | \$ 8,972 | \$ 539,062 |

See accompanying notes to consolidated financial statements.

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**Table of Contents****First Interstate Bancsystem, Inc. And Subsidiaries  
Consolidated Statements of Cash Flows***(In thousands)*

| Year Ended December 31,                                                                           | 2008      | 2007     | 2006      |
|---------------------------------------------------------------------------------------------------|-----------|----------|-----------|
| Cash flows from operating activities:                                                             |           |          |           |
| Net income                                                                                        | \$ 70,648 | \$68,641 | \$ 75,609 |
| Adjustments to reconcile net income from operations to net cash provided by operating activities: |           |          |           |
| Cumulative effect of change in accounting principle                                               | (633)     |          |           |
| Equity in undistributed earnings of joint ventures                                                | (92)      | (243)    | 176       |
| Provisions for loan losses                                                                        | 33,356    | 7,750    | 7,761     |
| Depreciation                                                                                      | 15,089    | 14,145   | 13,327    |
| Amortization of core deposit intangibles                                                          | 2,503     | 174      | 772       |
| Amortization of mortgage servicing rights                                                         | 5,918     | 4,441    | 4,024     |
| Net premium amortization (discount accretion) on investment securities                            | 728       | (2,393)  | (7,825)   |
| Net loss (gain) on disposal of investment securities                                              | (101)     | (59)     | 722       |
| Other than temporary impairment on investment securities                                          | 1,286     |          |           |
| Net loss (gain) on sale of other real estate owned                                                | 56        | (133)    | (12)      |
| Gain on sale of mortgage servicing rights                                                         |           | (996)    |           |
| Gain on sale of investment in unconsolidated equity method joint venture                          |           |          | (19,801)  |
| Gain on sale of nonbank subsidiary                                                                | (27,096)  |          |           |
| Loss on disposal of premises and equipment                                                        | 111       | 286      | 19        |
| Write-down of other real estate pending sale or disposal                                          | 34        | 164      | 72        |
| Net increase in valuation reserve for mortgage servicing rights                                   | 10,940    | 1,702    | 1,694     |
| Deferred income taxes                                                                             | (7,552)   | (2,180)  | (5,723)   |
| Increase in cash surrender value of company-owned life insurance                                  | (2,439)   | (2,371)  | (2,158)   |
| Stock-based compensation expense                                                                  | 911       | 1,093    | 1,328     |
| Excess tax benefits from stock-based compensation                                                 | (1,140)   | (2,508)  | (1,344)   |
| Changes in operating assets and liabilities:                                                      |           |          |           |
| Increase in loans held for sale                                                                   | (20,996)  | (720)    | (6,293)   |
| Decrease (increase) in accrued interest receivable                                                | 1,502     | (1,302)  | (4,811)   |
| Decrease (increase) in other assets                                                               | (8,284)   | 4,758    | (10,634)  |
| Increase (decrease) in accrued interest payable                                                   | (3,207)   | 2,232    | 5,699     |
| Increase (decrease) in accounts payable and accrued expenses                                      | 11,937    | (3,185)  | 9,566     |
| Net cash provided by operating activities                                                         | 83,479    | 89,296   | 62,168    |

**Table of Contents****First Interstate Bancsystem, Inc. And Subsidiaries  
Consolidated Statements of Cash Flows (Continued)***(In thousands)*

| Year Ended December 31,                                                                                        | 2008        | 2007        | 2006        |
|----------------------------------------------------------------------------------------------------------------|-------------|-------------|-------------|
| Cash flows from investing activities:                                                                          |             |             |             |
| Purchases of investment securities:                                                                            |             |             |             |
| Held-to-maturity                                                                                               | \$ (16,831) | \$ (17,995) | \$ (19,589) |
| Available-for-sale                                                                                             | (341,587)   | (1,936,961) | (4,644,632) |
| Proceeds from maturities, paydowns and calls of investment securities:                                         |             |             |             |
| Held-to-maturity                                                                                               | 20,684      | 15,300      | 10,899      |
| Available-for-sale                                                                                             | 505,862     | 1,947,408   | 4,507,790   |
| Proceeds from disposals of available-for-sale investment securities                                            | 8           |             | 49,774      |
| Net decrease (increase) in cash equivalent mutual funds classified as available-for-sale investment securities |             | 37          | (31)        |
| Purchases and originations of mortgage servicing rights                                                        | (6,145)     | (6,821)     | (6,246)     |
| Proceeds from sale of mortgage servicing rights                                                                |             | 2,603       |             |
| Extensions of credit to customers, net of repayments                                                           | (492,297)   | (254,240)   | (275,801)   |
| Recoveries of loans charged-off                                                                                | 1,837       | 2,361       | 2,451       |
| Proceeds from sales of other real estate owned                                                                 | 623         | 705         | 850         |
| Disposition of banking offices, net of cash and cash equivalents sold                                          |             |             | (2,540)     |
| Proceeds from sale of unconsolidated equity method joint venture                                               |             |             | 19,853      |
| Proceeds from sale of nonbank subsidiary, net of cash payments                                                 | 40,766      |             |             |
| Capital expenditures, net of sales                                                                             | (32,852)    | (17,957)    | (13,109)    |
| Capital contributions to unconsolidated subsidiaries and joint ventures                                        | (620)       | (1,857)     |             |
| Acquisition of banks and data services company, net of cash and cash equivalents received                      | (135,706)   |             |             |
| Net cash used in investing activities                                                                          | (456,258)   | (267,417)   | (370,331)   |
| Cash flows from financing activities:                                                                          |             |             |             |
| Net increase in deposits                                                                                       | 362,931     | 290,890     | 163,991     |
| Net increase (decrease) in federal funds purchased and repurchase agreements                                   | (53,668)    | (126,786)   | 211,330     |
| Net increase (decrease) in other borrowed funds                                                                | 69,857      | 3,036       | (1,801)     |
| Borrowings of long-term debt                                                                                   | 113,500     |             | 4,100       |
| Repayment of long-term debt                                                                                    | (38,107)    | (16,456)    | (37,153)    |
| Net decrease (increase) in debt issuance costs                                                                 | (497)       | 98          | 37          |
| Proceeds from issuance of subordinated debentures held by subsidiary trusts                                    | 20,620      | 61,857      |             |
| Preferred stock issuance costs                                                                                 | (38)        |             |             |
| Proceeds from issuance of common stock                                                                         | 13,662      | 6,571       | 9,135       |

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|                                                      |            |            |            |
|------------------------------------------------------|------------|------------|------------|
| Excess tax benefits from stock-based compensation    | 1,140      | 2,508      | 1,344      |
| Purchase and retirement of common stock              | (27,912)   | (25,887)   | (9,593)    |
| Dividends paid to common stockholders                | (20,578)   | (24,255)   | (18,413)   |
| Dividends paid to preferred stockholders             | (3,347)    |            |            |
| Net cash provided by financing activities            | 437,563    | 171,576    | 322,977    |
| Net increase (decrease) in cash and cash equivalents | 521,042    | 260,872    | 385,145    |
| Cash and cash equivalents at beginning of year       | 249,246    | 255,791    | 240,977    |
| Cash and cash equivalents at end of year             | \$ 770,288 | \$ 516,663 | \$ 626,122 |
| Supplemental disclosures of cash flow information:   |            |            |            |
| Cash paid during the year for income taxes           | \$ 35,376  | \$ 45,233  | \$ 42,984  |
| Cash paid during the year for interest expense       | 121,115    | 123,722    | 100,273    |

*See accompanying notes to consolidated financial statements.*

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### **First Interstate BancSystem, Inc. and Subsidiaries**

#### **Notes to Consolidated Financial Statements**

*(Dollars in thousands, except share and per share data)*

#### **(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Business.** First Interstate BancSystem, Inc. (the Parent Company and collectively with its subsidiaries, the Company) is a financial and bank holding company that, through the branch offices of its bank subsidiaries, provides a full range of banking services to individuals, businesses, municipalities and other entities throughout Montana, Wyoming and South Dakota. In addition to its primary emphasis on commercial and consumer banking services, the Company also offers trust, employee benefit, investment and insurance services through its bank subsidiaries. The Company is subject to competition from other financial institutions and nonbank financial companies, and is also subject to the regulations of various government agencies and undergoes periodic examinations by those regulatory authorities.

**Basis of Presentation.** The Company's consolidated financial statements include the accounts of the Parent Company and its operating subsidiaries: First Interstate Bank ( FIB ); First Western Bank ( Wall ); The First Western Bank Sturgis ( Sturgis ); First Western Data, Inc. ( Data ); FI Reinsurance Ltd.; i\_Tech Corporation ( i\_Tech ); First Interstate Insurance Agency, Inc.; Commerce Financial, Inc.; FIB, LLC; and, FIBCT, LLC. All significant intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications have been made in the consolidated financial statements for 2007 and 2006 to conform to the 2008 presentation.

**Sale of Nonbank Subsidiary.** On December 31, 2008, the Company sold its technology services subsidiary, i\_Tech, to Fiserv Solutions, Inc., a wholly-owned subsidiary of Fiserv Inc. Concurrent with the sale, the Company entered into a service agreement with Fiserv, Inc. to receive certain technology services previously provided by i\_Tech. In accordance with Emerging Issues Task Force ( EITF ) Issue No. 03-13, Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations, the assets, liabilities, and results of operations and cash flows of i\_Tech have not been presented as discontinued operations in the accompanying consolidated financial statements due to the continuation of cash flows between the Company and i\_Tech under the terms of the service agreement.

**Equity Method Investments.** The Company has an investment in a joint venture that is not consolidated because the Company does not own a majority voting interest, control the operations or receive a majority of the losses or earnings of the joint venture. This joint venture is accounted for using the equity method of accounting whereby the Company initially records its investment at cost and then subsequently adjusts the cost for the Company's proportionate share of distributions and earnings or losses of the joint venture.

**Variable Interest Entities.** The Company's wholly-owned business trusts, First Interstate Statutory Trust ( FIST ), FI Statutory Trust I ( Trust I ), FI Capital Trust II ( Trust II ), FI Statutory Trust III ( Trust III ), FI Capital Trust IV ( Trust IV ), FI Statutory Trust V ( Trust V ) and FI Statutory Trust VI ( Trust VI ) are variable interest entities for which the Company is not a primary beneficiary. Accordingly, the accounts of FIST, Trust I, Trust II, Trust III, Trust IV, Trust V and Trust VI are not included in the accompanying consolidated financial statements, and are instead accounted for using the equity method of accounting.

**Assets Held in Fiduciary or Agency Capacity.** The Company holds certain trust assets in a fiduciary or agency capacity. The Company also purchases and sells federal funds as an agent. These and other assets held in an agency or fiduciary capacity are not assets of the Company and, accordingly, are not included in the accompanying consolidated financial statements.

**Use of Estimates.** The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to change relate to the determination of the allowance for loan losses, the valuation of goodwill and mortgage servicing rights and the fair values of other financial instruments.

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**First Interstate BancSystem, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

*(Dollars in thousands, except share and per share data)*

**Cash and Cash Equivalents.** For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold for one day periods and interest bearing deposits in banks with original maturities of less than three months.

To reduce service charges for check clearing services, the Company maintained compensating balances with the Federal Reserve Bank of approximately \$65,000 and \$30,000 as of December 31, 2008 and 2007, respectively.

**Investment Securities.** Investments in debt securities that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity and carried at amortized cost. Investments in debt securities that may be sold in response to or in anticipation of changes in interest rates and resulting prepayment risk, or other factors, and marketable equity securities are classified as available-for-sale and carried at fair value. The unrealized gains and losses on these securities are reported, net of applicable income taxes, as a separate component of stockholders' equity and comprehensive income. Management determines the appropriate classification of securities at the time of purchase and at each reporting date management reassesses the appropriateness of the classification.

The amortized cost of debt securities classified as held-to-maturity or available-for-sale is adjusted for accretion of discounts to maturity and amortization of premiums over the estimated average life of the security, or in the case of callable securities, through the first call date, using the effective yield method. Such amortization and accretion is included in interest income. Realized gains and losses are included in investment securities gains (losses). Declines in value judged to be other-than-temporary are included in other expenses. The cost of securities sold is based on the specific identification method.

The Company invests in securities on behalf of certain officers and directors of the Company who have elected to participate in the Company's deferred compensation plans. These securities are included in other assets and are carried at their fair value based on quoted market prices. Net realized and unrealized holding gains and losses are included in other non-interest income.

**Loans.** Loans are reported at the principal amount outstanding. Interest is calculated using the simple interest method on the daily balance of the principal amount outstanding.

Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. Accrual of interest on loans is discontinued either when reasonable doubt exists as to the full, timely collection of interest or principal or when a loan becomes contractually past due by ninety days or more with respect to interest or principal, unless such past due loan is well secured and in the process of collection. When a loan is placed on nonaccrual status, interest previously accrued but not collected is reversed against current period interest income. Interest accruals are resumed on such loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest. Loans renegotiated in troubled debt restructurings are those loans on which concessions in terms have been granted because of a borrower's financial difficulty.

Loan origination fees, prepaid interest and certain direct origination costs are deferred, and the net amount is amortized as an adjustment of the related loan's yield using a level yield method over the expected lives of the related loans. The amortization of deferred loan fees and costs and the accretion of unearned discounts on non-performing loans is discontinued during periods of nonperformance.

Included in loans are certain residential mortgage loans originated for sale. These loans are carried at the lower of aggregate cost or estimated market value. Market value is estimated based on binding contracts or quotes or bids from third party investors. Residential mortgages held for sale were \$47,076 and \$26,080 as of December 31, 2008 and 2007, respectively.

Gains and losses on sales of mortgage loans are determined using the specific identification method and are included in income from the origination and sale of loans. These gains and losses are adjusted to recognize the present value of future servicing fee income over the estimated lives of the related loans.

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**First Interstate BancSystem, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

*(Dollars in thousands, except share and per share data)*

**Allowance for Loan Losses.** The allowance for loan losses is established through a provision for loan losses which is charged to expense. Loans, or portions thereof, are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely or, with respect to consumer installment loans, according to an established delinquency schedule. The allowance balance is an amount that management believes will be adequate to absorb known and inherent losses in the loan portfolio based upon quarterly analyses of the size and current risk characteristics of the loan portfolio, an assessment of individual problem loans and actual loss experience, industry concentrations, current economic, political and regulatory factors and the estimated impact of current economic, political, regulatory and environmental conditions on historical loss rates.

A loan is considered impaired when, based upon current information and events, it is probable that the Company will be unable to collect, on a timely basis, all amounts due according to the contractual terms of the loan's original agreement. The amount of the impairment is measured using cash flows discounted at the loan's effective interest rate, except when it is determined that the primary source of repayment for the loan is the operation or liquidation of the underlying collateral. In such cases, the current value of the collateral, reduced by anticipated selling costs, is used to measure impairment. The Company considers impaired loans to be those non-consumer loans which are nonaccrual or have been renegotiated in a troubled debt restructuring. Interest income is recognized on impaired loans only to the extent that cash payments received exceed the principal balance outstanding.

**Goodwill.** The excess purchase price over the fair value of net assets from acquisitions ( goodwill ) is evaluated for impairment at the reporting unit level at least annually, or on an interim basis if an event or circumstance indicates that it is more likely than not that an impairment loss has occurred. As of December 31, 2008 and 2007, all goodwill is attributable to the Company's community banking operating segment. No impairment losses were recognized during 2008, 2007 or 2006.

**Core Deposit Intangibles.** Core deposit intangibles represent the intangible value of depositor relationships resulting from deposit liabilities assumed and are amortized using an accelerated method based on the estimated weighted average useful lives of the related deposits of 9.5 years. Accumulated core deposit intangibles amortization was \$14,238 as of December 31, 2008 and \$11,735 as of December 31, 2007. Amortization expense related to core deposit intangibles recorded as of December 31, 2008 is expected to total \$2,131, \$1,748, \$1,446, \$1,421 and \$1,417 in 2009, 2010, 2011, 2012 and 2013, respectively.

**Mortgage Servicing Rights.** The Company recognizes the rights to service mortgage loans for others, whether acquired or internally originated. Mortgage servicing rights are initially recorded at fair value based on comparable market quotes and are amortized in proportion to and over the period of estimated net servicing income. Mortgage servicing rights are evaluated quarterly for impairment by discounting the expected future cash flows, taking into consideration the estimated level of prepayments based on current industry expectations and the predominant risk characteristics of the underlying loans including loan type, note rate and loan term. Impairment adjustments, if any, are recorded through a valuation allowance.

**Premises and Equipment.** Buildings, furniture and equipment are stated at cost less accumulated depreciation. Depreciation expense is computed using straight-line methods over estimated useful lives of 5 to 50 years for buildings and improvements and 2.5 to 15 years for furniture and equipment. Leasehold improvements and assets acquired under capital lease are amortized over the shorter of their estimated useful lives or the terms of the related leases. Land is recorded at cost.



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**First Interstate BancSystem, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

*(Dollars in thousands, except share and per share data)*

**Company Owned Life Insurance.** Key executive life insurance policies are recorded at their cash surrender value. Group life insurance policies are subject to a stable value contract that offsets the impact of interest rate fluctuations on the market value of the policies. Group life insurance policies are recorded at the stabilized investment value. Increases in the cash surrender or stabilized investment value of insurance policies, as well as insurance proceeds received, are recorded as other non-interest income, and are not subject to income taxes.

**Impairment of Long-Lived Assets.** Long-lived assets, including premises and equipment and certain identifiable intangibles, are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. The amount of the impairment loss, if any, is based on the asset's fair value. No impairment losses were recognized during 2008, 2007 or 2006.

**Other Real Estate Owned.** Real estate acquired in satisfaction of loans (OREO) is carried at the lower of the recorded investment in the property at the date of foreclosure or its current fair value less selling costs. OREO of \$6,025 and \$928 as of December 31, 2008 and 2007, respectively, is included in other assets.

**Restricted Equity Securities.** Restricted equity securities of the Federal Reserve Bank and the Federal Home Loan Bank (FHLB) of \$21,411 and \$12,746 as of December 31, 2008 and 2007, respectively, are included in other assets at par value.

**Income from Fiduciary Activities.** Consistent with industry practice, income for trust services is recognized on the basis of cash received. However, use of this method in lieu of accrual basis accounting does not materially affect reported earnings.

**Income Taxes.** The Parent Company and its subsidiaries, other than FI Reinsurance Ltd., have elected to be included in a consolidated federal income tax return. For state income tax purposes, the combined taxable income of the Parent Company and its subsidiaries is apportioned among the states in which operations take place. Federal and state income taxes attributable to the subsidiaries, computed on a separate return basis, are paid to or received from the Parent Company.

The Company accounts for income taxes using the liability method. Under the liability method, deferred tax assets and liabilities are determined based on enacted income tax rates which will be in effect when the differences between the financial statement carrying values and tax bases of existing assets and liabilities are expected to be reported in taxable income.

Positions taken in the Company's tax returns may be subject to challenge by the taxing authorities upon examination. Uncertain tax positions are initially recognized in the financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are both initially and subsequently measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon settlement with the tax authority, assuming full knowledge of the position and all relevant facts. The Company provides for interest and, in some cases, penalties on tax positions that may be challenged by the taxing authorities. Interest expense is recognized beginning in the first period that such interest would begin accruing. Penalties are recognized in the period that the Company claims the position in the tax return. Interest and penalties on income tax uncertainties are classified within income tax expense in the income statement. With few exceptions, the Company is no longer subject to U.S. federal and state examinations by tax authorities for years before 2005.

**Earnings Per Common Share.** Basic earnings per common share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is calculated by dividing net income available to common shareholders by the weighted average number of common shares and potential common shares outstanding during the period.

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**First Interstate BancSystem, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

*(Dollars in thousands, except share and per share data)*

**Comprehensive Income.** Comprehensive income includes net income, as well as other changes in stockholders equity that result from transactions and economic events other than those with stockholders. In addition to net income, the Company's comprehensive income includes the after tax effect of changes in unrealized gains and losses on available-for-sale investment securities and pension liability adjustments.

**Segment Reporting.** An operating segment is defined as a component of a business for which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and evaluate performance. The Company has two operating segments, community banking and technology services. Community banking encompasses commercial and consumer banking services offered to individuals, businesses, municipalities and other entities. Technology services encompasses services provided through i\_Tech to affiliated and non-affiliated customers including core application data processing, ATM and debt card processing, item proof and capture, wide area network services and system support. On December 31, 2008, the Company sold i\_Tech and moved certain operational functions previously provided by i\_Tech to FIB.

**Advertising Costs.** Advertising costs are expensed as incurred. Advertising expense was \$3,447, \$2,892, and \$2,728 in 2008, 2007 and 2006, respectively.

**Transfers of Financial Assets.** Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company; the transferee obtains the right, free of conditions that constrain it from taking advantage of that right, to pledge or exchange the transferred assets; and, the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

**Technology Services Revenue Recognition.** Revenues from technology services are transaction-based and are recognized as transactions are processed or services are rendered.

**Stock-Based Compensation.** The Company accounts for stock-based compensation in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standard (SFAS) No. 123 (revised), Share-Based Payment. SFAS No. 123 (revised) requires measurement of compensation cost for all stock-based awards at fair value on the date of grant and recognition of compensation expense over the requisite service period for awards expected to vest. Stock-based compensation expense of \$911, \$1,093 and \$1,328 for the years ended December 31, 2008, 2007 and 2006, respectively, is included in salaries, wages and benefits expense in the Company's consolidated statements of income. Related income tax benefits recognized for the years ended December 31, 2008, 2007 and 2006 were \$348, \$418 and \$508, respectively.

**Fair Value Measurements.** On January 1, 2008, the Company adopted the provisions of SFAS No. 157, Fair Value Measurements, for financial assets and liabilities. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. See Note 22 Fair Value Measurements. In general, fair value measurements are based upon quoted market prices, where available. If quoted market prices are not available, fair value measurements are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and require some degree of judgment regarding interest rates, credit risk, prepayments and other factors. The use of different assumptions or estimation techniques may have a significant effect on the fair value amounts reported.

**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)***(2) REGULATORY CAPITAL**

The Company is subject to the regulatory capital requirements administered by federal banking regulators and the Federal Reserve. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The Parent Company, like all bank holding companies, is not subject to the prompt corrective action provisions. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

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

The Company's actual capital amounts and ratios and selected minimum regulatory thresholds as of December 31, 2008 and 2007 are presented in the following table:

|                            | Actual    |       | Adequately Capitalized |       | Well Capitalized |       |
|----------------------------|-----------|-------|------------------------|-------|------------------|-------|
|                            | Amount    | Ratio | Amount                 | Ratio | Amount           | Ratio |
| <i>As of December 31,</i>  |           |       |                        |       |                  |       |
| <i>2008:</i>               |           |       |                        |       |                  |       |
| Total risk-based capital:  |           |       |                        |       |                  |       |
| Consolidated               | \$554,418 | 10.5% | \$422,952              | 8.0%  | NA               | NA    |
| FIB                        | 459,785   | 10.3  | 356,100                | 8.0   | \$445,125        | 10.0% |
| Wall                       | 51,417    | 12.1  | 33,907                 | 8.0   | 42,383           | 10.0  |
| Sturgis                    | 48,432    | 12.4  | 31,184                 | 8.0   | 38,980           | 10.0  |
| Tier 1 risk-based capital: |           |       |                        |       |                  |       |
| Consolidated               | 453,070   | 8.6   | 211,476                | 4.0   | NA               | NA    |
| FIB                        | 388,966   | 8.7   | 178,050                | 4.0   | \$267,075        | 6.0   |
| Wall                       | 46,062    | 10.9  | 16,953                 | 4.0   | 25,460           | 6.0   |
| Sturgis                    | 43,529    | 11.2  | 15,592                 | 4.0   | 23,388           | 6.0   |
| Leverage capital ratio:    |           |       |                        |       |                  |       |
| Consolidated               | 453,070   | 7.1   | 254,085                | 4.0   | NA               | NA    |
| FIB                        | 388,966   | 7.2   | 217,247                | 4.0   | \$271,559        | 5.0   |
| Wall                       | 46,062    | 9.7   | 19,093                 | 4.0   | 23,867           | 5.0   |
| Sturgis                    | 43,529    | 9.8   | 17,781                 | 4.0   | 22,226           | 5.0   |

|  | Actual |       | Adequately Capitalized |       | Well Capitalized |       |
|--|--------|-------|------------------------|-------|------------------|-------|
|  | Amount | Ratio | Amount                 | Ratio | Amount           | Ratio |

*As of December 31,  
2007:*

Total risk-based capital:

|              |           |       |           |      |           |       |
|--------------|-----------|-------|-----------|------|-----------|-------|
| Consolidated | \$557,278 | 13.6% | \$326,755 | 8.0% | NA        | NA    |
| FIB          | 437,440   | 10.8  | 323,173   | 8.0  | \$403,966 | 10.0% |

Tier 1 risk-based capital:

|              |         |      |         |     |           |      |
|--------------|---------|------|---------|-----|-----------|------|
| Consolidated | 506,207 | 12.4 | 163,377 | 4.0 | NA        | NA   |
| FIB          | 389,921 | 9.6  | 161,586 | 4.0 | \$242,380 | 6.0% |

Leverage capital ratio:

|              |         |     |         |     |           |      |
|--------------|---------|-----|---------|-----|-----------|------|
| Consolidated | 506,207 | 9.9 | 163,377 | 4.0 | NA        | NA   |
| FIB          | 389,921 | 7.6 | 161,586 | 4.0 | \$242,380 | 5.0% |

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)***(3) INVESTMENT SECURITIES**

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

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

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

Gross gains of \$102 and gross losses of \$1 were realized on the disposition of available-for-sale securities in 2008.

| <i>Available-for-Sale</i>               |             | Gross      | Gross      | Estimated   |
|-----------------------------------------|-------------|------------|------------|-------------|
|                                         | Amortized   | Unrealized | Unrealized | Fair        |
| December 31, 2007                       | Cost        | Gains      | Losses     | Value       |
| Obligations of U.S. government agencies | \$ 451,079  | \$1,714    | \$ (173)   | \$ 452,620  |
| Mortgage-backed securities              | 565,584     | 1,863      | (5,790)    | 561,657     |
| Mutual funds                            | 3           |            |            | 3           |
| Total                                   | \$1,016,666 | \$3,577    | \$(5,963)  | \$1,014,280 |

| <i>Held-to-Maturity</i> |           | Gross      | Gross      | Estimated |
|-------------------------|-----------|------------|------------|-----------|
|                         | Amortized | Unrealized | Unrealized | Fair      |
| December 31, 2007       | Cost      | Gains      | Losses     | Value     |

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|                                        |            |        |          |            |
|----------------------------------------|------------|--------|----------|------------|
| State, county and municipal securities | \$ 113,610 | \$ 710 | \$ (474) | \$ 113,846 |
| Other securities                       | 767        |        |          | 767        |
| Total                                  | \$ 114,377 | \$ 710 | \$ (474) | \$ 114,613 |

Gross gains of \$59 were realized on the disposition of available-for-sale securities in 2007. No gross losses were realized on the disposition of available-for-sale investment securities in 2007.

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)*

The following table shows the gross unrealized losses and fair values of investment securities, aggregated by investment category, and the length of time individual investment securities have been in a continuous unrealized loss position, as of December 31, 2008 and 2007.

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

*Held-to-Maturity*

|                                        |           |           |          |         |           |           |
|----------------------------------------|-----------|-----------|----------|---------|-----------|-----------|
| State, county and municipal securities | \$ 28,537 | \$(1,002) | \$11,278 | \$(407) | \$ 39,815 | \$(1,409) |
|----------------------------------------|-----------|-----------|----------|---------|-----------|-----------|

|                                         | Less than 12 Months |                         | 12 Months or More |                         | Total      |                         |
|-----------------------------------------|---------------------|-------------------------|-------------------|-------------------------|------------|-------------------------|
|                                         | Fair Value          | Gross Unrealized Losses | Fair Value        | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| December 31, 2007                       |                     |                         |                   |                         |            |                         |
| <i>Available-for-Sale</i>               |                     |                         |                   |                         |            |                         |
| Obligations of U.S. Government agencies | \$14,995            | \$ (1)                  | \$100,510         | \$(172)                 | \$115,505  | \$(173)                 |
| Other mortgage-backed securities        | 50,956              | (251)                   | 254,225           | (5,539)                 | 305,181    | (5,790)                 |
| Total                                   | \$65,951            | \$(252)                 | \$354,735         | \$(5,711)               | \$420,686  | \$(5,963)               |

*Held-to-Maturity*

|                                        |          |         |           |         |           |         |
|----------------------------------------|----------|---------|-----------|---------|-----------|---------|
| State, county and municipal securities | \$19,206 | \$(187) | \$ 21,065 | \$(287) | \$ 40,271 | \$(474) |
|----------------------------------------|----------|---------|-----------|---------|-----------|---------|

The investment portfolio is evaluated quarterly for other-than-temporary declines in the market value of each individual investment security. Consideration is given to the length of time and the extent to which the fair value has been less than cost; the financial condition and near term prospects of the issuer; and, the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Unrealized losses as of December 31, 2008 and 2007 related primarily to fluctuations in the current interest rates. As of December 31, 2008, the Company had the intent and ability to hold these investment securities for a period of time sufficient to allow for an anticipated recovery. Impairment losses of \$1,286 were recorded in other expenses in 2008. No impairment losses were recorded during 2007 or 2006.

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)*

Maturities of investment securities at December 31, 2008 are shown below. Maturities of mortgage-backed securities have been adjusted to reflect shorter maturities based upon estimated prepayments of principal. All other investment securities maturities are shown at contractual maturity dates.

|                                       | Available-for-Sale |                         | Held-to-Maturity  |                         |
|---------------------------------------|--------------------|-------------------------|-------------------|-------------------------|
|                                       | Amortized<br>Cost  | Estimated<br>Fair Value | Amortized<br>Cost | Estimated<br>Fair Value |
| December 31, 2008                     |                    |                         |                   |                         |
| Within one year                       | \$317,053          | \$320,469               | \$ 10,146         | \$ 10,214               |
| After one year but within five years  | 469,679            | 479,266                 | 22,805            | 23,109                  |
| After five years but within ten years | 93,261             | 94,614                  | 27,853            | 28,079                  |
| After ten years                       | 66,649             | 67,561                  | 48,940            | 47,789                  |
| Total                                 | 946,642            | 961,910                 | 109,744           | 109,191                 |
| Investments with no stated maturity   | 4                  | 4                       | 618               | 618                     |
| Total                                 | \$946,646          | \$961,914               | \$ 110,362        | \$ 109,809              |

At December 31, 2008, the Company had investment securities callable within one year with amortized costs and estimated fair values of \$96,211 and \$97,401, respectively. These investment securities are primarily classified as available-for-sale and included in the after one year but within five years category in the table above.

Maturities of securities do not reflect rate repricing opportunities present in adjustable rate mortgage-backed securities. At December 31, 2008 and 2007, the Company had variable rate securities with amortized costs of \$1,558 and \$466, respectively.

There are no significant concentrations of investments at December 31, 2008, (greater than 10 percent of stockholders equity) in any individual security issuer, except for U.S. government or agency-backed securities.

Investment securities with amortized cost of \$894,045 and \$909,241 at December 31, 2008 and 2007, respectively, were pledged to secure public deposits and securities sold under repurchase agreements. The approximate fair value of securities pledged at December 31, 2008 and 2007 was \$907,156 and \$907,007, respectively. All securities sold under repurchase agreements are with customers and mature on the next banking day. The Company retains possession of the underlying securities sold under repurchase agreements.

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)***(4) LOANS**

Major categories and balances of loans included in the loan portfolios are as follows:

| December 31,                       | 2008        | 2007        |
|------------------------------------|-------------|-------------|
| Real estate loans:                 |             |             |
| Residential                        | \$ 587,464  | \$ 419,001  |
| Agricultural                       | 191,831     | 142,256     |
| Commercial                         | 1,483,967   | 1,018,831   |
| Construction                       | 790,177     | 664,272     |
| Mortgage loans originated for sale | 47,076      | 26,080      |
| Total real estate loans            | 3,100,515   | 2,270,440   |
| Consumer:                          |             |             |
| Indirect consumer loans            | 417,243     | 373,457     |
| Credit card loans                  | 74,068      | 68,136      |
| Other consumer loans               | 198,324     | 166,409     |
| Total consumer loans               | 689,635     | 608,002     |
| Commercial                         | 833,894     | 593,669     |
| Agricultural                       | 145,876     | 81,890      |
| Other loans, including overdrafts  | 2,893       | 4,979       |
| Total loans                        | \$4,772,813 | \$3,558,980 |

At December 31, 2008, the Company had no concentrations of loans which exceeded 10% of total loans other than the categories disclosed above.

Nonaccrual loans were \$85,632 and \$31,552 at December 31, 2008 and 2007, respectively. If interest on nonaccrual loans had been accrued, such income would have approximated \$4,632, \$1,712 and \$1,135 during the years ended December 31, 2008, 2007 and 2006, respectively. Loans contractually past due ninety days or more aggregating \$3,828 on December 31, 2008 and \$2,171 on December 31, 2007 were on accrual status. These loans are deemed adequately secured and in the process of collection.

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

| December 31,                                 | 2008                        |                                   | 2007                        |                                   |
|----------------------------------------------|-----------------------------|-----------------------------------|-----------------------------|-----------------------------------|
|                                              | Recorded<br>Loan<br>Balance | Specific<br>Loan Loss<br>Reserves | Recorded<br>Loan<br>Balance | Specific<br>Loan Loss<br>Reserves |
| Impaired loans                               |                             |                                   |                             |                                   |
| With specific loan loss reserves assigned    | \$17,749                    | \$8,015                           | \$ 7,492                    | \$2,831                           |
| With no specific loan loss reserves assigned | 66,667                      |                                   | 24,471                      |                                   |

|                      |          |         |          |         |
|----------------------|----------|---------|----------|---------|
| Total impaired loans | \$84,416 | \$8,015 | \$31,963 | \$2,831 |
|----------------------|----------|---------|----------|---------|

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)*

The average recorded investment in impaired loans for the years ended December 31, 2008, 2007 and 2006 was approximately \$60,728, \$22,065 and \$15,335, respectively. If interest on impaired loans had been accrued, interest income on impaired loans during 2008, 2007 and 2006 would have been approximately \$4,069, \$1,728 and \$1,162, respectively. At December 31, 2008, there were no material commitments to lend additional funds to borrowers whose existing loans have been renegotiated or are classified as nonaccrual.

Most of the Company's business activity is with customers within the states of Montana, Wyoming and South Dakota. Loans where the customers or related collateral are out of the Company's trade area are not significant.

**(5) ALLOWANCE FOR LOAN LOSSES**

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

| Year ended December 31,                             | 2008      | 2007     | 2006     |
|-----------------------------------------------------|-----------|----------|----------|
| Balance at beginning of year                        | \$ 52,355 | \$47,452 | \$42,450 |
| Allowance of acquired banking offices               | 14,463    |          |          |
| Provision charged to operating expense              | 33,356    | 7,750    | 7,761    |
| Less loans charged-off                              | (14,695)  | (5,208)  | (5,210)  |
| Add back recoveries of loans previously charged-off | 1,837     | 2,361    | 2,451    |
| Balance at end of year                              | \$ 87,316 | \$52,355 | \$47,452 |

**(6) PREMISES AND EQUIPMENT**

Premises and equipment and related accumulated depreciation are as follows:

| December 31,                  | 2008       | 2007       |
|-------------------------------|------------|------------|
| Land                          | \$ 31,934  | \$ 18,279  |
| Buildings and improvements    | 171,668    | 122,853    |
| Furniture and equipment       | 57,802     | 73,352     |
|                               | 261,404    | 214,484    |
| Less accumulated depreciation | (83,605)   | (90,443)   |
| Premises and equipment, net   | \$ 177,799 | \$ 124,041 |

The Parent Company and a FIB branch office lease premises from an affiliated partnership (see Note 21).

**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)***(7) MORTGAGE SERVICING RIGHTS**

Information with respect to the Company's mortgage servicing rights follows:

| Year ended December 31,                   | 2008      | 2007     | 2006     |
|-------------------------------------------|-----------|----------|----------|
| Balance at beginning of year              | \$ 27,561 | \$26,788 | \$24,581 |
| Sales of mortgage servicing rights        |           | (1,607)  |          |
| Purchases of mortgage servicing rights    | 34        | 311      | 1,660    |
| Originations of mortgage servicing rights | 6,111     | 6,510    | 4,586    |
| Amortization expense                      | (5,918)   | (4,441)  | (4,024)  |
| Write-off of permanent impairment         |           |          | (15)     |
| Balance at end of year                    | 27,788    | 27,561   | 26,788   |
| Less valuation reserve                    | (16,786)  | (5,846)  | (4,144)  |
| Balance at end of year                    | \$ 11,002 | \$21,715 | \$22,644 |

At December 31, 2008, the estimated fair value and weighted average life of the Company's mortgage servicing rights were \$11,832 and 1.9 years, respectively. The fair value of mortgage servicing rights was determined using discount rates ranging from 8.50% to 20.50% and monthly prepayment speeds ranging from 1.3% to 5.0% depending upon the risk characteristics of the underlying loans. The Company recorded as other expense impairment charges of \$10,940, \$1,702 and \$1,694 in 2008, 2007 and 2006, respectively.

Principal balances of mortgage loans underlying mortgage servicing rights of approximately \$2,077,131 and \$1,938,180 at December 31, 2008 and 2007, respectively, are not included in the accompanying consolidated financial statements.

**(8) COMPANY OWNED LIFE INSURANCE**

Company owned life insurance consists of the following:

| December 31,                         | 2008     | 2007     |
|--------------------------------------|----------|----------|
| Key executive, principal shareholder | \$ 4,359 | \$ 4,224 |
| Key executive split dollar           | 4,088    | 3,968    |
| Group life                           | 61,068   | 58,884   |
| Total                                | \$69,515 | \$67,076 |

The Company maintains key executive life insurance policies on certain principal shareholders. Under these policies, the Company receives benefits payable upon the death of the insured. The net cash surrender value of key executive, principal shareholder insurance policies was \$4,359 and \$4,224 at December 31, 2008 and 2007, respectively.

The Company also has life insurance policies covering selected other key officers. The net cash surrender value of these policies was \$4,088 and \$3,968 at December 31, 2008 and 2007, respectively. Under these policies, the Company receives benefits payable upon death of the insured. An endorsement split dollar agreement has been executed with the selected key officers whereby a portion of the policy death benefit is payable to their designated beneficiaries. The endorsement split dollar agreement will provide postretirement coverage for those selected key officers meeting specified retirement qualifications. The Company expenses the earned portion of the post-employment benefit through the vesting period.

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)*

The Company has a group life insurance policy covering selected officers of FIB. The net cash surrender value of the policy was \$61,068 and \$58,884 at December 31, 2008 and 2007, respectively. Under the policy, the Company receives benefits payable upon death of the insured. An endorsement split dollar agreement has been executed with the insured officers whereby a portion of the policy death benefit is payable to their designated beneficiaries if they are employed by the Company at the time of death. The marginal income produced by the policy is used to offset the cost of employee benefit plans of FIB.

**(9) DEPOSITS**

Deposits are summarized as follows:

| December 31,                | 2008        | 2007        |
|-----------------------------|-------------|-------------|
| Non-interest bearing demand | \$ 985,155  | \$ 836,753  |
| Interest bearing:           |             |             |
| Demand                      | 1,059,818   | 1,019,208   |
| Savings                     | 1,198,783   | 992,571     |
| Time, \$100 and over        | 821,437     | 464,560     |
| Time, other                 | 1,109,066   | 686,309     |
| Total interest bearing      | 4,189,104   | 3,162,648   |
| Total deposits              | \$5,174,259 | \$3,999,401 |

Maturities of time deposits at December 31, 2008 are as follows:

|            | Time, \$100<br>and Over | Total Time  |
|------------|-------------------------|-------------|
| 2009       | \$691,285               | \$1,548,851 |
| 2010       | 98,458                  | 260,400     |
| 2011       | 10,817                  | 44,050      |
| 2012       | 10,511                  | 43,021      |
| 2013       | 10,366                  | 34,154      |
| Thereafter |                         | 27          |
| Total      | \$821,437               | \$1,930,503 |

Interest expense on time deposits of \$100 or more was \$28,794, \$21,634 and \$15,291 for the years ended December 31, 2008, 2007 and 2006, respectively.

**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)***(10) INCOME TAXES**

Income tax expense consists of the following:

| Year ended December 31, | 2008     | 2007     | 2006     |
|-------------------------|----------|----------|----------|
| Current:                |          |          |          |
| Federal                 | \$39,389 | \$34,669 | \$42,014 |
| State                   | 5,618    | 4,304    | 5,208    |
| Total current           | 45,007   | 38,973   | 47,222   |
| Deferred:               |          |          |          |
| Federal                 | (6,691)  | (2,031)  | (5,005)  |
| State                   | (887)    | (149)    | (718)    |
| Total deferred          | (7,578)  | (2,180)  | (5,723)  |
| Balance at end of year  | \$37,429 | \$36,793 | \$41,499 |

Total income tax expense differs from the amount computed by applying the statutory federal income tax rate of 35 percent in 2008, 2007 and 2006 to income before income taxes as a result of the following:

| Year ended December 31,                             | 2008     | 2007     | 2006     |
|-----------------------------------------------------|----------|----------|----------|
| Tax expense at the statutory tax rate               | \$37,827 | \$36,902 | \$40,988 |
| Increase (decrease) in tax resulting from:          |          |          |          |
| Tax-exempt income                                   | (4,028)  | (3,434)  | (2,915)  |
| State income tax, net of federal income tax benefit | 3,130    | 2,632    | 2,919    |
| Amortization of nondeductible intangibles           | 34       | 28       | 28       |
| Other, net                                          | 466      | 665      | 479      |
| Tax expense at effective tax rate                   | \$37,429 | \$36,793 | \$41,499 |



**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)*

The tax effects of temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities that give rise to significant portions of the net deferred tax asset relate to the following:

| December 31,                                                                                                  | 2008      | 2007      |
|---------------------------------------------------------------------------------------------------------------|-----------|-----------|
| Deferred tax assets:                                                                                          |           |           |
| Loans, principally due to allowance for loan losses                                                           | \$ 29,130 | \$ 18,182 |
| Employee benefits                                                                                             | 5,115     | 3,693     |
| Investment securities, unrealized losses                                                                      |           | 904       |
| Other                                                                                                         | 443       | 329       |
| Deferred tax assets                                                                                           | 34,688    | 23,108    |
| Deferred tax liabilities:                                                                                     |           |           |
| Fixed assets, principally differences in bases and depreciation                                               | (3,500)   | (3,127)   |
| Investment securities, unrealized gains                                                                       | (6,014)   |           |
| Investment in joint venture partnership, principally due to differences in depreciation of partnership assets | (832)     | (902)     |
| Prepaid amounts                                                                                               | (633)     | (1,333)   |
| Government agency stock dividends                                                                             | (2,060)   | (2,051)   |
| Goodwill and core deposit intangibles                                                                         | (12,215)  | (3,214)   |
| Mortgage servicing rights                                                                                     | (1,186)   | (5,156)   |
| Other                                                                                                         | (847)     | (584)     |
| Deferred tax liabilities                                                                                      | (27,287)  | (16,367)  |
| Net deferred tax assets                                                                                       | \$ 7,401  | \$ 6,741  |

The Company believes a valuation allowance is not needed to reduce the net deferred tax assets as it is more likely than not that the net deferred tax assets will be realized through recovery of taxes previously paid and/or future taxable income.

The Company had current income taxes payable of \$7,126 at December 31, 2008 and income taxes receivable of \$1,711 at December 31, 2007, which are included in accrued expenses.

**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)***(11) LONG-TERM DEBT AND OTHER BORROWED FUNDS**

A summary of long-term debt follows:

| December 31,                                                                                                                                                              | 2008     | 2007    |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|---------|
| Parent Company:                                                                                                                                                           |          |         |
| 6.81% subordinated term loan maturing January 9, 2018, principal due at maturity, interest payable quarterly                                                              | \$20,000 | \$      |
| Variable rate term notes, principal and interest due quarterly, balloon payment due at maturity on January 10, 2013 (weighted average rate of 2.51% at December 31, 2008) | 42,857   |         |
| Variable rate revolving line of credit maturing January 10, 2011, principal due at maturity, interest payable quarterly                                                   |          |         |
| Subsidiaries:                                                                                                                                                             |          |         |
| Variable rate subordinated term loan maturing February 28, 2018, principal due at maturity, interest payable quarterly (rate of 4.20% at December 31, 2008)               | 15,000   |         |
| Various notes payable to FHLB, interest due monthly at various rates and maturities through October 31, 2017 (weighted average rate of 4.12% at December 31, 2008)        | 4,413    | 3,237   |
| 8.00% capital lease obligation with term ending October 25, 2029                                                                                                          | 1,878    | 1,908   |
| Total long-term debt                                                                                                                                                      | \$84,148 | \$5,145 |

Maturities of long-term debt at December 31, 2008 are as follows:

|            |          |
|------------|----------|
| 2009       | \$ 9,010 |
| 2010       | 9,065    |
| 2011       | 7,388    |
| 2012       | 7,191    |
| 2013       | 14,538   |
| Thereafter | 36,956   |
| Total      | \$84,148 |

Proceeds from the variable rate term notes, revolving line of credit and the 6.81% subordinated term loan were used to fund the First Western acquisition. See Note 24 - Acquisitions.

On January 10, 2008, the Company entered into a credit agreement ( Credit Agreement ) with four syndicated banks. The Credit Agreement supersedes the Company's unsecured revolving term loan with its primary lender and is secured by all of the outstanding stock of FIB. Under the terms of the Credit Agreement, the Company borrowed \$50,000 on variable rate term notes ( Term Notes ) and \$9,000 on a \$25,000 revolving credit facility maturing on January 10, 2011, with interest payable quarterly.

On October 3, 2008, the Company entered into the first amendment to the Credit Agreement. The amendment reduced the maximum amount that may be advanced under the revolving credit facility from \$25,000 to \$15,000, increased the interest rate charged on the revolving credit facility and increased the annual commitment fee. As of December 31, 2008, the Company had no outstanding balances due under the revolving credit line. The revolving credit line requires an annual commitment fee ranging from 0.25% to 0.35% of the average daily unadvanced amount depending on the Company's funded debt ratio.

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**First Interstate BancSystem, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

*(Dollars in thousands, except share and per share data)*

As of December 31, 2008, \$42,857 was outstanding on the Term Notes bearing interest at a weighted average rate of 2.51%. The Term Notes mature January 10, 2013 and are payable in equal quarterly principal installments of \$1,786 beginning March 31, 2008, with one final installment of \$14,286 due at maturity. Interest on the Term Notes is payable quarterly. Under the terms of the Credit Agreement, as amended, the Company may elect at various dates to convert interest on the Term Notes to either (i) a fluctuating rate equal to the higher of the federal funds rate plus 0.50% or prime plus from 0.125% to 0.375% depending on the Company's funded debt ratio at the date of the conversion, or (ii) a fixed rate equal to the London Interbank Offering Rate (LIBOR) divided by a percentage equal to 1.00 minus the applicable percentage prescribed by the Board of Governors of the Federal Reserve System for determining the maximum reserve requirements applicable to eurodollar fundings plus 1.625% to 1.875%.

The Credit Agreement contains various covenants that, among other things, establish minimum capital and financial performance ratios; and, place certain restrictions on indebtedness, non-performing assets, the allowance for loan losses, the redemption and issuance of common stock and the amounts of dividends payable to shareholders. As of June 30, 2008, the Company was in violation of two financial performance covenants related to non-performing assets. The October 3, 2008 amendment to the Credit Agreement revised certain debt covenants related to non-performing assets and waived all debt covenant defaults resulting from breaches existing as of June 30, 2008. The Company paid amendment and waiver fees of \$85. The Company was in compliance with all existing and amended debt covenants as of December 31, 2008.

On January 10, 2008, the Company borrowed \$20,000 on a 6.81% unsecured subordinated term loan maturing January 9, 2018, with interest payable quarterly and principal due at maturity. The unsecured subordinated term loan qualifies as tier 2 capital under regulatory capital adequacy guidelines.

During February 2008, the Company borrowed \$15,000 on a variable rate unsecured subordinated term loan maturing February 28, 2018, with interest payable quarterly and principal due at maturity. The Company may elect at various dates either prime or LIBOR plus 2.00%. The interest rate on the subordinated term loan was 4.20% as of December 31, 2008. The unsecured subordinated term loan qualifies as tier 2 capital under regulatory capital adequacy guidelines.

The notes payable to FHLB are secured by a blanket assignment of the Company's qualifying residential and commercial real estate loans. The Company has available lines of credit with the FHLB of approximately \$163,534, subject to collateral availability. As of December 31, 2008 and 2007, FHLB advances of \$4,413 and \$3,237, respectively, were included in long-term debt. As of December 31, 2008 and 2007, short-term FHLB advances of \$75,000 and \$0, respectively, were included in other borrowed funds.

The Company has a capital lease obligation on a banking office. The balance of the obligation was \$1,878 and \$1,908 as of December 31, 2008 and 2007, respectively. Assets acquired under capital lease, consisting solely of a building and leasehold improvements, are included in premises and equipment and are subject to depreciation.

Other borrowed funds consist of overnight and term borrowings with original maturities of less than one year.

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)*

The following is a summary of other borrowed funds:

| December 31,                                                                                                                                                                   | 2008     | 2007    |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|---------|
| Interest bearing demand notes issued to the United States Treasury, secured by investment securities (0.0% interest rate at December 31, 2008)                                 | \$ 4,216 | \$8,730 |
| Various notes payable to the FHLB, principal and interest due at various rates and maturities through September 22, 2009 (weighted average rate of 3.37% at December 31, 2008) | 75,000   |         |
|                                                                                                                                                                                | \$79,216 | \$8,730 |

The Company has federal funds lines of credit with third parties amounting to \$176,750, subject to funds availability. These lines are subject to cancellation without notice. The Company also has a line of credit with the Federal Reserve Bank for borrowings up to \$305,076 secured by a blanket pledge of indirect consumer loans.

**(12) SUBORDINATED DEBENTURES HELD BY SUBSIDIARY TRUSTS**

The Company sponsors seven wholly-owned business trusts, FIST, Trust I, Trust II, Trust III, Trust IV, Trust V and Trust VI (collectively, the Trusts). The Trusts were formed for the exclusive purpose of issuing an aggregate of \$120,000 of 30-year floating rate mandatorily redeemable capital trust preferred securities (Trust Preferred Securities) to third-party investors. The Trusts also issued, in aggregate, \$3,715 of common equity securities to the Parent Company. Proceeds from the issuance of the Trust Preferred Securities and common equity securities were invested in 30-year junior subordinated deferrable interest debentures (Subordinated Debentures) issued by the Parent Company. A summary of Subordinated Debenture issuances follows:

| Issuance      | Maturity Date     | Principal Amount Outstanding as of December 31, |           |
|---------------|-------------------|-------------------------------------------------|-----------|
|               |                   | 2008                                            | 2007      |
| March 2003    | March 26, 2033    | \$ 41,238                                       | \$ 41,238 |
| October 2007  | January 1, 2038   | 10,310                                          | 10,310    |
| November 2007 | December 15, 2037 | 15,464                                          | 15,464    |
| December 2007 | December 15, 2037 | 20,619                                          | 20,619    |
| December 2007 | April 1, 2038     | 15,464                                          | 15,464    |
| January 2008  | April 1, 2038     | 10,310                                          |           |
| January 2008  | April 1, 2038     | 10,310                                          |           |

|                                                         |           |           |
|---------------------------------------------------------|-----------|-----------|
| Total subordinated debentures held by subsidiary trusts | \$123,715 | \$103,095 |
|---------------------------------------------------------|-----------|-----------|

In March 2003, the Company issued \$41,238 of Subordinated Debentures to FIST. The Subordinated Debentures bear a cumulative floating interest rate equal to LIBOR plus 3.15% per annum. As of December 31, 2008 the interest rate on the Subordinated Debentures was 4.62%.

In October 2007, the Company issued \$10,310 of Subordinated Debentures to Trust II. The Subordinated Debentures bear a cumulative floating interest rate equal to LIBOR plus 2.25% per annum. As of December 31, 2008 the interest rate on the Subordinated Debentures was 6.13%.

In November 2007, the Company issued \$15,464 of Subordinated Debentures to Trust I. The Subordinated Debentures bear interest at a fixed rate of 7.50% for five years after issuance, and thereafter at a variable rate equal to LIBOR plus 2.75% per annum.

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**First Interstate BancSystem, Inc. and Subsidiaries**

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*(Dollars in thousands, except share and per share data)*

In December 2007, the Company issued \$20,619 of Subordinated Debentures to Trust III. The Subordinated Debentures bear interest at a fixed rate of 6.88% for five years after issuance, and thereafter at a variable rate equal to LIBOR plus 2.40% per annum.

In December 2007, the Company issued \$15,464 of Subordinated Debentures to Trust IV. The Subordinated Debentures bear a cumulative floating interest rate equal to LIBOR plus 2.70% per annum. As of December 31, 2008 the interest rate on the Subordinated Debentures was 6.58%.

In January 2008, the Company issued \$10,310 of Subordinated Debentures to Trust V. The Subordinated Debentures bear interest at a fixed rate of 6.78% for five years after issuance, and thereafter at a variable rate equal to LIBOR plus 2.75% per annum.

In January 2008, the Company issued \$10,310 of Subordinated Debentures to Trust VI. The Subordinated Debentures bear a cumulative floating interest rate equal to LIBOR plus 2.75% per annum. As of December 31, 2008, the interest rate on the Subordinated Debentures was 6.38%.

The Subordinated Debentures are unsecured with interest distributions payable quarterly. The Company may defer the payment of interest at any time provided that the deferral period does not extend past the stated maturity. During any such deferral period, distributions on the Trust Preferred Securities will also be deferred and the Company's ability to pay dividends on its common shares is restricted. The Subordinated Debentures may be redeemed, subject to approval by the Federal Reserve Bank, at the Company's option on or after five years from the date of issue, or at any time in the event of unfavorable changes in laws or regulations. Debt issuance costs consisting primarily of underwriting discounts and professional fees were capitalized and are being amortized through maturity to interest expense using the straight-line method.

The terms of the Trust Preferred Securities are identical to those of the Subordinated Debentures. The Trust Preferred Securities are subject to mandatory redemption upon repayment of the Subordinated Debentures at their stated maturity dates or earlier redemption in an amount equal to their liquidation amount plus accumulated and unpaid distributions to the date of redemption. The Company guarantees the payment of distributions and payments for redemption or liquidation of the Trust Preferred Securities to the extent of funds held by the Trusts.

The Trust Preferred Securities qualify as tier 1 capital of the Parent Company under the Federal Reserve Board's capital adequacy guidelines. Proceeds from the issuance of the Trust Preferred Securities were used to fund acquisitions. For additional information regarding acquisitions, see Note 24 Acquisitions.

**(13) STOCK-BASED COMPENSATION**

The Company has equity awards outstanding under three stock-based compensation plans; the 2006 Equity Compensation Plan (the 2006 Plan), the 2001 Stock Option Plan and the 2004 Restricted Stock Benefit Plan. These plans were primarily established to enhance the Company's ability to attract, retain and motivate employees. The Company's Board of Directors or, upon delegation, the Compensation Committee of the Board of Directors (the Compensation Committee) has exclusive authority to select employees, advisors and others, including directors, to receive awards and to establish the terms and conditions of each award made pursuant to the Company's stock-based compensation plans.

**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)*

The 2006 Plan, approved by the Company's shareholders in May 2006, was established to consolidate into one plan the benefits available under the 2001 Stock Option Plan and the 2004 Restricted Stock Award Plan (collectively, the

Previous Plans). The Previous Plans continue with respect to awards made prior to May 2006. All shares of common stock available for future grant under the Previous Plans were transferred into the 2006 Plan. At December 31, 2008, there were 429,893 common shares available for future grant under the 2006 Plan.

**Stock Options.** All options granted have an exercise price equal to the minority appraised value of the Company's common stock at the date of grant, may be subject to vesting as determined by the Company's Board of Directors or Compensation Committee and can be exercised for periods of up to ten years from the date of grant. Stock issued upon exercise of options is generally subject to a shareholder agreement prohibiting transfer of the stock for a period of six months following the exercise. In addition, the shareholder agreement grants the Company a right of first refusal to repurchase the stock at the then current minority appraised value and provides the Company a right to call some or all of the stock under certain conditions.

Compensation expense related to stock option awards of \$896, \$996 and \$935 was included in salaries, wages and benefits expense on the Company's consolidated income statements for the years ended December 31, 2008, 2007 and 2006, respectively. Related income tax benefits recognized for the years ended December 31, 2008, 2007 and 2006 were \$342, \$380 and \$357, respectively.

The weighted average grant date fair value of options granted was \$5.74, \$7.89 and \$5.95 during the years ended December 31, 2008, 2007 and 2006, respectively. The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model. The following table presents the weighted-average assumptions used in the option pricing model for the periods indicated:

| Years ended December 31,            | 2008  | 2007  | 2006  |
|-------------------------------------|-------|-------|-------|
| Expected volatility                 | 6.91% | 5.23% | 5.87% |
| Expected dividend yield             | 3.11% | 2.95% | 3.01% |
| Risk-free interest rate             | 3.72% | 4.80% | 4.51% |
| Expected life of options (in years) | 6.2   | 6.2   | 6.2   |

Expected dividend yield is based on the Company's annualized expected dividends per share divided by the average common stock price. Risk-free interest rate is based on the U.S. treasury constant maturity yield for treasury securities with maturities approximating the expected life of the options granted on the date of grant. The Company has elected to use the simplified method to estimate expected life until its analysis of historical exercise and post-vesting employment termination behaviors is refined. Expected volatility is based on the historical volatility of the Company's common stock calculated using the quarterly appraised value of a minority interest over the expected life of options.



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The following table summarizes stock option activity under the Company's active stock option plans for the year ended December 31, 2008:

|                                              | Number of<br>Shares | Weighted-Average<br>Exercise Price | Weighted-Average<br>Remaining<br>Contract Life |
|----------------------------------------------|---------------------|------------------------------------|------------------------------------------------|
| Outstanding options, beginning of year       | 829,869             | \$ 57.33                           |                                                |
| Granted                                      | 161,081             | 83.52                              |                                                |
| Exercised                                    | (93,093)            | 47.65                              |                                                |
| Forfeited                                    | (8,302)             | 74.55                              |                                                |
| Expired                                      | (6,300)             | 53.84                              |                                                |
| Outstanding options, end of year             | 883,255             | \$ 62.99                           | 6.01 years                                     |
| Outstanding options exercisable, end of year | 673,943             | \$ 57.35                           | 5.23 years                                     |

The total intrinsic value of fully-vested stock options outstanding as of December 31, 2008 was \$15,575. The total intrinsic value of options exercised was \$3,296, \$6,631 and \$3,630 during the years ended December 31, 2008, 2007 and 2006, respectively. The actual tax benefit realized for the tax deduction from option exercises totaled \$1,178, \$2,536 and \$1,368 for the years ended December 31, 2008, 2007 and 2006, respectively. Cash received from stock option exercises during the years ended December 31, 2008, 2007 and 2006 was \$1,741, \$5,074 and \$3,306, respectively.

Information with respect to the Company's nonvested stock options as of and for the year ended December 31, 2008 follows:

|                                            | Number of<br>Shares | Weighted-Average<br>Grant Date Fair<br>Value |
|--------------------------------------------|---------------------|----------------------------------------------|
| Nonvested stock options, beginning of year | 196,543             | \$ 6.97                                      |
| Granted                                    | 113,194             | 5.74                                         |
| Vested                                     | (92,123)            | 6.31                                         |
| Forfeited                                  | (8,302)             | 6.76                                         |
| Nonvested stock options, end of year       | 209,312             | \$ 6.48                                      |

As of December 31, 2008, there was \$770 of unrecognized compensation cost related to nonvested stock options granted under the Company's active stock option plans. That cost is expected to be recognized over a weighted-average period of 1.71 years. The total fair value of shares vested during 2008 was \$581.

**Restricted Stock Awards.** Common stock issued under the Company's restricted stock plans may not be sold or otherwise transferred until restrictions have lapsed or performance objectives have been obtained. During the

vesting period, participants have voting rights and receive dividends on the restricted shares. Upon termination of employment, common shares upon which restrictions have not lapsed must be returned to the Company. Common stock issued under the Company's restricted stock plans is also subject to a shareholder's agreement granting the Company the right of first refusal to repurchase vested shares at the then current minority appraised value and providing the Company a right to call some or all of the vested shares under certain circumstances.

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The fair value of restricted stock awards, based on the most recent quarterly minority appraised value of the Company's common stock at the date of grant, is being amortized as compensation expense on a straight-line basis over the period restrictions lapse. Compensation expense related to restricted share awards of \$15, \$97 and \$393 was included in salaries, wages and benefits expense on the Company's consolidated statements of income for the years ended December 31, 2008, 2007 and 2006, respectively.

The following table presents information regarding the Company's restricted stock as of December 31, 2008:

|                                     | Number of<br>Shares | Weighted-Average<br>Measurement<br>Date<br>Fair Value |
|-------------------------------------|---------------------|-------------------------------------------------------|
| Restricted stock, beginning of year | 2,000               | \$ 65.00                                              |
| Vested                              | (1,000)             | 65.00                                                 |
| Restricted stock, end of year       | 1,000               | \$ 65.00                                              |

As of December 31, 2008, there was \$36 of unrecognized compensation cost related to nonvested restricted stock awards expected to be recognized over a period of 2.3 years.

**(14) EMPLOYEE BENEFIT PLANS**

**Profit Sharing Plan.** The Company has a noncontributory profit sharing plan. All employees, other than temporary employees, working 20 hours or more per week are eligible to participate in the profit sharing plan. Quarterly contributions are determined by the Company's Board of Directors, but are not to exceed, on an individual basis, the lesser of 100% of compensation or \$40 annually. Participants become 100% vested upon the completion of three years of vesting service. The Company accrued contribution expense for this plan of \$2,739, \$2,816 and \$3,097 in 2008, 2007 and 2006, respectively.

**Savings Plan.** In addition, the Company has a contributory employee savings plan. Eligibility requirements for this plan are the same as those for the profit sharing plan discussed in the preceding paragraph. Employee participation in the plan is at the option of the employee. The Company contributes \$1.25 for each \$1.00 of employee contributions up to 4% of the participating employee's compensation. The Company accrued contribution expense for this plan of \$3,896, \$3,243 and \$2,947 in 2008, 2007 and 2006, respectively.

**Postretirement Healthcare Plan.** The Company sponsors a contributory defined benefit healthcare plan (the Plan) for active employees and employees and directors retiring from the Company at the age of at least 55 years and with at least 15 years of continuous service. Retired Plan participants contribute the full cost of benefits based on the average per capita cost of benefit coverage for both active employees and retired Plan participants.

The Plan's unfunded benefit obligation of \$1,042 and \$926 as of December 31, 2008 and 2007, respectively, is included in accounts payable and accrued expenses in the Company's consolidated balance sheets. Net periodic benefit costs of \$152, \$130 and \$174 for the years ended December 31, 2008, 2007 and 2006, respectively, are included in salaries, wages and employee benefits expense in the Company's consolidated statements of income.

Weighted average actuarial assumptions used to determine the postretirement benefit obligation at December 31, 2008 and 2007, and the net periodic benefit costs for the years then ended, included a discount rate of 5.8% and a 6.0% annual increase in the per capita cost of covered healthcare benefits. The estimated effect of a one percent increase or a one percent decrease in the assumed healthcare cost trend rate did not significantly impact the service and interest cost components of the net periodic benefit cost or the accumulated postretirement benefit obligation. Future benefit payments are expected to be \$124, \$147, \$149, \$141, \$161 and \$943 for 2009, 2010, 2011, 2012, 2013, and 2014 through 2018, respectively.

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At December 31, 2008, the Company had accumulated other comprehensive loss related to the Plan of \$452, or \$282 net of related income tax benefit, comprised of net actuarial gains of \$240 and unamortized transition asset of \$692. The Company estimates \$13 will be amortized from accumulated other comprehensive loss into net period benefit costs in 2009.

**(15) COMMITMENTS AND CONTINGENCIES**

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

The Company had commitments under construction contracts of \$26,716 and \$1,713 as of December 31, 2008 and 2007, respectively.

The Company had commitments to purchase held-to-maturity municipal investment securities of \$1,325 and available-for-sale mortgage-backed investment securities of \$12,561 as of December 31, 2008.

The Company leases certain premises and equipment from third parties under operating leases. Total rental expense to third parties was \$3,474 in 2008, \$3,224 in 2007 and \$3,166 in 2006.

The total future minimum rental commitments, exclusive of maintenance and operating costs, required under operating leases that have initial or remaining noncancelable lease terms in excess of one year at December 31, 2008, are as follows:

|                                  | Third<br>Parties | Related<br>Partnership | Total    |
|----------------------------------|------------------|------------------------|----------|
| For the year ending December 31: |                  |                        |          |
| 2009                             | \$ 1,191         | \$ 1,903               | \$ 3,094 |
| 2010                             | 1,184            | 1,903                  | 3,087    |
| 2011                             | 1,121            | 1,794                  | 2,915    |
| 2012                             | 796              | 1,674                  | 2,470    |
| 2013                             | 576              | 1,553                  | 2,129    |
| Thereafter                       | 6,998            | 2,614                  | 9,612    |
| Total                            | \$11,866         | \$11,441               | \$23,307 |

The Parent Company and the Billings office of FIB are the anchor tenants in a building owned by a partnership in which FIB is one of two partners, and has a 50% partnership interest.

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**First Interstate BancSystem, Inc. and Subsidiaries**

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**(16) FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK**

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recorded in the consolidated balance sheet. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained is based on management's credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, premises and equipment, and income-producing commercial properties.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the commitment contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Generally, commitments to extend credit are subject to annual renewal. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments to extend credit to borrowers approximated \$1,135,217 at December 31, 2008, which included \$330,514 on unused credit card lines and \$301,338 with commitment maturities beyond one year. Commitments to extend credit to borrowers approximated \$1,112,651 at December 31, 2007, which included \$313,621 on unused credit card lines and \$302,489 with commitment maturities beyond one year.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Most commitments extend for no more than two years and are generally subject to annual renewal. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. At December 31, 2008 and 2007, the Company had outstanding stand-by letters of credit of \$90,761 and \$105,667, respectively. The estimated fair value of the obligation undertaken by the Company in issuing standby letters of credit is included in accounts payable and accrued expenses in the Company's consolidated balance sheets.

**(17) CAPITAL STOCK AND DIVIDEND RESTRICTIONS**

On January 10, 2008, the Company issued 5,000 shares of 6.75% Series A noncumulative redeemable preferred stock ( Series A Preferred Stock ) with an aggregate value of \$50,000 as partial consideration for the acquisition of the First Western entities, see

Note 24 Acquisitions. The Series A Preferred Stock was issued to the former owner of the First Western entities, an accredited investor, in a private placement transaction made in reliance upon exemptions from registration pursuant to Section 4(2) under the Securities Act of 1933, as amended, and Rule 506 promulgated thereunder. The Series A Preferred Stock ranks senior to the Company's common stock with respect to dividend and liquidation rights and has no voting rights. Holders of the Series A Preferred Stock are entitled to receive, if and when declared, noncumulative dividends at an annual rate of \$675 per share, based on a 360 day year. The Company may redeem all or part of the Series A Preferred Stock at any time after the fifth anniversary of the date issued at a redemption price of \$10,000 per share plus all accrued and unpaid dividends. Following the tenth anniversary of the date issued, the Series A Preferred Stock may be converted, at the option of the holder, into shares of the Company's common stock at a ratio of 80 shares of common stock for every one share of Series A Preferred Stock.

At December 31, 2008, 91.0% of common shares held by shareholders were subject to shareholder's agreements ( Agreements ). Under the Agreements, shares may not be sold or transferred, except in limited circumstances,

without triggering the Company's right of first refusal to repurchase shares from the shareholder at fair value. Additionally, shares held under the Agreements are subject to repurchase under certain conditions.

The payment of dividends by subsidiary banks is subject to various federal and state regulatory limitations. In general, a bank is limited, without the prior consent of its regulators, to paying dividends that do not exceed current year net profits together with retained earnings from the two preceding calendar years. The Company's debt instruments also include limitations on the payment of dividends.

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)***(18) EARNINGS PER COMMON SHARE**

The following table sets forth the computation of basic and diluted earnings per common share:

| For the year ended December 31,                                                                     | 2008      | 2007      | 2006      |
|-----------------------------------------------------------------------------------------------------|-----------|-----------|-----------|
| Net income                                                                                          | 70,648    | 68,641    | 75,609    |
| Less preferred stock dividends                                                                      | 3,347     |           |           |
| Net income available to common shareholders, basic and diluted                                      | \$ 67,301 | \$ 68,641 | \$ 75,609 |
| Weighted average common shares outstanding                                                          | 7,871,034 | 8,126,804 | 8,112,610 |
| Weighted average commons shares issuable upon exercise of stock options and restricted stock awards | 157,134   | 195,676   | 191,380   |
| Weighted average common and common equivalent shares outstanding                                    | 8,028,168 | 8,322,480 | 8,303,990 |
| Basic earnings per common share                                                                     | \$ 8.55   | \$ 8.45   | \$ 9.32   |
| Diluted earnings per common share                                                                   | \$ 8.38   | \$ 8.25   | \$ 9.11   |

The Company had 284,583, 137,092 and 10,732 stock options outstanding that were antidilutive as of December 31, 2008, 2007 and 2006, respectively.

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)***(19) CONDENSED FINANCIAL INFORMATION (PARENT COMPANY ONLY)**

Following is condensed financial information of First Interstate BancSystem, Inc.

|                                                            |           |           |          |
|------------------------------------------------------------|-----------|-----------|----------|
| December 31,                                               | 2008      | 2007      |          |
| <i>Condensed balance sheets:</i>                           |           |           |          |
| Cash and cash equivalents                                  | \$ 47,141 | \$ 8,443  |          |
| Investment securities available-for-sale                   |           | 99,977    |          |
| Investment in subsidiaries, at equity:                     |           |           |          |
| Bank subsidiaries                                          | 683,509   | 424,108   |          |
| Nonbank subsidiaries                                       | 2,562     | 8,454     |          |
| Total investment in subsidiaries                           | 686,071   | 432,562   |          |
| Premises and equipment                                     | 1,584     | 1,765     |          |
| Other assets                                               | 21,551    | 20,400    |          |
| Total assets                                               | \$756,347 | \$563,147 |          |
| Other liabilities                                          | \$ 25,362 | \$ 8,923  |          |
| Advances from subsidiaries, net                            | 5,351     | 6,686     |          |
| Long-term debt                                             | 62,857    |           |          |
| Subordinated debentures held by subsidiary trusts          | 123,715   | 103,095   |          |
| Total liabilities                                          | 217,285   | 118,704   |          |
| Stockholders' equity                                       | 539,062   | 444,443   |          |
| Total liabilities and stockholders' equity                 | \$756,347 | \$563,147 |          |
| Years Ended December 31,                                   | 2008      | 2007      | 2006     |
| <i>Condensed statements of income:</i>                     |           |           |          |
| Dividends from subsidiaries                                | \$ 64,539 | \$74,548  | \$28,866 |
| Other interest income                                      | 29        | 71        | 172      |
| Other income, primarily management fees from subsidiaries  | 9,101     | 9,625     | 8,155    |
| Gain on sale of nonbank subsidiary                         | 27,096    |           |          |
| Gain on sale of unconsolidated equity method joint venture |           |           | 19,801   |
| Total income                                               | 100,765   | 84,244    | 56,994   |
| Salaries and benefits                                      | 9,030     | 10,687    | 10,052   |
| Interest expense                                           | 12,075    | 4,588     | 4,031    |
| Other operating expenses, net                              | 7,713     | 6,475     | 6,399    |
| Total expenses                                             | 28,818    | 21,750    | 20,482   |

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|                                                      |           |          |          |
|------------------------------------------------------|-----------|----------|----------|
| Earnings before income tax benefit                   | 71,947    | 62,494   | 36,512   |
| Income tax expense (benefit)                         | 2,814     | (4,812)  | 2,522    |
| Income before undistributed earnings of subsidiaries | 69,133    | 67,306   | 33,990   |
| Undistributed earnings of subsidiaries               | 1,515     | 1,335    | 41,619   |
| Net income                                           | \$ 70,648 | \$68,641 | \$75,609 |

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| Years Ended December 31,                                                                 | 2008      | 2007      | 2006      |
|------------------------------------------------------------------------------------------|-----------|-----------|-----------|
| <i>Condensed statements of cash flows:</i>                                               |           |           |           |
| Cash flows from operating activities:                                                    |           |           |           |
| Net income                                                                               | \$ 70,648 | \$ 68,641 | \$ 75,609 |
| Cumulative effect of adoption of new accounting principle                                | (560)     |           |           |
| Adjustments to reconcile net income to cash provided by operating activities:            |           |           |           |
| Undistributed earnings of subsidiaries                                                   | (1,515)   | (1,335)   | (41,619)  |
| Depreciation and amortization                                                            | 181       | 227       | 245       |
| Provision for deferred income taxes                                                      | (706)     | (539)     | (59)      |
| Stock-based compensation expense                                                         | 911       | 1,093     | 1,239     |
| Excess tax benefits from stock-based compensation                                        | (1,140)   | (2,508)   | (1,344)   |
| Gain on sale of nonbank subsidiary                                                       | (27,096)  |           |           |
| Gain on sale of unconsolidated equity method joint venture                               |           |           | (19,801)  |
| Other, net                                                                               | 11,868    | (8,263)   | 7,102     |
| Net cash provided by operating activities                                                | 52,591    | 57,316    | 21,372    |
| Cash flows from investing activities:                                                    |           |           |           |
| Maturities of available-for-sale investment securities                                   | 100,000   |           |           |
| Purchases of available-for-sale investment securities                                    |           | (99,931)  |           |
| Capital expenditures, net of sales                                                       |           | (47)      | (8)       |
| Capitalization of subsidiaries                                                           | (1,140)   | (2,117)   | (400)     |
| Acquisition of banks and data service company, net of cash and cash equivalents received | (198,081) |           |           |
| Proceeds from disposition of nonbank subsidiary                                          | 41,026    |           |           |
| Disposition of unconsolidated equity method joint venture                                |           |           | 19,853    |
| Net cash provided by (used in) investing activities                                      | (58,195)  | (102,095) | 19,445    |
| Cash flows from financing activities:                                                    |           |           |           |
| Net increase (decrease) in advances from nonbank subsidiaries                            | (1,634)   | 529       | 2,219     |
| Borrowings of long-term debt                                                             | 98,500    |           | 4,100     |
| Repayments of long-term debt                                                             | (35,643)  |           | (8,700)   |
| Proceeds from issuance subordinated debentures                                           | 20,620    | 61,857    |           |
| Net (increase) decrease in debt issuance costs                                           | (468)     | 98        | 37        |
| Preferred stock issuance costs                                                           | (38)      |           |           |
| Proceeds from issuance of common stock                                                   | 13,662    | 9,090     | 10,503    |
| Excess tax benefits from stock-based compensation                                        | 1,140     | 2,485     | 1,344     |
| Payments to retire common stock                                                          | (27,912)  | (25,887)  | (9,593)   |
| Dividends paid on common stock                                                           | (20,578)  | (24,255)  | (18,413)  |

|                                                     |           |          |           |
|-----------------------------------------------------|-----------|----------|-----------|
| Dividends paid on preferred stock                   | (3,347)   |          |           |
| Net cash provided by (used in) financing activities | 44,302    | 23,917   | (18,503)  |
| Net change in cash and cash equivalents             | 38,698    | (20,862) | 22,314    |
| Cash and cash equivalents, beginning of year        | 8,443     | 29,305   | 6,991     |
| Cash and cash equivalents, end of year              | \$ 47,141 | \$ 8,443 | \$ 29,305 |

*Noncash Investing and Financing Activities* During 2008, the Company transferred \$38 from accrued liabilities to common stock in conjunction with the exercise of stock options. No transfers were made from accrued liabilities to common stock during 2007 or 2006.

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**First Interstate BancSystem, Inc. and Subsidiaries**

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In conjunction with the sale of a nonbank subsidiary in December 2008, the Parent Company settled intercompany balances through its investment in the i\_Tech subsidiary. The settlement resulted in increases in other assets, accrued liabilities and long-term debt of \$320, \$1,188 and \$299, respectively, with corresponding decreases in investment in subsidiary.

On January 10, 2008, the Company issued 5,000 shares of Series A Preferred Stock with an aggregate value of \$50,000. The Series A Preferred Stock was issued in partial consideration for the First Western acquisition. For additional information regarding the acquisition, see Note 24 Acquisitions.

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

**(20) NON-CASH INVESTING AND FINANCING ACTIVITIES**

The Company transferred loans of \$5,645, \$1,135 and \$348 to other real estate owned in 2008, 2007 and 2006, respectively.

During 2008, the Company transferred accrued liabilities of \$38 to common stock in conjunction with the exercise of stock options. No transfers were made from accrued liabilities to common stock during 2007 or 2006.

In conjunction with the sale of a nonbank subsidiary in December 2008, the Company divested assets and liabilities with book values of \$9,299 and \$128, respectively. For additional information regarding the sale, see Note 25 Disposals.

On January 10, 2008, the Company issued 5,000 shares of Series A Preferred Stock with an aggregate value of \$50,000. The Series A Preferred Stock was issued in partial consideration for the First Western acquisition. For additional information regarding the acquisition, see Note 24 Acquisitions.

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

In conjunction with the sale of the net assets of a branch banking office in 2006, the Company divested assets and liabilities with book values of \$542 and \$3,082, respectively. For additional information regarding the sale, see Note 25 Disposals.

**(21) RELATED PARTY TRANSACTIONS**

The Company conducts banking transactions in the ordinary course of business with related parties, including directors, executive officers, shareholders and their associates, on the same terms as those prevailing at the same time for comparable transactions with unrelated persons and that do not involve more than a normal risk of collectibility or present other unfavorable features.

Certain executive officers and directors of the Company and certain corporations and individuals related to such persons, incurred indebtedness in the form of loans, as customers, of \$24,977 at December 31, 2008 and \$24,974 at December 31, 2007. During 2008, new loans and advances on existing loans of \$19,989 were funded and loan repayments totaled \$19,793. These loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans and are allowable under the Sarbanes Oxley Act of 2002. Additionally, during 2008, loans of \$193 were removed due to changes in related parties from the prior year.

The Company purchases property, casualty and other insurance through an agency in which a director of the Company has a majority ownership interest. The Company paid insurance premiums to the agency of \$649, \$340, and \$357 in 2008, 2007 and 2006, respectively.

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**Notes to Consolidated Financial Statements**

*(Dollars in thousands, except share and per share data)*

The Company leases aircraft from an entity wholly-owned by the chairman of the Company's Board of Directors. Under the terms of the lease, the Company pays all of the third-party operating expenses of the aircraft, which totaled approximately \$315, \$325 and \$246 in 2008, 2007 and 2006, respectively. In addition to paying the third-party operating expenses, the Company paid \$143, \$168 and \$68 for use of the aircraft and received reimbursement of \$140, \$161 and \$77 from the chairman for his personal use of the aircraft during 2008, 2007 and 2006, respectively.

The Company purchases services from a company in which seven directors of the Company, including the chairman and vice chairman of the Board of Directors, have an aggregate ownership interest of 17.1%. The Company paid fees and reimbursed out-of-pocket costs of \$513, \$384 and \$336 in 2008, 2007 and 2006, respectively. Services provided for the Company's benefit include majority shareholder education and communication, strategic enterprise planning and corporate governance consultation.

During 2008, the Company purchased real property previously owned by a director of the Company for \$1,250. The Company purchased the property from a developer who had purchased it from the director immediately prior to the Company's purchase. Prior to the purchase, the Company's board of directors approved the transaction after reviewing fully the relationships and proposed terms regarding the transaction.

**(22) FAIR VALUE MEASUREMENTS**

Effective January 1, 2008, the Company adopted SFAS No. 157, Fair Value Measurements. SFAS No. 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives highest priority to unadjusted quoted prices in active markets for identical assets (level 1 measurements) and lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described below:

*Level 1* Unadjusted quoted market prices in active markets that are accessible at the measurement date for identical, unrestricted assets.

*Level 2* Significant other observable inputs other than Level 1 prices such as quoted market prices in markets that are not active, quoted prices for similar assets, or other inputs that are observable, either directly or indirectly, for substantially the full term of the asset.

*Level 3* Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general level of each instrument in the fair value hierarchy, is set forth below. A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)*

Financial assets and financial liabilities measured at fair value on a recurring basis as of December 31, 2008 are as follows:

|                                          | Fair Value Measurements at Reporting Date Using                                           |                                                           |                                                    |                  |
|------------------------------------------|-------------------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|------------------|
|                                          | Quoted<br>Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Balance<br>as of |
| Assets                                   |                                                                                           |                                                           |                                                    | 12/31/2008       |
| Investment securities available-for-sale | \$                                                                                        | \$ 961,914                                                | \$                                                 | \$961,914        |
| Mortgage servicing rights                |                                                                                           | 11,832                                                    |                                                    | 11,832           |

*Investment Securities Available for Sale.* Investment securities available for sale are generally classified within level 2 of the valuation hierarchy. The Company obtains fair value measurements for investment securities from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. In certain cases, where the pricing service cannot obtain fair values and/or there is limited activity or less transparency around inputs to the valuation, investment securities are classified within level 3 of the valuation hierarchy.

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

The Company has certain other financial assets that are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Financial assets and liabilities measured at fair value on a non-recurring basis include the following.

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

*Impaired Loans.* Certain impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from collateral. Collateral values are estimated using Level 3 inputs based on observable market data and customized discounting criteria. During 2008, certain impaired loans were remeasured and reported at fair value through a specific valuation allowance allocation of the allowance for loan losses based upon the fair value of the underlying collateral. As of December 31, 2008, the Company had approximately \$9,734 of impaired loans



recorded at fair value.

As of December 31, 2008, the Company had not made any fair value elections with respect to any of its eligible assets or liabilities as permitted under the provisions of SFAS No. 159, The Fair Value Option for Financial Assts and Financial Liabilities Including an amendment of FASB Statement No. 115.

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

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)*

**Financial Assets.** Carrying values of cash, cash equivalents and accrued interest receivable approximate fair values due to the liquid and/or short-term nature of these instruments. Fair values of held-to-maturity investment securities are based on quoted market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. Fair values of fixed rate loans are calculated by discounting scheduled cash flows adjusted for prepayment estimates using discount rates based on secondary market sources, if available, or based on estimated market discount rates that reflect the credit and interest rate risk inherent in the loan category. Fair values of adjustable rate loans approximate the carrying values of these instruments due to frequent repricing, provided there have been no changes in credit quality since origination.

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

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

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

| As of December 31,                          | 2008            |                      | 2007            |                      |
|---------------------------------------------|-----------------|----------------------|-----------------|----------------------|
|                                             | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| <b>Financial assets:</b>                    |                 |                      |                 |                      |
| Cash and cash equivalents                   | \$ 314,030      | \$ 314,030           | \$ 249,246      | \$ 249,246           |
| Investment securities available-for-sale    | 961,914         | 961,914              | 1,014,280       | 1,014,280            |
| Investment securities held-to-maturity      | 110,362         | 109,809              | 114,377         | 114,613              |
| Net loans                                   | 4,685,497       | 4,696,287            | 3,506,625       | 3,489,199            |
| Accrued interest receivable                 | 38,694          | 38,694               | 32,215          | 32,215               |
| Mortgage servicing rights, net              | 11,002          | 11,832               | 21,715          | 23,538               |
| <br>Total financial assets                  | <br>\$6,121,499 | <br>\$6,132,566      | <br>\$4,938,458 | <br>\$4,923,091      |
| <b>Financial liabilities:</b>               |                 |                      |                 |                      |
| Total deposits, excluding time deposits     | \$3,243,756     | \$3,243,756          | \$2,848,532     | \$2,848,532          |
| Time deposits                               | 1,930,503       | 1,934,296            | 1,150,869       | 1,151,572            |
| Federal funds purchased                     | 30,625          | 30,625               |                 |                      |
| Securities sold under repurchase agreements | 525,501         | 525,501              | 604,762         | 604,762              |

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|                                                   |             |             |             |             |
|---------------------------------------------------|-------------|-------------|-------------|-------------|
| Accrued interest payable                          | 20,531      | 20,531      | 21,104      | 21,104      |
| Other borrowed funds                              | 79,216      | 79,216      | 8,730       | 8,730       |
| Long-term debt                                    | 84,148      | 88,255      | 5,145       | 5,470       |
| Subordinated debentures held by subsidiary trusts | 123,715     | 119,608     | 103,095     | 104,410     |
| Total financial liabilities                       | \$6,037,995 | \$6,041,788 | \$4,742,237 | \$4,744,580 |

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)***(23) SEGMENT REPORTING**

Selected operating segment information as of and for the years ended December 31, 2008, 2007 and 2006 follows.

The Other category includes the net funding cost and other expenses of the Parent Company and the operational results of consolidated nonbank subsidiaries.

| For the year ended December 31, 2008                             | Community<br>Banking | Technology<br>Services | Other    | Intersegment<br>Eliminations | Total       |
|------------------------------------------------------------------|----------------------|------------------------|----------|------------------------------|-------------|
| Net interest income                                              | \$ 247,176           | \$ 80                  | \$54,060 | \$(65,939)                   | \$ 235,377  |
| Provision for loan losses                                        | 33,356               |                        |          |                              | 33,356      |
| Net interest income after provision for<br>loan losses           | 213,820              | 80                     | 54,060   | (65,939)                     | 202,021     |
| Non-interest income:                                             |                      |                        |          |                              |             |
| External sources                                                 | 83,083               | 18,592                 | 26,707   |                              | 128,382     |
| Intersegment                                                     | 30                   | 12,622                 | 11,249   | (23,901)                     |             |
| Total non-interest income                                        | 83,113               | 31,214                 | 37,956   | (23,901)                     | 128,382     |
| Non-interest expense                                             | 200,899              | 26,459                 | 18,869   | (23,901)                     | 222,326     |
| Net income before income tax expense                             | 96,034               | 4,835                  | 73,147   | (65,939)                     | 108,077     |
| Income tax expense                                               | 32,670               | 1,924                  | 2,835    |                              | 37,429      |
| Net income                                                       | \$ 63,364            | \$ 2,911               | \$70,312 | \$(65,939)                   | \$ 70,648   |
| Depreciation and core deposit intangible<br>amortization         | \$ 17,346            | \$                     | \$ 246   | \$                           | \$ 17,592   |
| Total assets as of December 31, 2008                             | \$6,618,374          | \$                     | \$ 9,973 | \$                           | \$6,628,347 |
| Investment in equity method investees as<br>of December 31, 2008 | \$ 5,847             | \$                     | \$       | \$                           | \$ 5,847    |

| For the year ended December 31, 2007 | Community<br>Banking | Technology<br>Services | Other | Intersegment<br>Eliminations | Total |
|--------------------------------------|----------------------|------------------------|-------|------------------------------|-------|
|--------------------------------------|----------------------|------------------------|-------|------------------------------|-------|

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|                                                               |             |          |           |              |             |
|---------------------------------------------------------------|-------------|----------|-----------|--------------|-------------|
| Net interest income                                           | \$ 202,653  | \$ 190   | \$ 71,469 | \$ (74,709)  | \$ 199,603  |
| Provision for loan losses                                     | 7,750       |          |           |              | 7,750       |
| Net interest income after provision for loan losses           | 194,903     | 190      | 71,469    | (74,709)     | 191,853     |
| Non-interest income:                                          |             |          |           |              |             |
| External sources                                              | 72,681      | 19,080   | 687       |              | 92,448      |
| Intersegment                                                  | 1           | 12,675   | 9,408     | (22,084)     |             |
| Total non-interest income                                     | 72,682      | 31,755   | 10,095    | (22,084)     | 92,448      |
| Non-interest expense                                          | 157,199     | 25,805   | 17,947    | (22,084)     | 178,867     |
| Net income before income tax expense                          | 110,386     | 6,140    | 63,617    | (74,709)     | 105,434     |
| Income tax expense (benefit)                                  | 39,142      | 2,434    | (4,783)   |              | 36,793      |
| Net income                                                    | \$ 71,244   | \$ 3,706 | \$ 68,400 | \$ (74,709)  | \$ 68,641   |
| Depreciation and core deposit intangible amortization         | \$ 14,092   | \$       | \$ 227    | \$           | \$ 14,319   |
| Total assets as of December 31, 2007                          | \$5,091,252 | \$ 7,120 | \$561,686 | \$ (443,261) | \$5,216,797 |
| Investment in equity method investees as of December 31, 2007 | \$ 5,772    | \$       | \$        | \$           | \$ 5,772    |

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)*

| For the year ended December 31, 2006                          | Community<br>Banking | Technology<br>Services | Other      | Intersegment<br>Eliminations | Total        |
|---------------------------------------------------------------|----------------------|------------------------|------------|------------------------------|--------------|
| Net interest income                                           | \$ 191,073           | \$ 162                 | \$ 66,713  | \$ (70,485)                  | \$ 187,463   |
| Provision for loan losses                                     | 7,761                |                        |            |                              | 7,761        |
| Net interest income after provision for loan losses           | 183,312              | 162                    | 66,713     | (70,485)                     | 179,702      |
| Non-interest income:                                          |                      |                        |            |                              |              |
| External sources                                              | 65,341               | 15,845                 | 20,933     |                              | 102,119      |
| Intersegment                                                  | 1                    | 13,535                 | 7,733      | (21,269)                     |              |
| Total non-interest income                                     | 65,342               | 29,380                 | 28,666     | (21,269)                     | 102,119      |
| Non-interest expense                                          | 145,504              | 23,317                 | 17,161     | (21,269)                     | 164,713      |
| Net income before income tax expense                          | 103,150              | 6,225                  | 78,218     | (70,485)                     | 117,108      |
| Income tax expense                                            | 36,459               | 2,464                  | 2,576      |                              | 41,499       |
| Net income                                                    | \$ 66,691            | \$ 3,761               | \$ 75,642  | \$ (70,485)                  | \$ 75,609    |
| Depreciation and core deposit intangible amortization         | \$ 13,853            | \$                     | \$ 246     | \$                           | \$ 14,099    |
| Total assets as of December 31, 2006                          | \$ 4,949,955         | \$ 7,141               | \$ 474,126 | \$ (457,088)                 | \$ 4,974,134 |
| Investment in equity method investees as of December 31, 2006 | \$ 5,439             | \$                     | \$         | \$                           | \$ 5,439     |

**(24) ACQUISITIONS**

On September 18, 2007, the Company entered into an agreement to purchase all of the outstanding stock of Sturgis, Wall and Data (collectively, First Western ), from Christen Group, Inc., formerly known as First Western Bancorp, Inc. The acquisition, which was completed on January 10, 2008, allowed the Company to gain a significant market presence in South Dakota. Consideration for the acquisition of \$248,081, consisted of cash of \$198,081 and 5,000 shares of Series A Preferred Stock with an aggregate value of \$50,000. See Note 17 Capital Stock and Dividend Restrictions for further information regarding the Series A Preferred Stock. The cash portion of the purchase price was funded through debt financing. See Note 11 Long-term Debt and Other Borrowed Funds and Note 12 Subordinated Debentures Held by Subsidiary Trusts for further information regarding debt financing.

The premiums paid over the historical carrying value of net assts at the acquisition date are as follows:

|                                             | Sturgis    | Wall       | Data   | Total      |
|---------------------------------------------|------------|------------|--------|------------|
| Consideration paid                          | \$ 110,838 | \$ 136,827 | \$ 416 | \$ 248,081 |
| Estimated acquisition costs                 | 62         | 62         |        | 124        |
| Total consideration paid for acquistion     | 110,900    | 136,889    | 416    | 248,205    |
| Historical net assets carrying value        | 36,804     | 45,852     | 416    | 83,072     |
| Premium paid over historical carrying value | \$ 74,096  | \$ 91,037  | \$     | \$ 165,133 |

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)*

The total cost of the acquisition has been allocated to the assets acquired and the liabilities assumed based upon their estimated fair values at the date of the acquisition. The increase (decrease) in net asset values as a result of estimated fair value adjustments are as follows:

|                                       | Sturgis      | Wall         | Data   | Total         |
|---------------------------------------|--------------|--------------|--------|---------------|
| Intangible assets:                    |              |              |        |               |
| Goodwill                              | \$62,384     | \$83,909     | \$     | \$146,293     |
| Core deposit intangible               | 6,263        | 8,665        |        | 14,928        |
| <br>Total intangible assets           | <br>68,647   | <br>92,574   |        | <br>161,221   |
| Premises and equipment                | 8,991        | 6,138        |        | 15,129        |
| Investments                           | 191          | 652          |        | 843           |
| Loans                                 | (1,348)      | (5,021)      |        | (6,369)       |
| Deposits                              | (745)        | (1,191)      |        | (1,936)       |
| Accounts payable and accrued expenses | (1,475)      | (1,484)      |        | (2,959)       |
| Other assets                          | (165)        | (631)        |        | (796)         |
| <br>Total assets                      | <br>\$74,096 | <br>\$91,037 | <br>\$ | <br>\$165,133 |

The premium paid and estimated fair value adjustments have been pushed down to the acquired entities.

The estimated fair values of net assets at the acquisition date are summarized as follows:

|                                          | Sturgis  | Wall      | Data  | Total     |
|------------------------------------------|----------|-----------|-------|-----------|
| Cash and due from banks                  | \$ 8,925 | \$ 11,004 | \$ 70 | \$ 19,999 |
| Federal funds sold                       | 29,500   | 13,000    |       | 42,500    |
| Investment securities available-for-sale | 44,787   | 51,227    |       | 96,014    |
| Loans                                    | 315,828  | 405,052   |       | 720,880   |
| Allowance for loan losses                | (6,065)  | (8,398)   |       | (14,463)  |
| Premises and equipment                   | 17,931   | 23,543    | 224   | 41,698    |
| Accrued interest receivable              | 3,499    | 4,482     |       | 7,981     |
| Goodwill                                 | 62,384   | 83,909    |       | 146,293   |
| Core deposit intangible                  | 6,263    | 8,665     |       | 14,928    |
| Other assets                             | 644      | 1,407     | 178   | 2,229     |
|                                          | 483,696  | 593,891   | 472   | 1,078,059 |
| <br>Deposits:                            |          |           |       |           |
| Noninterest bearing                      | 57,595   | 74,906    |       | 132,501   |
| Interest bearing                         | 309,138  | 370,288   |       | 679,426   |



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|                                             |            |            |        |            |
|---------------------------------------------|------------|------------|--------|------------|
| Total deposits                              | 366,733    | 445,194    |        | 811,927    |
| Securities sold under repurchase agreements | 1,339      | 3,693      |        | 5,032      |
| Accrued interest payable                    | 1,178      | 1,456      |        | 2,634      |
| Accounts payable and accrued expenses       | 2,636      | 3,330      | 56     | 6,022      |
| Other borrowed funds                        |            | 629        |        | 629        |
| Long-term debt                              | 910        | 2,700      |        | 3,610      |
|                                             | 372,796    | 457,002    | 56     | 829,854    |
| Consideration paid                          | \$ 110,900 | \$ 136,889 | \$ 416 | \$ 248,205 |

During 2008, the Company finalized its preliminary purchase price allocation. Significant adjustments to the preliminary purchase price allocation included an increase in the fair values allocated to premises and equipment of \$3,830 resulting from completion of independent appraisals on purchased properties and a decrease in fair value allocated to loans of \$4,080 due to revisions of preliminary loan valuations.

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**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)*

Goodwill recognized in the transaction totaled \$146,293, of which approximately \$133,239 is expected to be deductible for income tax purposes. All goodwill was assigned to the Community Banking operating segment.

Core deposits intangible assets recognized in the transaction totaled \$14,928 and have a weighted average amortization period of approximately 9.2 years.

The consolidated statement of income for the year ended December 31, 2008 includes the operating results of the acquired entities from the date of acquisition. The following table presents actual results of the acquired entities included in the consolidated statement of income for the year ended December 31, 2008, and pro forma consolidated amounts as if the acquisition had occurred as of the beginning of each period presented.

|                                                      | Results of<br>Acquired<br>Entities<br><br>Included in the<br>2008<br>Consolidated<br>Statement of<br>Income | Pro Forma<br>Consolidated<br>Statement of<br>Income<br>As if<br>Acquisition<br>Had Occurred<br>January 1, 2008 | Pro Forma<br>Consolidated<br>Statement of<br>Income<br>As if<br>Acquisition<br>Had Occurred<br>January 1, 2007 |
|------------------------------------------------------|-------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------|
| Year ended December 31, (unaudited)                  |                                                                                                             |                                                                                                                |                                                                                                                |
| Interest income                                      | \$ 55,347                                                                                                   | \$ 357,477                                                                                                     | \$ 387,304                                                                                                     |
| Interest expense                                     | 19,730                                                                                                      | 121,191                                                                                                        | 161,592                                                                                                        |
| Net interest income                                  | 35,617                                                                                                      | 236,286                                                                                                        | 225,712                                                                                                        |
| Provision for loan losses                            | 7,696                                                                                                       | 33,356                                                                                                         | 16,575                                                                                                         |
| Net interest income after provisions for loan losses | 27,921                                                                                                      | 202,930                                                                                                        | 209,137                                                                                                        |
| Non-interest income                                  | 9,666                                                                                                       | 128,516                                                                                                        | 78,770                                                                                                         |
| Non-interest expense                                 | 27,086                                                                                                      | 222,743                                                                                                        | 184,535                                                                                                        |
| Net income, before income tax                        | 10,501                                                                                                      | 108,703                                                                                                        | 103,372                                                                                                        |
| Income tax expense                                   | 4,044                                                                                                       | 37,648                                                                                                         | 39,147                                                                                                         |
| Net income                                           | 6,457                                                                                                       | 71,055                                                                                                         | 64,225                                                                                                         |
| Preferred stock dividends                            |                                                                                                             | 3,347                                                                                                          | 3,347                                                                                                          |
| Net income to common shareholders                    | \$ 6,457                                                                                                    | \$ 67,708                                                                                                      | \$ 60,878                                                                                                      |

The unaudited pro forma information above has been prepared for comparative purposes only and does not purport to be indicative of the actual results that would have occurred if the operations had been combined during the period presented nor is it intended to be a projection of future results.

**(25) DISPOSALS**

On December 31, 2008, the Company completed the sale of its technology services subsidiary, i\_Tech, to Fiserv Solutions, Inc. ( Fiserv ), a wholly-owned subsidiary of Fiserv Inc. i\_Tech represented the Company's technology services operating segment. The aggregate sales price under the agreement was \$41,180. Concurrent with the sale, the Company entered into a service agreement with Fiserv to receive data processing, electronic funds transfer and other technology services for a period of seven years at current market rates for such services. A net gain of \$31,596 was recognized on the sale, of which \$4,500 was deferred and will be amortized to outsourced technology services expense using the straight-line method over the term of the service agreement. The Company paid i\_Tech \$12,622, \$12,675 and \$13,535 for technology services during 2008, 2007 and 2006, respectively.

On December 7, 2006, the Company sold its equity interest in an unconsolidated joint venture. Aggregate consideration for the sale was \$21,242, of which \$19,853 was received in cash and \$1,389 was placed in escrow to offset purchase price adjustments related to working capital ( Working Capital Escrow ) and indemnify potential loss claims ( Indemnity Escrow ) pursuant to the terms of the purchase agreement. At the date of sale, the Company's equity investment was \$192. A net gain of \$19,801 was recognized on the sale and a receivable of \$151 was recorded for the Working Capital Escrow funds during 2006. During March 2008, excess Working Capital Escrow and Indemnity Escrow funds of \$1,083 were released to the Company and are included in other income.

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On January 27, 2006, the Company completed the sale of the net assets of a branch banking office. Included in the sale were loans of approximately \$527 and deposits of approximately \$3,070. In conjunction with the sale, the Company wrote-off goodwill of \$10. A gain of \$78 was recognized on the sale.

**(26) RECENT ACCOUNTING PRONOUNCEMENTS**

**Statement of Financial Accounting Standards.** In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, establishing a framework for measuring fair value and expanding fair value measurement disclosures. SFAS No. 157 establishes a fair value hierarchy that distinguishes between independent observable inputs and unobservable inputs based on the best information available. When issued, SFAS No. 157 was effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued Staff Position ( FSP ) No. 157-2, Effective Date of FASB Statement No. 157, to allow entities to electively defer the effective date of SFAS No. 157 for nonfinancial assets and liabilities, except for those items recognized or disclosed at fair value on an annual or more frequently recurring basis, until January 1, 2009. The Company adopted SFAS No. 157 effective January 1, 2008 for financial assets and liabilities and elected to defer adoption of SFAS No. 157 for nonfinancial assets and liabilities measured at fair value on a nonrecurring basis until January 1, 2009. The adoption of SFAS No. 157 for financial assets and liabilities did have a material impact on the Company's consolidated financial statements, results of operations or liquidity. The Company does not expect adoption of SFAS No. 157 for nonfinancial assets and liabilities to have material impact on its consolidated financial statements, results of operations or liquidity.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Liabilities including an amendment of FASB Statement No. 115, which permits entities to choose to measure financial instruments and certain warranty and insurance contracts at fair value. SFAS No. 159 was effective for the Company on January 1, 2008. The adoption of SFAS No. 159 did not impact the Company's consolidated financial statements, results of operations or liquidity.

In December 2007, the FASB issued SFAS No. 141(revised 2007), Business Combinations. SFAS No. 141(revised 2007) provides revised guidance on how acquirers recognize and measure the consideration transferred, identifiable assets acquired, liabilities assumed, contingencies, noncontrolling interests and goodwill acquired in a business combination. SFAS No. 141(revised 2007) also expands required disclosures surrounding the nature and financial effects of business combinations. SFAS No. 141(revised 2007) is effective, on a prospective basis, for fiscal years beginning after December 15, 2008. The adoption of SFAS No. 141(revised 2007) on January 1, 2009 will not have a material impact on the Company's consolidated financial statements, results of operations or liquidity.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB 51, establishing accounting and reporting standards for noncontrolling interests in a subsidiary and for the deconsolidation of a subsidiary. Under the provisions of SFAS No. 160, a noncontrolling interest in a subsidiary is reported as equity in the consolidated financial statements and income attributable to both the parent company and the noncontrolling interest is included in the consolidated statement of income. SFAS No. 160 also establishes a single method of accounting for changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation and requires expanded disclosures in the consolidated financial statements. SFAS No. 160 is effective for the Company on January 1, 2009 with earlier adoption prohibited. The provisions of SFAS No. 160 are to be applied prospectively, except for the presentation and disclosure requirements which are to be applied retrospectively for all periods presented. The adoption of SFAS No. 160 on January 1, 2009 will not have a material impact on the Company's consolidated financial

statements, results of operations or liquidity.

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### **First Interstate BancSystem, Inc. and Subsidiaries**

#### **Notes to Consolidated Financial Statements**

*(Dollars in thousands, except share and per share data)*

In March 2008, the FASB issued SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133. SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. SFAS No. 161 will impact disclosures only and will not have an impact the Company's consolidated financial statements, results of operations or liquidity.

**Emerging Issues Task Force.** In September 2006, the EITF reached a final consensus on Issue No. 06-4 ( EITF 06-4 ), Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements. EITF 06-4 requires the recognition of a liability and related compensation expense for endorsement split dollar life insurance policies that provide a benefit to an employee that extends to postretirement periods. The Company adopted EITF 06-4 effective January 1, 2008 as a change in accounting principle through a cumulative-effect adjustment to retained earnings of \$633. Compensation expense for the postretirement aspects of the Company's endorsement split dollar life insurance policies of \$70 in 2008 is included in salaries wages and employee benefits expense on the accompanying consolidated statements of income.

In June 2007, the EITF reached a final consensus on Issue No. 06-11 ( EITF 06-11 ), Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards. EITF 06-11 requires realized income tax benefits from dividends paid to employees for equity classified nonvested equity shares to be recognized as an increase in additional paid in capital and be included in the pool of excess tax benefits available to absorb potential future tax deficiencies on share-based payment awards. The provisions of EITF 06-11 are effective for income tax benefits resulting from dividends declared subsequent to January 1, 2008. The adoption of EITF 06-11 did not have a significant impact on the Company's consolidated financial statements, results of operations or liquidity.

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

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

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

Company's consolidated financial statements, results of operations or liquidity.

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**First Interstate BancSystem, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

*(Dollars in thousands, except share and per share data)*

In October 2008, the FASB issued FSP 157-3, *Determining Fair Value of a Financial Asset in a Market That Is Not Active*. FSP 157-3 clarifies the application of SFAS No. 157 in an inactive market and demonstrates how the fair value of a financial asset is determined when the market for that financial asset is inactive. FSP 157-3 was effective upon issuance, including prior periods for which financial statements have not been issued. The adoption of FSP 157-3 did not have a material impact on the Company's consolidated financial statements, results of operations or liquidity.

In December 2008, the FASB issued FSP 140-4 and FIN 46(R)-8, *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interest in Variable Interest Entities*. This FSP was issued in advance of the finalization of other proposed amendments to SFAS No. 140 and Interpretation No. 46R and required additional disclosures about transfers of financial assets and about an entity's involvement with variable interest entities. This FSP is effective for financial statements issued after December 15, 2008. Adoption of FSP 140-4 and FIN 46(R)-8 affects disclosures only and therefore, had no impact on the Company's consolidated financial statements, results of operations or liquidity.

In January 2009, the FASB issued FSP EITF 99-20-1, *Amendments to the Impairment Guidance of EITF Issue No. 99-20*. This FSP amends the impairment guidance in EITF Issue No. 99-20, *Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interest That Continue to be Held by a Transferor in Securitized Financial Assets*, to align it with the impairment guidance within SFAS No. 115 by removing from EITF 99-20 the requirement to place exclusive reliance on market participants' assumptions about future cash flows when evaluating an asset for other-than-temporary impairment. Both standards will now require that assumptions about future cash flows consider reasonable management judgment about the probability that the holder of an asset will be unable to collect all amounts due. FSP EITF 99-20-1 is effective for interim and annual reporting periods ending after December 15, 2008. The adoption of FSP EITF 99-20-1 did not impact the Company's consolidated financial statements, operations or results of liquidity.

**SEC Staff Accounting Bulletins.** In November 2007, the SEC issued Staff Accounting Bulletin No. 109 (SAB 109), *Written Loan Commitments Recorded at Fair Value Through Earnings*. SAB 109 supersedes SAB 105, *Application of Accounting Principles to Loan Commitments*, and indicates that the expected net future cash flows related to the associated servicing of the loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. The guidance in SAB 109 was effective for derivative loan commitments issued or modified by the Company subsequent to January 1, 2008. The adoption of SAB 109 did not have a significant impact on the Company's consolidated financial statements, results of operations or liquidity.



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(a) 2. Financial statement schedules

All other schedules to the consolidated financial statements of the Registrant are omitted since the required information is either not applicable, deemed immaterial, or is shown in the respective financial statements or in notes thereto.

(a) 3. Exhibits

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

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|           |                                                                                                                                                                 |
|-----------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.3(2)   | Security Agreement dated as of January 10, 2008, between First Interstate BancSystem, Inc. and Wells Fargo Bank, National Association, as Administrative Agent. |
| 10.4(2)   | Credit Agreement Re: Subordinated Term Note dated as of January 10, 2008, between First Interstate BancSystem, Inc. and First Midwest Bank.                     |
| 10.5(3)   | Lease Agreement Between Billings 401 Joint Venture and First Interstate Bank Montana and addendum thereto                                                       |
| 10.6(3)   | Stock Option and Stock Appreciation Rights Plan of First Interstate BancSystem, Inc., as amended                                                                |
| 10.7(13)  | 2001 Stock Option Plan                                                                                                                                          |
| 10.8(14)  | Employee Stock Purchase Plan of First Interstate BancSystem, Inc., as amended and restated effective April 30, 2008                                             |
| 10.9(15)  | First Interstate BancSystem, Inc. Executive Non-Qualified Deferred Compensation Plan dated November 20, 1998                                                    |
| 10.10(16) | First Interstate BancSystem's Deferred Compensation Plan dated December 6, 2000                                                                                 |
| 10.11(9)  | First Interstate BancSystem, Inc. 2004 Restricted Stock Award Plan                                                                                              |
| 10.12(17) | First Interstate BancSystem, Inc. 2006 Equity Compensation Plan                                                                                                 |
| 10.13     | Form of First Interstate BancSystem, Inc. 2006 Equity Compensation Plan Restricted Stock Agreement (Time) for Certain Executive Officers                        |
| 10.14     | Form of First Interstate BancSystem, Inc. 2006 Equity Compensation Plan Restricted Stock Agreement (Performance) for Certain Executive Officers                 |
| 10.15     | First Interstate BancSystem, Inc. 2006 Equity Compensation Plan Restricted Stock Agreement (Performance) for Lyle R. Knight                                     |
| 10.16     | First Interstate BancSystem, Inc. 2006 Equity Compensation Plan Restricted Stock Agreement for Lyle R. Knight                                                   |

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|           |                                                                                                                                                                                                                                                                       |
|-----------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.17     | Relocation Services Agreement between First Interstate BancSystem, Inc. and NRI Relocation, Inc. dated April 25, 2008 for the benefit of Julie Castle, and related Memorandum Agreement between First Interstate BancSystem, Inc. and Julie Castle dated May 23, 2008 |
| 10.18(18) | Trademark License Agreements between Wells Fargo & Company and First Interstate BancSystem, Inc.                                                                                                                                                                      |
| 14.1(19)  | Code of Ethics for Chief Executive Officer and Senior Financial Officers                                                                                                                                                                                              |
| 21.1      | Subsidiaries of First Interstate BancSystem, Inc.                                                                                                                                                                                                                     |
| 23.1      | Consent of McGladrey & Pullen, LLP, Independent Registered Public Accounting Firm                                                                                                                                                                                     |
| 31.1      | Certification of Annual Report on Form 10-K pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Chief Executive Officer                                                                                                                                      |
| 31.2      | Certification of Annual Report on Form 10-K pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Chief Financial Officer                                                                                                                                      |
| 32        | Certification of Annual Report on Form 10-K pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                 |

Management  
contract or  
compensatory  
plan or  
arrangement.

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

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

No. 333-76825.

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

- (16) Incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 2002.
- (17) Incorporated by reference to the Registrant's Proxy Statement on Schedule 14A related to the Registrant's Annual Meeting of Shareholders to be held May 5, 2006.
- (18) Incorporated by reference to the Registrant's Registration Statement on Form S-1, No. 333-25633.
- (19) Incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 2004.
- (b) Exhibits  
See Item 15(a)3 above.
- (c) Financial Statements Schedules  
See Item 15(a)2 above.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

First Interstate BancSystem, Inc.

By: /s/ LYLE R. KNIGHT

March 23, 2009

Lyle R. Knight

Date

President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ THOMAS W. SCOTT

March 23, 2009

Thomas W. Scott, Chairman of the Board

Date

By: /s/ JAMES R. SCOTT

March 23, 2009

James R. Scott, Vice Chairman of the Board

Date

By: /s/ JONATHAN R. SCOTT

March 23, 2009

Jonathan R. Scott, Director

Date

By: /s/ JULIE A. SCOTT

March 23, 2009

Julie A. Scott, Director

Date

By: /s/ RANDALL I. SCOTT

March 23, 2009

Randall I. Scott, Director

Date

By: /s/ SANDRA A. SCOTT SUZOR

March 23, 2009

Sandra A. Scott Suzor, Director

Date

By: /s/ ELOUISE C. COBELL

March 23, 2009

Elouise C. Cobell, Director

Date

By: /s/ STEVEN J. CORNING

March 23, 2009

Steven J. Corning, Director

Date

By: /s/ DAVID H. CRUM

March 23, 2009

David H. Crum, Director

Date

By: /s/ RICHARD A. DORN

March 23, 2009

|                                       |                |
|---------------------------------------|----------------|
| Richard A. Dorn, Director             | Date           |
| By: /s/ WILLIAM B. EBZERY             | March 23, 2009 |
| William B. Ebzery, Director           | Date           |
| By: /s/ CHARLES E. HART, M.D., M.S.   | March 23, 2009 |
| Charles W. Hart, M.D., M.S., Director | Date           |
| By: /s/ JAMES W. HAUGH                | March 23, 2009 |
| James W. Haugh, Director              | Date           |
| By: /s/ CHARLES M. HEYNEMAN           | March 23, 2009 |
| Charles M. Heyneman, Director         | Date           |

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|                                                                                                                          |                |
|--------------------------------------------------------------------------------------------------------------------------|----------------|
| By: /s/ TERRY W. PAYNE                                                                                                   | March 23, 2009 |
| Terry W. Payne, Director                                                                                                 | Date           |
| By: /s/ MICHAEL J. SULLIVAN                                                                                              | March 23, 2009 |
| Michael J. Sullivan, Director                                                                                            | Date           |
| By: /s/ MARTIN A. WHITE                                                                                                  | March 23, 2009 |
| Martin A. White, Director                                                                                                | Date           |
| By: /s/ LYLE R. KNIGHT                                                                                                   | March 23, 2009 |
| Lyle R. Knight<br>President, Chief Executive Officer and Director<br>(Principal executive officer)                       | Date           |
| By: /s/ TERRILL R. MOORE                                                                                                 | March 23, 2009 |
| Terrill R. Moore<br>Executive Vice President and Chief Financial Officer<br>(Principal financial and accounting officer) | Date           |

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**Exhibit Index**

| Exhibit No. | Description                                                                                                                                                                                               |
|-------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
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|-----------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
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| 21.1        | Subsidiaries of First Interstate BancSystem, Inc.                                                                                |
| 23.1        | Consent of McGladrey & Pullen, LLP, Independent Registered Public Accounting Firm                                                |
| 31.3        | Certification of Annual Report on Form 10-K pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Chief Executive Officer |
| 31.4        | Certification of Annual Report on Form 10-K pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Chief Financial Officer |
| 32          | Certification of Annual Report on Form 10-K pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                            |

Management  
contract or  
compensatory  
plan or  
arrangement.

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

(4)

Incorporated by  
reference to the  
Registrant's Form  
8-K dated  
October 1, 1996.

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

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

(16)

Incorporated by  
reference to the  
Registrant's Form  
10-K for the  
fiscal year ended  
December 31,  
2002.

(17) Incorporated by  
reference to the  
Registrant's Proxy  
Statement on  
Schedule 14A  
related to the  
Registrant's  
Annual Meeting  
of Shareholders  
to be held May 5,  
2006.

(18) Incorporated by  
reference to the  
Registrant's  
Registration  
Statement on  
Form S-1,  
No. 333-25633.

(19) Incorporated by  
reference to the  
Registrant's Form  
10-K for the  
fiscal year ended  
December 31,  
2004.

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