

FIRST INTERSTATE BANCSYSTEM INC

Form 10-K

March 17, 2008

**Table of Contents**

**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, 2007, 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 29, 2008 was 7,885,638.

**Documents Incorporated by Reference**

The registrant intends to file a definitive Proxy Statement for the Annual Meeting of Shareholders scheduled to be held May 9, 2008. The information required by Part III of this Form 10-K is incorporated by reference from such Proxy Statement.

---

**TABLE OF CONTENTS**

**PART I**

Item 1. Business

Item 1A. Risk Factors

Item 1B. Unresolved Staff Comments

Item 2. Properties

Item 3. Legal Proceedings

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

**PART II**

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

Item 6. Selected Consolidated Financial Data

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Item 8. Financial Statements and Supplementary Data

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

Item 9A(T). Controls and Procedures

Item 9B. Other Information

**PART III**

Item 10. Directors, Executive Officers and Corporate Governance

Item 11. Executive Compensation

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

Item 13. Certain Relationships and Related Transactions and Director Independence

Item 14. Principal Accountant Fees and Services

**PART IV**

Item 15. Exhibits and Financial Statement Schedules

**SIGNATURES**

Exhibit Index

Articles of Amendment to Restated Articles of Incorporation

Specimen of Series A Preferred Stock Certificate

Statement Regarding Computation of Ratio of Earnings to Fixed Charges

Subsidiaries

Consent of McGladrey & Pullen LLP

Certification

Certification

Certification

---

**Table of Contents**

**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.*

**The Company**

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 Bank or Banks in this report, we mean First Interstate Bank, our only bank subsidiary as of December 31, 2007, and First Western Bank and The First Western Bank Sturgis, bank subsidiaries acquired in January 2008. When we refer to the South Dakota Banks in this report, we mean First Western Bank and The First Western Bank Sturgis.

First Interstate BancSystem, Inc. is a financial and bank holding company incorporated in 1971 and headquartered in Billings, Montana. As of February 29, 2008, we had consolidated assets of \$6.2 billion, deposits of \$4.8 billion and total stockholders' equity of \$671 million. Our wholly-owned bank subsidiaries, First Interstate Bank, First Western Bank and The First Western Bank Sturgis, have 69 banking offices in 42 Montana, Wyoming and South Dakota communities. Through the 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.

Through i\_Tech Corporation and First Western Data, Inc., wholly-owned nonbank subsidiaries, collectively referred to in this report as i\_Tech, we provide data technology support services to affiliated and non-affiliated customers in Montana, Wyoming, South Dakota and nine additional states. i\_Tech also provides processing support for 2,183 ATM locations in 39 states. We have various other consolidated nonbank subsidiaries that are not significant to the consolidated entity.

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 noninterest 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, among others, 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.

**Strategic Vision**

The financial services industry continues to experience change with respect to regulatory matters, consolidation, consumer needs and economic and market conditions. We believe we can best address this changing environment through our Strategic Vision. 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 growing internally and expanding into new and complementary markets when appropriate opportunities arise. In recent years, our profitability, market share and asset size have been enhanced principally through organic loan and deposit growth in the market areas served by our existing banking offices. We recently expanded our markets into western South Dakota through the acquisition described below.

**First Western Acquisition**

On January 10, 2008, we completed the acquisition of all of the outstanding stock of The First Western Bank Sturgis, Sturgis, South Dakota, First Western Bank, Wall, South Dakota, and First Western Data, Inc., a South Dakota corporation, from Christen Group, Inc., formerly known as First Western Bancorp, Inc. The acquired entities operate eighteen banking offices in twelve western South Dakota communities. As of the date of acquisition, the acquired entities had combined total assets of approximately \$908 million, combined total loans of approximately \$729 million

and combined total deposits of approximately \$810 million. Consideration for the acquisition of \$248 million consisted of cash

## **Table of Contents**

of \$198 million and 5,000 shares of newly issued 6.75% Series A noncumulative redeemable preferred stock, or Series A Preferred Stock, with an aggregate value of \$50 million.

The cash portion of the purchase price was funded with available cash of \$39 million and debt financing of \$159 million. Debt financing transactions included the sale of \$80 million of 30-year floating rate mandatorily redeemable trust preferred securities, or Trust Preferred Securities, advances of \$59 million on variable rate term and revolving notes pursuant to a syndicated credit agreement secured by all of the outstanding stock of First Interstate Bank and \$20 million of unsecured subordinated term debt.

For additional information regarding acquisition financing, including the issuance of Series A Preferred Stock and debt financing transactions, see Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities Description of Our Capital Stock Preferred Stock included in Part II, Item 5, Managements Discussion and Analysis Financial Condition Long-Term Debt included in Part II, Item 7 and Notes to Consolidated Financial Statements Subsequent Events and Notes to Consolidated Financial Statements Subordinated Debentures Held by Subsidiary Trusts included in Part IV, Item 15.

### **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 described above.

### **Operating Segments**

Our business consists of two reportable operating segments, community banking and technology services. Financial information and analysis of our reportable operating segments is 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 of this report.

### **Community Banking**

Our principal operating segment, 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. Our profitability, market share and asset size have been enhanced in recent years principally through organic loan and deposit growth in market areas served by our existing banking offices.

### **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.

-3-

---



**Table of Contents**

**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. The estimated fair value of trust assets held in a fiduciary or agent capacity is in excess of \$3 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 Bank to serve its markets more effectively. These services include credit administration, finance, accounting, human resource management, internal audit and other support services.

**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.

**Technology Services**

The technology services operating segment encompasses services provided by i\_Tech to affiliated and non-affiliated customers, including core application data processing; ATM and debit card processing; item proof and capture; wide area network services and system support; and, processing support for a network of ATM locations.

i\_Tech provides centralized technology support services to the Banks, including system support of the general ledger, investment security, loan, deposit, web banking, document imaging, management reporting and cash management systems. i\_Tech also manages our wide-area network and the ATM network used by the Banks and provides item proof and capture services. These technology services are performed through the use of computer hardware owned by the Banks and leased to i\_Tech and software licensed by i\_Tech.

While historically the data technology services industry has been highly decentralized, there is an accelerating trend toward consolidation resulting in fewer companies competing over larger geographic regions. i\_Tech's competitors vary in size and include national and regional operations. i\_Tech generally competes on the basis of customer service, price, product offering, reliability and available technology.

**Table of Contents**

**Employees**

At February 29, 2008, we employed 1,858 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 bank and financial 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 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.

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.

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.

-5-

---

**Table of Contents**

**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 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, 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.

*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 it's 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.

-6-

---

## **Table of Contents**

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.

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 FIDICIA. 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. 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.

-7-

---

## **Table of Contents**

### **Deposit Insurance**

Deposits in the Banks are insured by the FDIC in accordance with the FDIA. Insurance premiums are assessed semiannually by the FDIC at a level sufficient to maintain the insurance reserves required under the FDIA and relevant regulations. In 2006, the FDIC amended its risk-based assessment system for 2007 to implement authority granted by the Federal Deposit Insurance Reform Act of 2005, or Reform Act. Under the revised system, insured institutions are assigned to one of four risk categories based upon risk assessment criteria, including relevant capital levels, results of bank examinations by state and federal regulators and other information. An institution's assessment rate depends upon the risk category to which it is assigned. Risk Category I, which contains the least risky depository institutions, is expected to include more than 90% of all institutions. Unlike the other risk categories, Risk Category I contains further risk assessment based on the FDIC's analysis of financial ratios, examination component ratios and certain other information. Assessment rates are determined by the FDIC and currently range from five to seven basis points of assessable deposits for institutions in Risk Category I to 43 basis points of assessable deposits for the riskiest institutions (Risk Category IV). The FDIC may adjust rates uniformly from one quarter to the next, except that no single adjustment can exceed three basis points. No institution may pay a dividend if in default of the FDIC assessment. The Banks currently are each assessed the most favorable deposit insurance premiums under the risk-based premium system.

### **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. Under these requirements, a financial holding 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 holding 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.

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.

-8-

---

**Table of Contents**

**Sarbanes-Oxley Act of 2002**

The Sarbanes-Oxley Act of 2002 imposed new or revised corporate governance, accounting, and reporting requirements on us and all other companies having securities registered with the SEC. In addition to a requirement that chief executive officers and chief financial officers certify financial statements in writing, the statute imposed requirements affecting, among other matters, the composition and activities of audit committees, disclosures relating to corporate insiders and insider transactions, codes of ethics, and the effectiveness of internal controls over financial reporting.

**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, legislation is enacted which has the effect of imposing additional operating restrictions and increasing the cost of doing business, as has been the case with relatively recent laws regarding anti-terrorism and consumer privacy. New legislation may also limit or expand permissible activities or affect the competitive balance between banks and other financial service providers. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies and other financial service providers are frequently made in Congress, in the Montana, Wyoming and South Dakota legislatures and before various bank regulatory and other professional agencies. The likelihood of major legislative changes and the impact such changes might have on us are impossible to predict.

**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.

-9-

---

**Table of Contents**

**Item 1A. Risk Factors**

Like other financial and bank holding companies, we are subject to a number of risks, some 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 shares of our common stock are subject to (5) investment risks. Readers should consider carefully the following important factors in evaluating us, our business and an investment in our securities.

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

**We extend credit to a variety of customers based on internally set standards and judgment. We manage the credit risk through a program of underwriting standards, the review of certain credit decisions, and an on-going process of assessment of the quality of the credit already extended. Our credit standards, the nature of our loan portfolio and on-going process of credit management and assessment might not protect us from significant credit losses.**

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.

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

At February 29, 2008, we had approximately \$2.8 billion of commercial, agricultural, construction, residential and other real estate loans representing approximately 65% of our total loan portfolio. An economic downturn or a deterioration in the real estate markets could have an adverse effect on the collateral value for many of our loans and could affect the repayment ability of many of our borrowers. 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 results of operations. A significant 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 and negatively impact our results of operations.

**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 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. 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 borrower's 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 29, 2008, we had approximately \$2.0 billion of commercial loans, including commercial real estate loans, representing approximately 46% of our total loan portfolio.

**Our loans and deposits are focused in Montana, Wyoming and South Dakota. Adverse economic conditions in these states could adversely impact our results from operations, cash flows and financial condition.**

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, in the event of adverse economic conditions in Montana, Wyoming or South Dakota, we could 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

-10-

---

## **Table of Contents**

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 results of operations, cash flows and financial condition.

### **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. 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 bank regulatory authorities require us to increase the allowance for loan losses as a part of their examination process, our results of operations and financial condition could be significantly and adversely affected.

As of February 29, 2008, our allowance for loan losses was \$68 million which represented 1.57% 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 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 results of operations and financial condition.

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

#### **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 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 obtain 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. We regularly monitor our overall liquidity position to ensure that various alternative strategies exist to cover unanticipated events that could affect liquidity. 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

sources of liquidity available to us should they be needed. These sources include the drawing of additional funds on our revolving term loan, the sale of loans, 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, and the issuance of equity securities. We may also be able to borrow through the Federal Reserve's discount window. Without sufficient liquidity, we may not be able to meet the cash flow requirements of our depositors and borrowers.

-11-

---

**Table of Contents**

**Dividends from our subsidiaries account for most of our revenue. The inability of our 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 are a separate and distinct legal entity from our subsidiaries. We receive substantially all of our revenue from management fees and dividends paid by our 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 subsidiary banks and certain nonbank 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 the Bank constitute an unsafe and unsound banking practice, the regulatory agencies have the authority by statute to restrict the Bank's 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 required for the payment of a dividend if the total of all dividends declared by the Bank 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.

Payment of dividends could also be subject to regulatory limitations if the Bank 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, 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 the debt becoming immediately due and payable and the subsequent liquidation of our assets in satisfaction of the debt.

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

**We have significant competition in both attracting and retaining deposits and in originating loans.**

Competition is intense in most of our markets. We compete on price, product availability, customer service and responsiveness to customer needs with other banks and financial services companies such as brokerage firms, finance companies, mortgage banking companies, insurance companies and credit unions. Competition could intensify in the future as a result of industry consolidation, the increasing availability of products and services from larger, multi-state financial holding companies and their bank and non-bank subsidiaries, greater technological developments in the industry, and banking reform.

**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.

-12-

---

**Table of Contents**

**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 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. Our wholly-owned subsidiary, i\_Tech, provides technology services to the Banks and other non-affiliated customers. In addition, 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.

**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 results of operations, cash flows and financial condition.

**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 noninterest expense. Any future losses related to internal operating control systems could have an adverse effect on our business.

**We may encounter unforeseen difficulties in combining First Western operations with our own operations, including unanticipated integration problems, business disruptions and dilution of shareholder value.**

The acquisition of First Western exposes us to various risks commonly associated with acquisitions, including, among other things, (i) potential exposure to unknown or contingent liabilities of the acquired entity; (ii) exposure to potential asset quality issues of the acquired entity; (iii) difficulty and expense associated with integration of the operations and personnel of the acquired entity; (iv) potential disruption of our business; (v) potential diversion of the management team's time and attention from the our existing operations; and (vi) the possible loss of key employees or customers of the acquired entity.

The First Western acquisition involved the payment of a premium over book and market values, which could result in dilution of our tangible book value and net income per common share. Furthermore, failure to realize the expected revenue increases, cost savings, increases in geographic or product presence and/or other projected benefits from the First Western acquisition, or the impairment of goodwill recognized in connection with the First Western acquisition,

could have a material adverse effect on our results of operations, cash flows and financial condition.

-13-

---

**Table of Contents**

**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, or Edward Garding, Executive Vice President and Chief Credit Officer, could harm our ability to operate our business or execute our business strategy.

**We may not be able to attract and retain qualified employees to operate our business effectively and low unemployment rates may increase our labor costs.**

There is substantial competition for qualified personnel in our markets. Current low unemployment rates in Montana, Wyoming, South Dakota and the surrounding region may increase labor costs and make it 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, low unemployment rates may lead to significant increases in salaries, wages and employee benefits expenses as we compete for qualified, skilled employees.

**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.

**Indemnification obligations arising from our membership in Visa USA could adversely impact our results of operations, cash flows and financial condition.**

We are a member of Visa USA, Inc. for issuance and processing of its card transactions. As a member, we have an obligation to indemnify Visa USA under its bylaws and to indemnify Visa, Inc. under a retrospective responsibility plan, for contingent losses in connection with certain covered litigation disclosed in Visa's public filings with the SEC based on our membership proportion of 0.02448%. We are not a party to the lawsuits brought against Visa USA. Visa USA is currently undergoing a restructuring and initial public offering, or IPO, that is expected to occur in the first half of 2008. In connection with the restructuring and IPO, Visa USA members are expected to receive shares in Visa, Inc. in exchange for their membership interest. A portion of these shares allocated to Visa USA members is expected to be withheld to cover the costs associated with the covered litigation described above whereby Visa USA members would not be required to make any cash payments to settle indemnification obligations. There can be no assurance that the restructuring or IPO of Visa will be successful or that the shares of Visa allocated to us will have sufficient value to cover our indemnification obligations. If the restructuring or IPO of Visa is unsuccessful or if the shares of Visa allocated to us are insufficient to cover our indemnification obligations, we may be exposed to significant financial liability. Such results could adversely impact our results of operations, cash flows and financial condition.

**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 sometimes impose significant limitations on operations. The significant federal and state banking

-14-

---

## **Table of Contents**

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 constantly evolving and may change significantly over time.

Events that may not have a direct impact on us, such as the bankruptcy of major U.S. companies, 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 and regulations, or changes in or repeal of existing laws and regulations or specific actions of regulators, may have a negative impact on our business. It is impossible for us to predict accurately at this time the extent of any impact from these items.

### **Non-compliance with USA Patriot Act, Bank Secrecy Act, or other laws and regulations could result in fines, sanctions and other enforcement actions.**

The USA Patriot and Bank Secrecy Acts require us to develop programs to prevent us from being used for money laundering and terrorist activities. If such activities are detected, we are obligated to file suspicious activity reports with the U.S. Treasury Department's Office of Financial Crimes Enforcement Network. These rules require us to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts. Failure to comply with these regulations could result in fines or sanctions.

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 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 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 the Banks.**

The Federal Reserve, which examines us and our non-bank 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 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 results of operations and cash flows.

### **(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.



**Table of Contents**

**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.

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, the 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 common stock. Furthermore, 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.

Any shares we may repurchase are 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, unless amended or waived, limit the payment of dividends to our shareholders to a percentage of our consolidated net income for the immediately preceding fiscal year.

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

Future issuances of stock pursuant to our equity incentive plans or in connection with future financings or acquisitions 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 77% 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.



**Table of Contents**

**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 the Bank is one of two partners, owning a 50% interest in the partnership. We lease approximately 104,065 square feet of office space in the building. We also lease approximately 24,368 square feet of office space for our operations center, also located in Billings, Montana, and an aggregate of approximately 73,274 square feet of office space in Montana, Colorado, Idaho, Iowa, Nebraska and Oregon for our technology services subsidiary. We provide banking services at 68 additional locations in Montana, Wyoming and South Dakota, of which 17 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 2007.

**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 7,885,638 shares were outstanding as of February 29, 2008, 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 29, 2008, 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.



**Table of Contents***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 29, 2008, 90.7% of our shares of common stock were subject to contractual transfer restrictions set forth in shareholder agreements and 9.3% were held by 17 shareholders without such restrictions, including our 401(k) plan, or Savings Plan, which holds 79.2% of the unrestricted shares. See also Part I, Item 1, Risk Factors Liquidity Risks.

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

| Valuation Based on   |                          | Appraised<br>Minority<br>Value |
|----------------------|--------------------------|--------------------------------|
| Financial Data As of | Valuation Effective Date |                                |
| December 31, 2005    | February 23, 2006        | \$ 71.00                       |
| March 31, 2006       | May 19, 2006             | 74.50                          |
| June 30, 2006        | August 9, 2006           | 77.25                          |
| September 30, 2006   | November 14, 2006        | 82.50                          |
| 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                          |

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 733,244 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. However, since the Savings Plan does not allow distributions in kind, any distribution from an employee s account in the Savings Plan will require the Savings Plan administrator to authorize sale of the stock. While we have no obligation to repurchase the stock, it is likely that we will repurchase our stock sold by the Savings Plan.

As of February 29, 2008, we had 719 record shareholders, including the Wealth Management division of First Interstate Bank as trustee for 597,448 shares held on behalf of 1,214 individual participants in the Savings Plan. Of such participants, 337 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.

-18-

---

**Table of Contents***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 dividend amount is periodically reviewed and set by our board of directors. Our board of directors has no current intention to change its dividend policy, but no assurance can be given that the board may not, in the future, change or eliminate the payment of dividends.

Recent quarterly and special dividends follow:

| Month Declared and Paid       | Amount<br>Per Share | Total Cash<br>Dividend |
|-------------------------------|---------------------|------------------------|
| January 2006                  | \$0.50              | \$4,051,636            |
| April 2006                    | 0.58                | 4,698,081              |
| July 2006                     | 0.58                | 4,694,141              |
| October 2006                  | 0.61                | 4,969,757              |
| 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              |

*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 2007.

**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, 2007.

**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 2007  | 51,165                                           | \$ 86.75                              | Not<br>Applicable                                                                                     | Not<br>Applicable                                                                                   |
| November 2007 | 44,776                                           | 87.59                                 | Not<br>Applicable                                                                                     | Not<br>Applicable                                                                                   |
| December 2007 | 10,767                                           | 87.75                                 |                                                                                                       |                                                                                                     |

|                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |         |          | Not<br>Applicable | Not<br>Applicable |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------|----------|-------------------|-------------------|
| Total                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | 106,708 | \$ 87.20 | 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, 2007, 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.

-19-

---

**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 graph also presents the cumulative total return on equity securities of companies included in the Russell 2000 Index and SNL \$1B \$5B Bank Index, which were used as comparative indices in 2006. The SNL \$1B \$5B Bank Index is comprised of publicly-owned banks or bank holding companies with total assets between \$1 billion and \$5 billion. During 2007, we exceeded \$5 billion in total assets. As such, we selected the Nasdaq Bank Index as a comparative peer index in 2007. In coordination with our change in peer index to the Nasdaq Bank Index, we also selected the Nasdaq Composite Index as a comparative broad market index in 2007. The graph assumes an investment of \$100 on December 31, 2002 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 most recent minority appraised value of the common stock, which represents the estimated fair market valuation of a minority interest at a specific date, taking into account adjustments for the lack of marketability and other factors. Valuations are performed on a quarterly basis and are generally received approximately 45 days after each quarter end. As such, year end valuations used in the performance graph are based on financial data as of September 30<sup>th</sup> for each year. The performance graph represents past performance, which may not be indicative of the future performance of our common stock.

| <b><i>Index</i></b>               | <b><i>Period Ending</i></b> |                 |                 |                 |                 |                 |
|-----------------------------------|-----------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
|                                   | <b>12/31/02</b>             | <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> |
| First Interstate BancSystem, Inc. | \$ 100.00                   | 114.01          | 144.99          | 168.42          | 201.88          | 220.62          |
| Nasdaq Composite                  | 100.00                      | 150.01          | 162.89          | 165.13          | 180.85          | 198.60          |
| Nasdaq Bank                       | 100.00                      | 129.93          | 144.21          | 137.97          | 153.15          | 119.35          |
| Russell 2000                      | 100.00                      | 147.25          | 174.24          | 182.18          | 215.64          | 212.26          |
| SNL \$1B \$5B Bank                | 100.00                      | 135.99          | 167.83          | 164.97          | 190.90          | 139.06          |



**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, 2007 and 2006, and the results of our operations for the fiscal years ended December 31, 2007, 2006 and 2005, 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, 2005, 2004 and 2003, and the results of our operations for the fiscal years ended December 31, 2004 and 2003, 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,                             | 2007       | 2006       | 2005       | 2004       | 2003       |
|-----------------------------------------------------|------------|------------|------------|------------|------------|
| <i>Operating Data:</i>                              |            |            |            |            |            |
| Interest income                                     | \$ 325,557 | \$ 293,423 | \$ 233,857 | \$ 192,840 | \$ 189,258 |
| Interest expense                                    | 125,954    | 105,960    | 63,549     | 42,421     | 48,614     |
| Net interest income                                 | 199,603    | 187,463    | 170,308    | 150,419    | 140,644    |
| Provision for loan losses                           | 7,750      | 7,761      | 5,847      | 8,733      | 9,852      |
| Net interest income after provision for loan losses | 191,853    | 179,702    | 164,461    | 141,686    | 130,792    |
| Noninterest income                                  | 92,448     | 102,119    | 70,882     | 70,644     | 70,152     |
| Noninterest expense                                 | 178,867    | 164,713    | 151,318    | 142,980    | 137,925    |
| Income before income taxes                          | 105,434    | 117,108    | 84,025     | 69,350     | 63,019     |
| Income tax expense                                  | 36,793     | 41,499     | 29,310     | 23,929     | 22,267     |
| Net income                                          | \$ 68,641  | \$ 75,609  | \$ 54,715  | \$ 45,421  | \$ 40,752  |
| Basic earnings per common share                     | \$ 8.45    | \$ 9.32    | \$ 6.84    | \$ 5.74    | \$ 5.18    |
| Diluted earnings per common share                   | 8.25       | 9.11       | 6.71       | 5.68       | 5.15       |
| Dividends per common share                          | 2.97       | 2.27       | 1.88       | 1.56       | 1.32       |
| Weighted average common shares outstanding          | 8,322,480  | 8,303,990  | 8,149,337  | 7,997,579  | 7,909,947  |
| <i>Ratios:</i>                                      |            |            |            |            |            |
| Return on average assets                            | 1.37%      | 1.60%      | 1.26%      | 1.14%      | 1.09%      |
| Return on average common stockholders' equity       | 16.14      | 20.38      | 16.79      | 15.75      | 15.79      |
| Average stockholders' equity to average assets      | 8.52       | 7.85       | 7.52       | 7.22       | 6.93       |
| Net interest margin                                 | 4.46       | 4.47       | 4.48       | 4.34       | 4.37       |
| Net interest spread                                 | 3.78       | 3.89       | 4.13       | 4.12       | 4.14       |

|                                        |       |       |       |       |       |
|----------------------------------------|-------|-------|-------|-------|-------|
| Common stock dividend payout ratio (1) | 35.15 | 24.36 | 27.49 | 27.18 | 25.48 |
|----------------------------------------|-------|-------|-------|-------|-------|

*Balance Sheet Data at Year*

*End:*

|                                                   |             |             |             |             |             |
|---------------------------------------------------|-------------|-------------|-------------|-------------|-------------|
| Total assets                                      | \$5,216,797 | \$4,974,134 | \$4,562,313 | \$4,217,293 | \$3,879,744 |
| Loans                                             | 3,558,980   | 3,310,363   | 3,034,354   | 2,739,509   | 2,554,899   |
| Allowance for loan losses                         | 52,355      | 47,452      | 42,450      | 42,141      | 38,940      |
| Investment securities                             | 1,128,657   | 1,124,598   | 1,019,901   | 867,315     | 799,587     |
| Deposits                                          | 3,999,401   | 3,708,511   | 3,547,590   | 3,321,681   | 3,156,721   |
| Other borrowed funds                              | 8,730       | 5,694       | 7,495       | 7,995       | 7,137       |
| Long-term debt                                    | 5,145       | 21,601      | 54,654      | 61,926      | 47,590      |
| Subordinated debentures held by subsidiary trusts | 103,095     | 41,238      | 41,238      | 41,238      | 41,238      |
| Stockholders equity                               | 444,443     | 410,375     | 349,847     | 308,326     | 274,226     |

-21-

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

| Year ended December 31,                                                      | 2007   | 2006   | 2005   | 2004   | 2003   |
|------------------------------------------------------------------------------|--------|--------|--------|--------|--------|
| <i>Asset Quality Ratios at Year End:</i>                                     |        |        |        |        |        |
| Nonperforming assets to total loans and other real estate owned ( OREO ) (2) | 1.00%  | 0.55%  | 0.67%  | 0.79%  | 1.30%  |
| Allowance for loan losses to total loans                                     | 1.47   | 1.43   | 1.40   | 1.54   | 1.52   |
| Allowance for loan losses to nonperforming loans (3)                         | 150.66 | 269.72 | 236.17 | 212.04 | 124.53 |
| Net charge-offs to average loans                                             | 0.08   | 0.09   | 0.19   | 0.21   | 0.31   |
| <i>Regulatory Capital Ratios at Year End:</i>                                |        |        |        |        |        |
| Tier 1 risk-based capital                                                    | 12.39% | 10.71% | 10.07% | 9.67%  | 9.30%  |
| Total risk-based capital                                                     | 13.64  | 11.93  | 11.27  | 10.95  | 10.64  |
| Leverage ratio                                                               | 9.92   | 8.61   | 7.91   | 7.49   | 7.13   |

(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 risk
- concentrations of real estate loans
- commercial loan risk
- economic conditions in Montana, Wyoming and South Dakota
- adequacy of the allowance for loan losses
- changes in interest rates
- inability to meet liquidity requirements
- inability of our subsidiaries to pay dividends
- failure to meet debt covenants
- competition
- environmental remediation and other costs
- breach in information system security
- failure of technology

failure to effectively implement technology-driven products and services

ineffective internal operational controls

difficulties in integrating operations of First Western

-22-

---

**Table of Contents**

dependence on our management team

the ability to attract and retain qualified employees

disruption of vital infrastructure and other business interruptions

Visa indemnification obligations

litigation pertaining to fiduciary responsibilities

changes in or noncompliance with governmental regulations

capital required to support our bank subsidiaries

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.

**Executive Overview**

We are a financial and bank holding company with 69 banking offices in 42 communities throughout Montana, Wyoming and South Dakota. Our principal operating segment is community banking. We also provide data technology support services and ATM processing support to affiliated and non-affiliated customers through our technology services operating segment. We differentiate ourselves from competitors by providing superior service to our banking and technology services 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 noninterest 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; technology 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 organically 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 \$908 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 noninterest income. In the near-term, we plan to make investments to support our core community banking activities and enhance our financial services product offerings. Longer-term, we intend to continue looking for profitable expansion opportunities.

Our success is highly dependent on economic conditions and market interest rates. Because we operate in Montana, Wyoming, and now, South Dakota, the local economic conditions in each of these areas are particularly important. Our local economies remained strong in 2007 and the overall economic outlook for Montana, Wyoming and South Dakota remains favorable for 2008. During 2007, subprime lending and poor investment decisions, among other challenges, resulted in large losses and falling stock prices at many financial institutions across the country. We did not experience the financial instability that challenged many other banks. A conservative single borrower lending limit

and sound underwriting discipline, which did not include subprime loans, kept our credit quality high in 2007, even after a slight deterioration from 2006. Although the overall impact of the national economic and real estate downturn, subprime mortgage crisis and credit 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 2007, we reported net income of \$68.6 million, or \$8.25 per diluted share, as compared to \$75.6 million, or \$9.11 per diluted share, in 2006. During fourth quarter 2006, we recorded a one-time, after-tax gain of \$12.3 million, or \$1.48 per diluted share, from the sale of a minority interest in iPay Technologies, LLC, an unconsolidated internet bill payment joint venture. Exclusive of this one-time gain, net income for 2007 increased 8.4%, or \$0.62 per diluted share, from 2006. We not only grew in terms of net income but also in terms of asset size, exceeding \$5 billion in total assets in 2007. The increase in total assets is attributable to organic loan growth funded by increases in interest-bearing customer deposits.

-23-

---

## **Table of Contents**

Net interest income, on a fully taxable-equivalent, or FTE, basis, increased 6.5% to \$203.7 million in 2007, from \$191.3 million in 2006, primarily due to growth in average earning assets. Average earning assets grew 6.7% and comprised a larger percentage of total assets in 2007, as compared to 2006. During 2007, 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, primarily loans. Our net FTE interest margin remained stable at 4.46% in 2007, as compared to 4.47% in 2006.

During 2007, we recognized a non-recurring contract termination fee of \$2.0 million and recorded one-time gains of \$986 thousand on the sale of mortgage servicing rights and \$737 thousand on the conversion and sale of MasterCard stock. In addition, net income in 2007 was positively impacted by increases of \$1.8 million in fee income from higher debit and credit card transaction volumes and \$1.6 million in revenues from the origination and sale of loans. Increases in income were partially offset by a \$9.2 million increase in salaries, wages and employee benefits expense resulting from inflation, higher staffing levels, higher incentive compensation accruals and increases in group medical insurance costs; a \$1.4 million increase in occupancy expense resulting from increases in rental expense and higher depreciation due to a change in the useful lives of two buildings and related leasehold improvements; and, loss contingency accruals aggregating \$1.5 million related to an indemnification agreement with Visa USA and two operational losses incurred in the ordinary course of business.

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,





## **Table of Contents**

### *Valuation of Mortgage Servicing Rights*

We recognize as assets the rights to service mortgage loans for others, whether acquired or internally originated. Mortgage servicing rights are 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, 2007, 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 \$4.3 million and an immediate 50 basis point decrease in mortgage interest rates would result in a reduction in fair value of \$9.0 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.

### *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.

## **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.

**Table of Contents**

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

**Average Balance Sheets, Yields and Rates**

(Dollars in thousands)

|                                      | Year Ended December 31, |           |                 |                    |           |                 |                    |           |                 |
|--------------------------------------|-------------------------|-----------|-----------------|--------------------|-----------|-----------------|--------------------|-----------|-----------------|
|                                      | 2007                    |           |                 | 2006               |           |                 | 2005               |           |                 |
|                                      | 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)                         | \$3,449,809             | \$274,020 | 7.94%           | \$3,208,102        | \$246,861 | 7.69%           | \$2,874,723        | \$196,453 | 6.83%           |
| U.S. government agency securities    | 892,850                 | 42,650    | 4.78            | 915,844            | 40,985    | 4.48            | 779,369            | 30,054    | 3.86            |
| Federal funds sold                   | 87,460                  | 4,422     | 5.06            | 43,726             | 2,196     | 5.02            | 83,156             | 2,766     | 3.33            |
| Other securities                     | 857                     | 3         | 0.35            | 1,059              | 6         | 0.57            | 7,599              | 201       | 2.65            |
| Tax exempt securities (2)            | 111,732                 | 7,216     | 6.46            | 105,209            | 6,832     | 6.49            | 103,364            | 6,744     | 6.53            |
| Interest bearing deposits in banks   | 26,165                  | 1,307     | 5.00            | 8,190              | 360       | 4.40            | 31,325             | 1,021     | 3.26            |
| Total interest earnings assets       | 4,568,873               | 329,618   | 7.21            | 4,282,130          | 297,240   | 6.94            | 3,879,536          | 237,239   | 6.12            |
| Nonearning assets                    | 423,893                 |           |                 | 444,702            |           |                 | 454,545            |           |                 |
| Total assets                         | \$4,992,766             |           |                 | \$4,726,832        |           |                 | \$4,334,081        |           |                 |
| <i>Interest bearing liabilities:</i> |                         |           |                 |                    |           |                 |                    |           |                 |
| Demand deposits                      | 1,004,019               | 23,631    | 2.35%           | 850,925            | 15,852    | 1.86%           | \$ 667,668         | \$ 4,795  | 0.72%           |
| Savings deposits                     | 940,521                 | 24,103    | 2.56            | 845,967            | 17,424    | 2.06            | 902,749            | 11,151    | 1.24            |
| Time deposits                        | 1,105,959               | 51,815    | 4.69            | 1,010,820          | 39,991    | 3.96            | 1,013,159          | 29,641    | 2.93            |
| Borrowings (3)                       | 566,984                 | 21,640    | 3.82            | 683,776            | 27,636    | 4.04            | 507,131            | 12,750    | 2.51            |
|                                      | 9,230                   | 467       | 5.06            | 40,320             | 1,576     | 3.91            | 61,055             | 2,480     | 4.06            |

|                                                                                       |             |           |       |             |           |       |             |           |       |
|---------------------------------------------------------------------------------------|-------------|-----------|-------|-------------|-----------|-------|-------------|-----------|-------|
| Long-term debt Subordinated debentures held by subsidiary trusts                      | 47,099      | 4,298     | 9.13  | 41,238      | 3,481     | 8.44  | 41,238      | 2,732     | 6.62  |
| Total interest bearing liabilities                                                    | 3,673,812   | 125,954   | 3.43  | 3,473,046   | 105,960   | 3.05  | 3,193,000   | 63,549    | 1.99  |
| Noninterest bearing deposits                                                          | 842,239     |           |       | 837,909     |           |       | 780,427     |           |       |
| Other liabilities                                                                     | 51,529      |           |       | 44,860      |           |       | 34,854      |           |       |
| Stockholders equity                                                                   | 425,186     |           |       | 371,017     |           |       | 325,800     |           |       |
| Total liabilities and stockholders equity                                             | \$4,992,766 |           |       | \$4,726,832 |           |       | \$4,334,081 |           |       |
| Net FTE interest income                                                               |             | \$203,664 |       |             | \$191,280 |       |             | \$173,690 |       |
| Less FTE adjustments (2)                                                              |             | (4,061)   |       |             | (3,817)   |       |             | (3,382)   |       |
| Net interest income from consolidated statements of income                            |             | \$199,603 |       |             | \$187,463 |       |             | \$170,308 |       |
| Interest rate spread                                                                  |             |           | 3.78% |             |           | 3.89% |             |           | 4.13% |
| Net FTE interest margin (4)                                                           |             |           | 4.46% |             |           | 4.47% |             |           | 4.48% |
| (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.

**Table of Contents**

Net FTE interest income increased \$12.4 million, or 6.5%, to \$203.7 million in 2007 from \$191.3 million in 2006, and \$17.6 million, or 10.1%, to \$191.3 million in 2006 from \$173.7 million in 2005 primarily due to organic growth in earning assets, primarily loans. Average earning assets grew 6.7% in 2007 as compared to 2006, and 10.4% in 2006 as compared to 2005. During 2007, 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 net FTE interest margin remained stable at 4.46% in 2007, as compared to 4.47% in 2006 and 4.48% in 2005.

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, 2007<br>compared with<br>December 31, 2006 |          |          | Year Ended December 31, 2006<br>compared with<br>December 31, 2005 |          |          | Year Ended December 31, 2005<br>compared with<br>December 31, 2004 |          |          |
|--------------------------------------|--------------------------------------------------------------------|----------|----------|--------------------------------------------------------------------|----------|----------|--------------------------------------------------------------------|----------|----------|
|                                      | Volume                                                             | Rate     | Net      | Volume                                                             | Rate     | Net      | Volume                                                             | Rate     | Net      |
| <i>Interest earning assets:</i>      |                                                                    |          |          |                                                                    |          |          |                                                                    |          |          |
| Loans (1)                            | \$18,599                                                           | \$ 8,560 | \$27,159 | \$22,782                                                           | \$27,626 | \$50,408 | \$15,165                                                           | \$18,690 | \$33,855 |
| U.S. government agency securities    | (1,029)                                                            | 2,694    | 1,665    | 5,263                                                              | 5,668    | 10,931   | 2,261                                                              | 2,521    | 4,782    |
| Federal funds sold                   | 2,196                                                              | 30       | 2,226    | (1,312)                                                            | 742      | (570)    | 216                                                                | 1,479    | 1,695    |
| Other securities (2)                 | (1)                                                                | (2)      | (3)      | (173)                                                              | (22)     | (195)    | (128)                                                              | 14       | (114)    |
| Tax exempt securities (1)(2)         | 424                                                                | (40)     | 384      | 120                                                                | (32)     | 88       | 543                                                                | (288)    | 255      |
| Interest bearing deposits in banks   | 790                                                                | 157      | 947      | (754)                                                              | 93       | (661)    | 343                                                                | 397      | 740      |
| Total change                         | 20,979                                                             | 11,399   | 32,378   | 25,926                                                             | 34,075   | 60,001   | 18,400                                                             | 22,813   | 41,213   |
| <i>Interest bearing liabilities:</i> |                                                                    |          |          |                                                                    |          |          |                                                                    |          |          |
| Demand deposits                      | 2,852                                                              | 4,927    | 7,779    | 1,316                                                              | 9,741    | 11,057   | 255                                                                | 2,922    | 3,177    |
| Savings deposits                     | 1,947                                                              | 4,732    | 6,679    | (701)                                                              | 6,974    | 6,273    | 30                                                                 | 4,457    | 4,487    |
| Time deposits                        | 3,764                                                              | 8,060    | 11,824   | (68)                                                               | 10,418   | 10,350   | (353)                                                              | 3,972    | 3,619    |
| Borrowings (3)                       | (4,720)                                                            | (1,276)  | (5,996)  | 4,441                                                              | 10,445   | 14,886   | 1,176                                                              | 7,760    | 8,936    |

Edgar Filing: FIRST INTERSTATE BANCSYSTEM INC - Form 10-K

|                                                            |          |            |          |          |            |          |          |          |          |
|------------------------------------------------------------|----------|------------|----------|----------|------------|----------|----------|----------|----------|
| Long-term debt                                             | (1,215)  | 106        | (1,109)  | (842)    | (62)       | (904)    | 368      | (217)    | 151      |
| Subordinated<br>debentures held<br>by subsidiary<br>trusts | 495      | 322        | 817      |          | 749        | 749      |          | 758      | 758      |
| Total change                                               | 3,123    | 16,871     | 19,994   | 4,146    | 38,265     | 42,411   | 1,476    | 19,652   | 21,128   |
| Increase<br>(decrease) in<br>FTE net<br>interest income    |          |            |          |          |            |          |          |          |          |
| (1)                                                        | \$17,856 | \$ (5,472) | \$12,384 | \$21,780 | \$ (4,190) | \$17,590 | \$16,924 | \$ 3,161 | \$20,085 |

(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.

*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.





## **Table of Contents**

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. The provision for loan losses increased 32.7% to \$7.8 million in 2006, from \$5.8 million in 2005 primarily due to higher levels of internally classified loans in 2006 and refinement of our process for assessing risk known and inherent in our loan portfolio.

### *Noninterest Income*

Principal sources of noninterest 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. Noninterest income decreased \$9.7 million, or 9.5%, to \$92.4 million in 2007, from \$102.1 million in 2006, and increased 44.1% to \$102.1 million in 2006, from \$70.9 million in 2005. Fluctuations in noninterest 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 10.6% to \$24.2 million in 2007, from \$21.9 million in 2006, primarily due to additional fee income from higher volumes of credit and debit card transactions and increases in insurance commissions. Other service charges, commissions and fees increased 13.0% to \$21.9 million in 2006, from \$19.4 million in 2005, primarily due to additional fee income from higher volumes of credit and debit card transactions and increases in mortgage servicing revenues, the result of increases in the principal balances of loans serviced.

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 increase in the volume of core data and debit card transactions processed. Technology services revenues increased 19.1% to \$15.8 million in 2006, from \$13.3 million in 2005, primarily due to increases in the number of customers using core data processing services and the volume of core data and debit card transactions processed.

Wealth management revenues, comprised principally of fees earned for management of trust assets and investment services revenues, increased 5.0% to \$11.7 million in 2007, from \$11.2 million in 2006, and 10.4% to \$11.2 million in 2006, from \$10.1 million in 2005, 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 17.0% to \$11.2 million in 2007, from \$9.6 million in 2006 and 11.5% to \$9.6 million in 2006, from \$8.6 million in 2005.

We recorded net gains of \$59 thousand on the disposition of investment securities in 2007, as compared to net losses of \$722 thousand in 2006, and net losses of \$3.7 million in 2005. During 2005 and continuing in 2006, we partially restructured our investment security portfolio by selling lower yielding U.S. government agency securities and reinvesting the proceeds in higher yielding mortgage-backed and U.S. government agency securities.

During fourth quarter 2006, we recorded a one-time gain of \$19.8 million on the sale of our minority interest in an unconsolidated internet bill payment joint venture. Aggregate consideration for the sale was \$21.2 million, of which \$19.9 million was received in cash and \$1.4 million was placed in escrow to offset purchase price adjustments related to working capital and indemnify potential loss claims. For additional information concerning this sale and the resulting gain, see Notes to Consolidated Financial Statements Acquisitions and Dispositions 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 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 recorded during third quarter 2007 and \$986 thousand on the sale of mortgage

servicing rights recorded during first quarter 2007. Other income increased 18.7% to \$6.9 million in 2006, from \$5.8 million in 2005, primarily due to higher earnings on securities held under deferred compensation plans, higher earnings of unconsolidated equity method joint ventures and increases in the cash surrender value of life insurance.

-28-

---

## **Table of Contents**

### *Noninterest Expense*

Noninterest expense increased 8.6% to \$178.9 million in 2007, from \$164.7 million in 2006, and 8.9% to \$164.7 million in 2006, from \$151.3 million in 2005. Significant components of these increases are discussed below.

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 inflationary wage increases, higher staffing levels, higher incentive compensation accruals and increased group medical insurance costs. Salaries, wages and employee benefits expense increased 11.1% to \$88.9 million in 2006, from \$80.0 million in 2005, primarily due to inflationary wage increases, higher incentive compensation and profit sharing contributions reflective of operating results in 2006 and increases in group medical insurance costs. In addition, we adopted SFAS No. 123 (revised), Share-Based Payments, on January 1, 2006. We recognized compensation expense for stock option and restricted stock awards of \$1.1 million in 2007, \$1.3 million in 2006, and \$289 thousand in 2005.

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. Occupancy expense decreased less than 1% to \$13.3 million in 2006, from \$13.4 million in 2005.

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 10.4% to \$4.4 million in 2007, from \$4.0 million in 2006, and decreased 12.8% to \$4.0 million in 2006, from \$4.6 million in 2005.

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 \$1.7 million in each of 2007 and 2006 and reversed previously recorded impairment of \$2.2 million in 2005.

Professional fees increased 5.4% to \$3.3 million in 2007, from \$3.2 million in 2006 and 11.4% to \$3.2 million in 2006, from \$2.8 million in 2005, primarily due to consulting fees related to evaluation of software and the potential implementation of a company-wide data warehousing system.

Outsourced technology services principally include ATM network expense, credit card processing fees, technology consulting fees and other expenses related to technology services provided by third parties. Outsourced technology services expense decreased 1.1% to \$3.1 million in 2007, from \$3.2 million in 2006, and increased 37.6% to \$3.2 million in 2006, from \$2.3 million in 2005. The 2006 increase was primarily due to expenses related to the development of a new internet-based corporate cash management product and the redesign and customization of our corporate internet banking site.

Other expenses primarily include 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 10.8% to \$37.0 million in 2007, from \$33.4 million in 2006, and remained constant at \$33.4 million in 2006 and 2005. The increase in other expense in 2007, as compared to 2006, was 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.

### *Income Tax Expense*

Our effective federal tax rate was 31.0% for the year ended December 31, 2007; 31.6% for the year ended December 31, 2006; and, 31.0% for the year ended December 31, 2005. 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, Colorado, Idaho and Oregon. Our effective state tax rate was 3.9% for the year ended December 31, 2007 and 3.8% for the years ended December 31, 2006 and 2005.

**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) |          |          |
|-------------------------|-------------------|----------|----------|
|                         | 2007              | 2006     | 2005     |
| Community Banking       | \$71,244          | \$66,691 | \$57,750 |
| Technology Services     | 3,706             | 3,761    | 4,193    |
| Other                   | (6,309)           | 5,157    | (7,228)  |
| Consolidated            | \$68,641          | \$75,609 | \$54,715 |

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 2007, 2006 and 2005, and over 97% of our consolidated assets as of December 31, 2007 and 2006. Components of the changes in community banking net income in 2007 as compared to 2006, and in 2006 as compared to 2005, 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. Technology services net income decreased 1.5% to \$3.7 million in 2007, from \$3.8 million in 2006, and 10.3% to \$3.8 million in 2006, from \$4.2 million in 2005. 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 and 2006 were offset primarily by increases in salary and benefits expenses due to higher staffing levels and increases in equipment maintenance and repair expense.

Other includes the net funding cost and other expenses of the parent holding company, the operational results of consolidated nonbank subsidiaries (except i\_Tech) and intercompany eliminations. 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 losses decreased 11.4% to \$6.3 million in 2007, from \$7.1 million in 2006. This decrease in net losses in 2007, as compared to 2006, was principally due to income from the 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.

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

The following table presents unaudited quarterly results of operations for the fiscal years ended December 31, 2007 and 2006.

**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, 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   |
| Noninterest income                                     | 21,697           | 22,306            | 25,390           | 23,055            | 92,448    |
| Noninterest expense                                    | 42,770           | 42,586            | 44,581           | 48,930            | 178,867   |
| 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<br>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      |
| <i>Year Ended December 31, 2006:</i>                   |                  |                   |                  |                   |           |
| Interest income                                        | \$66,969         | \$71,558          | \$76,416         | \$78,480          | \$293,423 |
| Interest expense                                       | 21,354           | 25,594            | 28,614           | 30,398            | 105,960   |
| Net interest income                                    | 45,615           | 45,964            | 47,802           | 48,082            | 187,463   |
| Provision for loan losses                              | 1,753            | 2,578             | 2,029            | 1,401             | 7,761     |
| Net interest income after provision<br>for loan losses | 43,862           | 43,386            | 45,773           | 46,681            | 179,702   |
| Noninterest income                                     | 19,293           | 20,643            | 21,776           | 40,407            | 102,119   |
| Noninterest expense                                    | 38,367           | 39,301            | 41,698           | 45,347            | 164,713   |
| Income before income taxes                             | 24,788           | 24,728            | 25,851           | 41,741            | 117,108   |
| Income tax expense                                     | 8,654            | 8,591             | 9,105            | 15,149            | 41,499    |
| Net income                                             | \$16,134         | \$16,137          | \$16,746         | \$26,592          | \$ 75,609 |
| Basic earnings per common share                        | \$ 1.99          | \$ 1.99           | \$ 2.07          | \$ 3.27           | \$ 9.32   |
| Diluted earnings per common<br>share                   | 1.95             | 1.95              | 2.02             | 3.18              | 9.11      |

|                            |      |      |      |      |      |
|----------------------------|------|------|------|------|------|
| Dividends per common share | 0.50 | 0.58 | 0.58 | 0.61 | 2.27 |
|----------------------------|------|------|------|------|------|

### Financial Condition

Total assets increased 4.9% to \$5,217 million as of December 31, 2007, from \$4,974 million as of December 31, 2006, primarily due to organic loan growth. Asset growth was primarily funded by increases in customer deposits.

#### *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.

-31-

---

**Table of Contents**

**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.

**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, 2007, are 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 7.5% to \$3,559 million as of December 31, 2007, from \$3,310 as of December 31, 2006, and 9.1% to \$3,310 million as of December 31, 2006, from \$3,034 million as of December 31, 2005, due to organic growth within our market areas.

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

**Loans Outstanding**

(Dollars in thousands)

|              | As of December 31, |         |            |         |            |         |            |         |            |         |
|--------------|--------------------|---------|------------|---------|------------|---------|------------|---------|------------|---------|
|              | 2007               | Percent | 2006       | Percent | 2005       | Percent | 2004       | Percent | 2003       | Percent |
| Loans        |                    |         |            |         |            |         |            |         |            |         |
| Real estate: |                    |         |            |         |            |         |            |         |            |         |
| Commercial   | \$ 1,018,831       | 28.6%   | \$ 937,695 | 28.3%   | \$ 926,190 | 30.5%   | \$ 855,711 | 31.2%   | \$ 763,599 | 29.8%   |
| Construction | 664,272            | 18.7    | 579,603    | 17.5    | 403,751    | 13.3    | 296,773    | 10.8    | 244,784    | 9.6     |
| Residential  | 419,001            | 11.8    | 402,468    | 12.2    | 408,659    | 13.4    | 363,145    | 13.3    | 338,853    | 13.3    |
| Agricultural | 142,256            | 4.0     | 137,659    | 4.1     | 116,402    | 3.9     | 108,345    | 4.0     | 107,680    | 4.2     |
| Other        | 26,080             | 0.7     | 25,360     | 0.8     | 19,067     | 0.6     | 21,255     | 0.7     | 42,283     | 1.7     |
| Consumer     | 608,002            | 17.1    | 605,858    | 18.3    | 587,895    | 19.4    | 514,045    | 18.8    | 491,938    | 19.3    |
| Commercial   | 593,669            | 16.7    | 542,325    | 16.4    | 494,848    | 16.3    | 500,611    | 18.3    | 480,725    | 18.8    |
| Agricultural | 81,890             | 2.3     | 76,644     | 2.3     | 74,561     | 2.5     | 74,303     | 2.7     | 82,634     | 3.2     |
| Other loans  | 4,979              | 0.1     | 2,751      | 0.1     | 2,981      | 0.1     | 5,321      | 0.2     | 2,403      | 0.1     |
| Total loans  | 3,558,980          | 100.0%  | 3,310,363  | 100.0%  | 3,034,354  | 100.0%  | 2,739,509  | 100.0%  | 2,554,899  | 100.0%  |
| Less         | 52,355             |         | 47,452     |         | 42,450     |         | 42,141     |         | 38,940     |         |
| allowance    |                    |         |            |         |            |         |            |         |            |         |
| for loan     |                    |         |            |         |            |         |            |         |            |         |

Losses

|           |             |             |             |             |             |
|-----------|-------------|-------------|-------------|-------------|-------------|
| Net loans | \$3,506,625 | \$3,262,911 | \$2,991,904 | \$2,697,368 | \$2,515,959 |
|-----------|-------------|-------------|-------------|-------------|-------------|

|                                         |       |       |       |       |       |
|-----------------------------------------|-------|-------|-------|-------|-------|
| Ratio of<br>allowance to<br>total loans | 1.47% | 1.43% | 1.40% | 1.54% | 1.52% |
|-----------------------------------------|-------|-------|-------|-------|-------|

Commercial real estate loans increased 8.7% to \$1,019 million as of December 31, 2007, from \$938 million as of December 31, 2006, and 1.2% from \$938 million as of December 31, 2007, from \$926 million as of December 31, 2005. The increase in commercial real estate loans in 2007 is primarily due to strong demand for housing and overall growth in our market areas.

-32-

---



**Table of Contents**

Construction loans increased 14.6% to \$664 million as of December 31, 2007, from \$580 million as of December 31, 2006, and 43.6% to \$580 million as of December 31, 2006, from \$404 million as of December 31, 2005. 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 2007 and 2006 was primarily the result of strong demand for housing and overall growth in our market areas.

Commercial loans increased 9.5% to \$594 million as of December 31, 2007, from \$542 million as of December 31, 2006, and 9.6% to \$542 million as of December 31, 2006, from \$495 million as of December 31, 2005, due to a favorable economy and growth in our existing market areas and an increase in overall borrowing activity.

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, 2007:

**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                      | \$1,553,966        | \$577,733                 | \$138,741           | \$2,270,440        |
| Consumer                         | 328,634            | 262,992                   | 16,376              | 608,002            |
| Commercial                       | 467,686            | 116,597                   | 9,386               | 593,669            |
| Agricultural                     | 73,350             | 8,418                     | 122                 | 81,890             |
| Other loans                      | 4,979              |                           |                     | 4,979              |
| <b>Total loans</b>               | <b>\$2,428,615</b> | <b>\$965,740</b>          | <b>\$164,625</b>    | <b>\$3,558,980</b> |
| Loans at fixed interest rates    | \$ 773,538         | \$952,682                 | \$151,108           | \$1,877,328        |
| Loans at variable interest rates | 1,623,525          | 13,058                    | 13,517              | 1,650,100          |
| Nonaccrual loans                 | 31,552             |                           |                     | 31,552             |
| <b>Total loans</b>               | <b>\$2,428,615</b> | <b>\$965,740</b>          | <b>\$164,625</b>    | <b>\$3,558,980</b> |

**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 increased less than 1.0% to \$1,129 million as of December 31, 2007, from \$1,125 million as of December 31, 2006, and 10.3% to \$1,125 million as of December 31, 2006, from \$1,020 million as of December 31, 2005. As of December 31, 2007, investment securities with amortized costs and fair values of \$909 million and \$907 million, respectively, were pledged to secure public deposits and securities sold under repurchase agreements, as compared to \$1,040 million and \$1,029 million, respectively, 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. During 2006, we purchased short-term available-for-sale investment securities to provide the collateral necessary to support growth in securities sold under repurchase agreements. The weighted average yield on investment securities increased 28 basis points to 4.96% in 2007, from 4.68% in 2006, and 52 basis points to 4.68% in 2006, from 4.16% in 2005. For additional information concerning securities sold under repurchase agreements, see Federal Funds Purchased and Securities Sold Under Repurchase Agreements included herein.

-33-

---

**Table of Contents**

The following table sets forth the book value, percentage of total investment securities and average yield on investment securities as of December 31, 2007:

**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                                    | \$ 208,586    | 18.5%                                  | 4.08%                            |
| Maturing in one to five years                               | 192,507       | 17.1                                   | 4.88                             |
| Maturing in five to ten years                               | 49,986        | 4.4                                    | 5.13                             |
| Mark-to-market adjustments on securities available-for-sale | 1,541         |                                        |                                  |
| Total                                                       | 452,620       | 40.1                                   | 4.54                             |
| <i>Mortgage-backed securities</i>                           |               |                                        |                                  |
| Maturing within one year                                    | 73,526        | 6.6                                    | 4.85                             |
| Maturing in one to five years                               | 288,448       | 25.5                                   | 4.70                             |
| Maturing in five to ten years                               | 107,461       | 9.6                                    | 4.92                             |
| Maturing after ten years                                    | 96,149        | 8.5                                    | 5.32                             |
| Mark-to-market adjustments on securities available-for-sale | (3,927)       |                                        |                                  |
| Total                                                       | 561,657       | 49.8                                   | 4.87                             |
| <i>Tax exempt securities</i>                                |               |                                        |                                  |
| Maturing within one year                                    | 11,489        | 1.0                                    | 6.77                             |
| Maturing in one to five years                               | 39,523        | 3.5                                    | 6.66                             |
| Maturing in five to ten years                               | 18,409        | 1.6                                    | 6.23                             |
| Maturing after ten years                                    | 44,189        | 3.9                                    | 6.23                             |
| Total                                                       | 113,610       | 10.1                                   | 6.44                             |
| <i>Other securities (2)</i>                                 |               |                                        |                                  |
| Maturing within one year                                    |               | 0.0                                    | 0.0                              |
| Maturing in one to five years                               | 260           | 0.0                                    | 0.0                              |
| Maturing in five to ten years                               | 351           | 0.0                                    | 0.0                              |
| Maturing after ten years                                    | 156           | 0.0                                    | 0.0                              |
| Total                                                       | 767           | 0.0                                    | 0.0                              |
| Mutual funds with no stated maturity                        | 3             | 0.0                                    | 3.62                             |

|       |             |        |       |
|-------|-------------|--------|-------|
| Total | 3           | 0.0    | 3.62  |
| Total | \$1,128,657 | 100.0% | 4.96% |

(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 \$170 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, 2007.

There were no significant concentrations of investments at December 31, 2007 (greater than 10% of stockholders equity) in any individual security issuer, except for U.S. Government or agency-backed securities.

**Table of Contents**

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%.

As of December 31, 2005, we had U.S. Government agency securities with carrying values of \$507 million and a weighted average yield of 4.15%; mortgage-backed securities with carrying values of \$409 million and a weighted average yield of 4.41%; tax exempt securities with carrying values of \$102 million and a weighted average yield of 6.53%; other securities with carrying values of \$1 million and a weighted average yield of 0.00%; and, mutual funds with carrying values of \$9 thousand and a weighted average yield of 3.56%.

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, 2007, we had investment securities with fair values of \$376 million that had been in a continuous loss position more than twelve months. Gross unrealized losses on these securities totaled \$6 million as of December 31, 2007, and were primarily attributable to changes in interest rates. We recorded no impairment losses during 2007, 2006 or 2005.

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

**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 noninterest bearing and interest bearing demand, savings, individual retirement and time deposit accounts.

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

**Deposits**

(Dollars in thousands)

|                            | As of December 31, |         |             |         |             |         |             |         |             |         |
|----------------------------|--------------------|---------|-------------|---------|-------------|---------|-------------|---------|-------------|---------|
|                            | 2007               | Percent | 2006        | Percent | 2005        | Percent | 2004        | Percent | 2003        | Percent |
| <i>Deposits</i>            |                    |         |             |         |             |         |             |         |             |         |
| Noninterest bearing demand | \$ 836,753         | 20.9%   | \$ 888,694  | 24.0%   | \$ 864,128  | 24.4%   | \$ 756,687  | 22.8%   | \$ 688,712  | 21.8%   |
| Interest bearing:          |                    |         |             |         |             |         |             |         |             |         |
| Demand                     | 1,019,208          | 25.5    | 964,312     | 26.0    | 792,263     | 22.3    | 623,082     | 18.8    | 567,669     | 18.0    |
| Savings                    | 992,571            | 24.8    | 798,497     | 21.5    | 879,586     | 24.8    | 921,176     | 27.7    | 851,052     | 27.0    |
| Time, \$100 and over       | 464,560            | 11.6    | 408,813     | 11.0    | 352,324     | 9.9     | 364,744     | 11.0    | 375,528     | 11.9    |
| Time, other                | 686,309            | 17.2    | 648,195     | 17.5    | 659,289     | 18.6    | 655,992     | 19.7    | 673,760     | 21.3    |
| Total interest bearing     | 3,162,648          | 79.1    | 2,819,817   | 76.0    | 2,683,462   | 75.6    | 2,564,994   | 77.2    | 2,468,009   | 78.2    |
| Total deposits             | \$3,999,401        | 100.0%  | \$3,708,511 | 100.0%  | \$3,547,590 | 100.0%  | \$3,321,681 | 100.0%  | \$3,156,721 | 100.0%  |

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 noninterest 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 noninterest 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 noninterest 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 noninterest 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. Total deposits increased 4.5% to \$3,709 million as of December 31, 2006, from \$3,548 million as of December 31, 2005, primarily 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.

**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,    | 2007      | 2006      | 2005      |
|----------------------------------------------|-----------|-----------|-----------|
| Federal funds purchased:                     |           |           |           |
| Balance at period end                        | \$        | \$        | \$ 1,500  |
| Average balance                              | 5,172     | 31,579    | 836       |
| Maximum amount outstanding at any month-end  | 29,470    | 87,810    | 1,500     |
| Average interest rate:                       |           |           |           |
| During the year                              | 5.17%     | 5.22%     | 3.11%     |
| At period end                                |           |           | 3.81      |
| Securities sold under repurchase agreements: |           |           |           |
| Balance at period end                        | \$604,762 | \$731,548 | \$518,718 |
| Average balance                              | 558,469   | 638,686   | 502,177   |
| Maximum amount outstanding at any month-end  | 679,247   | 731,548   | 539,838   |
| Average interest rate:                       |           |           |           |
| During the year                              | 3.80%     | 3.96%     | 2.51%     |
| At period end                                | 3.09      | 4.15      | 3.46      |

*Other Borrowed Funds*

Other borrowed funds increased 53.3% to \$9 million as of December 31, 2007, from \$6 million as of December 31, 2006, and decreased 24.0% to \$6 million as of December 31, 2006, from \$7 million as of December 31, 2005. Fluctuations in other borrowed funds are generally due to 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*

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. The note payable to the FHLB is secured by a blanket assignment of our qualifying residential and commercial real estate loans. 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. Long-term debt decreased 60.5% to \$22 million as of December 31, 2006, from \$55 million as of December 31, 2005, primarily due to scheduled debt repayments and the repayment of a \$25 million fixed rate FHLB advance subject to immediate payment because the three-month London Interbank Offered Rate, or LIBOR, equaled or exceeded 5.00% in 2006. For additional information on long-term debt 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.

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 at an initial rate of 7.25%. Under the terms of the credit agreement, we also borrowed \$9 million on a \$25 million revolving credit facility maturing January 10, 2011 with interest payable quarterly at an initial rate of 7.25%.

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. For additional information regarding acquisition financing, see Notes to Consolidated Financial Statements Subsequent Events, included in Part IV, Item 15.

Our long-term debt agreements, including the syndicated credit agreement and unsecured subordinated credit agreement entered into in January 2008, contain various covenants that, among other things, establish minimum capital and



## **Table of Contents**

financial performance ratios; and, place certain restrictions on capital expenditures, indebtedness, the sale and issuance of common stock, and the amount of dividends payable to shareholders. We were in compliance with all applicable debt covenants as of December 31, 2007.

### *Subordinated Debentures Held by Subsidiary Trusts*

Subordinated debentures held by subsidiary trusts increased 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 Part I, Item 1, Business First Western Acquisition and Notes to Consolidated Financial Statements Subsequent Events included in Part IV, Item 15.

### *Accounts Payable and Accrued Expenses*

Accounts payable and accrued expenses decreased 17.0% to \$30 million as of December 31, 2007, from \$36 million as of December 31, 2006, and increased 29.2% to \$36 million as of December 31, 2006, from \$28 million as of December 31, 2005, primarily due to timing of corporate income tax payments. Also contributing to the increase in 2006, as compared to 2005, were higher accruals for incentive bonuses and profit sharing contributions to reflect 2006 operating results.

### *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 \$1.7 million, \$1.1 million, \$1.2 million, \$1.4 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, 2007, 2006, 2005, 2004 and 2003, respectively.

**Table of Contents**

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,                            | 2007     | 2006     | 2005     | 2004     | 2003     |
|-----------------------------------------------|----------|----------|----------|----------|----------|
| Non-performing loans:                         |          |          |          |          |          |
| Nonaccrual loans                              | \$31,552 | \$14,764 | \$17,142 | \$17,585 | \$24,298 |
| Accruing loans past due 90 days or more       | 2,171    | 1,769    | 1,001    | 905      | 5,558    |
| Restructured loans                            | 1,027    | 1,060    | 1,089    | 1,384    | 1,414    |
| Total non-performing loans                    | 34,750   | 17,593   | 19,232   | 19,874   | 31,270   |
| OREO                                          | 928      | 529      | 1,091    | 1,828    | 1,999    |
| Total non-performing assets                   | \$35,678 | \$18,122 | \$20,323 | \$21,702 | \$33,269 |
| Non-performing assets to total loans and OREO | 1.00%    | 0.55%    | 0.67%    | 0.79%    | 1.30%    |

Non-performing assets increased 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 quarters of 2007, all of which are believed to be adequately collateralized. Non-performing assets decreased 10.8% to \$18 million as of December 31, 2006, from \$20 million as of December 31, 2005, primarily due to the pay-off of the nonaccrual loans of one commercial borrower and the sale of OREO properties in 2006.

In addition to the non-performing loans included in the table above, we have serious doubts as to the ability of certain borrowers to comply with the present repayment terms on performing loans, which may result in future non-performing loans. There can be no assurance that we have identified all of our potential non-performing loans. Furthermore, we cannot predict the extent to which economic conditions in our market areas may worsen or the full impact such conditions may have on our loan portfolio. Accordingly, there can be no assurances that other loans will not become 90 days or more past due, be placed on nonaccrual, be renegotiated or become OREO in the future.

*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 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.

-38-

---

**Table of Contents**

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, | 2007        | 2006        | 2005        | 2004        | 2003        |
|-------------------------------------------|-------------|-------------|-------------|-------------|-------------|
| Balance at the beginning of period        | \$ 47,452   | \$ 42,450   | \$ 42,141   | \$ 38,940   | \$ 36,309   |
| Allowance of acquired banking offices     |             |             |             |             | 385         |
| Charge-offs:                              |             |             |             |             |             |
| Real estate                               | 671         | 86          | 382         | 475         | 856         |
| Consumer                                  | 3,778       | 4,030       | 4,133       | 5,304       | 5,265       |
| Commercial                                | 643         | 1,014       | 2,803       | 1,583       | 2,668       |
| Agricultural                              | 116         | 80          | 133         | 438         | 1,297       |
| Total charge-offs                         | 5,208       | 5,210       | 7,451       | 7,800       | 10,086      |
| Recoveries:                               |             |             |             |             |             |
| Real estate                               | 87          | 63          | 13          | 182         | 373         |
| Consumer                                  | 1,390       | 1,568       | 1,297       | 1,424       | 1,571       |
| Commercial                                | 854         | 699         | 596         | 511         | 400         |
| Agricultural                              | 30          | 121         | 7           | 151         | 136         |
| Total recoveries                          | 2,361       | 2,451       | 1,913       | 2,268       | 2,480       |
| Net charge-offs                           | 2,847       | 2,759       | 5,538       | 5,532       | 7,606       |
| Provision for loan losses                 | 7,750       | 7,761       | 5,847       | 8,733       | 9,852       |
| Balance at end of period                  | \$ 52,355   | \$ 47,452   | \$ 42,450   | \$ 42,141   | \$ 38,940   |
| Period end loans                          | \$3,558,980 | \$3,310,363 | \$3,034,354 | \$2,739,509 | \$2,554,899 |
| Average loans                             | 3,449,809   | 3,208,102   | 2,874,723   | 2,629,474   | 2,448,386   |
| Net charge-offs to average loans          | 0.08%       | 0.09%       | 0.19%       | 0.21%       | 0.31%       |
| Allowance to period end loans             | 1.47%       | 1.43%       | 1.40%       | 1.54%       | 1.52%       |

The allowance for loan losses was \$52 million, or 1.47% of period end loans, at December 31 2007, as compared to \$47 million, or 1.43% of period end loans, at December 31, 2006, and \$42 million, or 1.40% of period end loans, at December 31, 2005.

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, 2007, future provisions will be subject to on-going evaluations of the risks in the loan portfolio. If the economy declines or asset quality deteriorates, material additional provisions could be required.

**Table of Contents**

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, | 2007      |          | 2006      |          | 2005      |          | 2004      |          | 2003      |          |
|--------------------|-----------|----------|-----------|----------|-----------|----------|-----------|----------|-----------|----------|
|                    | % 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        | \$39,420  | 63.8%    | \$33,532  | 62.9%    | \$22,622  | 61.7%    | \$19,469  | 60.0%    | \$17,911  | 58.6%    |
| Consumer           | 4,838     | 17.1     | 5,794     | 18.3     | 7,544     | 19.4     | 7,492     | 18.8     | 7,153     | 19.3     |
| Commercial         | 7,170     | 16.7     | 6,746     | 16.4     | 7,607     | 16.3     | 8,952     | 18.3     | 8,657     | 18.8     |
| Agricultural       | 779       | 2.3      | 908       | 2.3      | 1,147     | 2.5      | 2,200     | 2.7      | 3,147     | 3.2      |
| Other loans        |           | 0.1      | 14        | 0.1      | 15        | 0.1      | 27        | 0.2      | 12        | 0.1      |
| Unallocated (1)    | 148       | N/A      | 458       | N/A      | 3,515     | N/A      | 4,001     | N/A      | 2,060     | N/A      |
| Totals             | \$52,355  | 100.0%   | \$47,452  | 100.0%   | \$42,450  | 100.0%   | \$42,141  | 100.0%   | \$38,940  | 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  
presentation.

The allocated reserve for loan losses on real estate loans increased 17.6% to \$39 million as of December 31, 2007, from \$34 million as of December 31, 2006, primarily due to a weakened demand for residential lots in four of the communities we serve. The allocated reserve for loan losses on real estate loans increased 48.2% to \$34 million as of December 31, 2006, from \$23 million as of December 31, 2005, primarily due to housing slowdowns in certain of our market areas and higher levels of internally classified commercial real estate loans.

-40-

---

**Table of Contents***Contractual Obligations*

Contractual obligations as of December 31, 2007 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<br>Years<br>to Five<br>Years | After<br>Five Years | Total       |
|-------------------------------------------------------|--------------------|----------------------------|----------------------------------------------------|---------------------|-------------|
| Deposits without a stated maturity                    | \$2,848,532        | \$                         | \$                                                 | \$                  | \$2,848,532 |
| Time deposits                                         | 934,690            | 164,689                    | 51,487                                             | 3                   | 1,150,869   |
| Securities sold under repurchase agreements           | 604,762            |                            |                                                    |                     | 604,762     |
| Other borrowed funds(1)                               | 8,730              |                            |                                                    |                     | 8,730       |
| Long-term debt obligations (2)                        | 1,429              | 1,808                      |                                                    |                     | 3,237       |
| Capital lease obligations                             | 29                 | 67                         | 77                                                 | 1,735               | 1,908       |
| Operating lease obligations                           | 2,115              | 3,905                      | 2,905                                              | 7,825               | 16,750      |
| Purchase obligations (3)                              | 1,713              |                            |                                                    |                     | 1,713       |
| Subordinated debentures held by subsidiary trusts (4) |                    |                            |                                                    | 103,095             | 103,095     |
| Total contractual obligations                         | \$4,402,000        | \$170,469                  | \$54,469                                           | \$112,658           | \$4,739,596 |

(1) Included in other borrowed funds are tax deposits made by customers pending subsequent withdrawal by the federal government. 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 a note payable to FHLB maturing March 5, 2010 and bearing interest at a fixed rate of 3.01%. 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 solely to obligations under construction contracts to build or renovate banking offices.
- (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.

*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.

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.

## **Table of Contents**

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

#### *Capital Resources*

Stockholders' equity is influenced primarily by earnings, dividends and, to a lesser extent, sales and redemptions of common stock and changes in the unrealized holding gains or losses, net of taxes, on available-for-sale investment securities. Stockholders' equity increased 8.3% to \$444 million as of December 31, 2007, from \$410 million as of December 31, 2006, and 17.3% to \$410 million as of December 31, 2006, from \$350 million as of December 31, 2005, primarily due to retention of earnings. We paid aggregate cash dividends to stockholders of \$24.3 million in 2007, \$18.4 million in 2006 and \$15.0 million in 2005.

Pursuant to FIDICIA, 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, 2007, the Bank 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.

Approximately 91% of our common shares are subject to shareholder agreements that give us a right of first refusal to repurchase the restricted stock. While we have no obligation, by contract, policy or otherwise to purchase stock from any shareholder, historically it has been our practice to repurchase common stock to maintain a shareholder base with restrictions on sale or transfer of the stock. We purchased 257,827 shares of common stock from restricted shareholders with an aggregate value of \$23 million in 2007, as compared to 107,074 shares with an aggregate value of \$8 million in 2006 and 37,206 shares with an aggregate value of \$2 million in 2005. Our ability to repurchase common shares is limited by our liquidity and capital resources and by our debt covenants.

In conjunction with the First Western acquisition in January 2008, we borrowed \$59 million pursuant to a syndicated credit agreement and \$20 million pursuant to a subordinated credit agreement. These agreements contain various covenants and restrictions as described in Long-Term Debt above.

In January 2008, we issued 5,000 shares of Series A Preferred Stock with an aggregate value of \$50 million to partially fund the First Western acquisition. We also issued an aggregate of \$20 million of Trust Preferred Securities to third parties and used to proceeds to purchase \$21 million of Subordinated Debentures issued by us. 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, and

Notes to Consolidated Financial Statements Subsequent Events, included in Part IV, Item 15. For additional information regarding the Subordinated Debentures and Trust Preferred Securities, see Subordinated Debentures Held by Subsidiary Trusts included herein and Notes to Consolidated Financial Statements Subsequent Events, included in Part IV, Item 15.

#### *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 term loan, 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 and the issuance of preferred or common securities. The Banks also can borrow through the Federal Reserve's discount window. We do not engage in derivatives or hedging activities to support our liquidity position.

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.

-42-

---

**Table of Contents**

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.

-43-

---

**Table of Contents**

The following table shows interest rate sensitivity gaps and the earnings sensitivity ratio for different intervals as of December 31, 2007. 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)

|                                                                            | Three<br>Months<br>or Less | Three<br>Months to<br>One Year | Projected Maturity or Repricing<br>One<br>Year to<br>Five Years | After<br>Five Years | Total       |
|----------------------------------------------------------------------------|----------------------------|--------------------------------|-----------------------------------------------------------------|---------------------|-------------|
| <i>Interest earning assets:</i>                                            |                            |                                |                                                                 |                     |             |
| Loans (1)                                                                  | \$1,516,389                | \$ 630,553                     | \$1,215,263                                                     | \$165,223           | \$3,527,428 |
| Investment securities (2)                                                  | 205,410                    | 256,394                        | 413,624                                                         | 253,229             | 1,128,657   |
| Interest bearing deposits in<br>banks                                      | 6,868                      |                                |                                                                 |                     | 6,868       |
| Federal funds sold                                                         | 60,635                     |                                |                                                                 |                     | 60,635      |
| Total interest earning assets                                              | \$1,789,302                | \$ 886,947                     | \$1,628,887                                                     | \$418,452           | \$4,723,588 |
| <i>Interest bearing liabilities:</i>                                       |                            |                                |                                                                 |                     |             |
| Interest bearing demand<br>accounts (3)                                    | \$ 76,441                  | \$ 229,322                     | \$ 713,445                                                      | \$                  | \$1,019,208 |
| Savings deposits (3)                                                       | 830,528                    | 39,416                         | 122,627                                                         |                     | 992,571     |
| Time deposits, \$100 or<br>more (4)                                        | 140,107                    | 267,309                        | 57,144                                                          |                     | 464,560     |
| Other time deposits                                                        | 165,610                    | 361,664                        | 159,032                                                         | 3                   | 686,309     |
| Securities sold under<br>repurchase agreements                             | 604,762                    |                                |                                                                 |                     | 604,762     |
| Other borrowed funds                                                       | 8,730                      |                                |                                                                 |                     | 8,730       |
| Long-term debt                                                             | 364                        | 1,094                          | 1,952                                                           | 1,735               | 5,145       |
| Subordinated debentures<br>held by subsidiary trusts                       | 67,012                     |                                | 36,083                                                          |                     | 103,095     |
| Total interest bearing<br>liabilities                                      | \$1,893,554                | \$ 898,805                     | \$1,090,283                                                     | \$ 1,738            | \$3,884,380 |
| Rate gap                                                                   | \$ (104,252)               | \$ (11,858)                    | \$ 538,604                                                      | \$416,714           | \$ 839,208  |
| Cumulative rate gap                                                        | (104,252)                  | (116,110)                      | 422,494                                                         | 839,208             |             |
| Cumulative rate gap as a<br>percentage of total interest<br>earning assets | -2.21%                     | -2.46%                         | 8.94%                                                           | 17.77%              | 17.77%      |

(1) Does not  
include  
nonaccrual  
loans of  
\$31,552.

- (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

\$1,209 million,  
a negative  
cumulative one  
year gap of  
\$952 million  
and a positive  
cumulative one  
to five year gap  
of \$422 million.

- (4) Included in the  
three month to  
one year  
category are  
deposits of  
\$123 million  
maturing in  
three to six  
months.

*Net Interest Income Sensitivity*

The view presented in the preceding interest rate sensitivity gap table does not illustrate 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.

-44-

---

**Table of Contents**

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, 2007, our income simulation model predicted net interest income would decrease \$343 thousand, or 0.2%, assuming a 2% increase in short-term market interest rates and 1.0% increase in long-term interest rates. As of December 31, 2007, our income simulation model also predicted net interest income would decrease \$1.1 million, or 0.5%, assuming a 2% decrease in short-term market interest rates and 1.0% decrease in long-term interest rates. Both scenarios predict that our funding sources will reprice faster than our interest earning assets. The preceding interest rate sensitivity analysis does not represent a forecast and should not be relied upon as being indicative of expected operating results.

**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.

-45-

---



**Table of Contents**

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, 2007. 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, 2007 Expected Maturity, Principal Repayment or Repricing |           |           |           |           |            |             |
|---------------------------------------------------|-----------------------------------------------------------------------|-----------|-----------|-----------|-----------|------------|-------------|
|                                                   | 2008                                                                  | 2009      | 2010      | 2011      | 2012      | Thereafter | Total       |
| <i>Interest-sensitive assets:</i>                 |                                                                       |           |           |           |           |            |             |
| Cash and short-term investments                   | \$ 249,246                                                            | \$        | \$        | \$        | \$        | \$         | \$ 249,246  |
| Net loans                                         | 2,481,777                                                             | 391,939   | 265,962   | 154,731   | 113,584   | 81,206     | 3,489,199   |
| Securities available for sale                     | 282,849                                                               | 107,593   | 37,158    | 86,019    | 70,053    | 430,608    | 1,014,280   |
| Securities held to maturity                       | 11,555                                                                | 14,106    | 11,470    | 8,619     | 5,956     | 62,907     | 114,613     |
| Accrued interest receivable                       | 32,215                                                                |           |           |           |           |            | 32,215      |
| Mortgage servicing rights                         | 3,176                                                                 | 3,217     | 2,872     | 2,391     | 1,977     | 9,905      | 23,538      |
| Total interest-sensitive assets                   | \$3,060,818                                                           | \$516,855 | \$317,462 | \$251,760 | \$191,570 | \$584,626  | \$4,923,091 |
| <i>Interest sensitive liabilities:</i>            |                                                                       |           |           |           |           |            |             |
| Deposits, excluding time                          | \$1,426,732                                                           | \$304,671 | \$304,671 | \$812,458 | \$        | \$         | \$2,848,532 |
| Time deposits                                     | 944,998                                                               | 121,310   | 40,615    | 16,749    | 27,897    | 3          | 1,151,572   |
| Repurchase agreements                             | 604,762                                                               |           |           |           |           |            | 604,762     |
| Accrued interest payable                          | 21,104                                                                |           |           |           |           |            | 21,104      |
| Other borrowed funds                              | 8,730                                                                 |           |           |           |           |            | 8,730       |
| Long-term debt                                    | 1,708                                                                 | 1,604     | 524       | 147       | 137       | 1,350      | 5,470       |
| Subordinated debentures held by subsidiary trusts | 2,580                                                                 | 2,417     | 2,264     | 2,121     | 1,987     | 93,041     | 104,410     |
| Total interest-sensitive liabilities              | \$3,010,614                                                           | \$430,002 | \$348,074 | \$831,475 | \$ 30,021 | \$ 94,394  | \$4,744,580 |

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, 2007 and 2006

Consolidated Statements of Income Years Ended December 31, 2007, 2006 and 2005

Consolidated Statements of Stockholders Equity and Comprehensive Income Years Ended December 31, 2007, 2006 and 2005

Consolidated Statements of Cash Flows Years Ended December 31, 2007, 2006 and 2005

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.

-46-

---

**Table of Contents**

**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, 2007, 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, 2007, 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, 2007. 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, 2007, 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, 2007 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 2007 that were not reported.

**Table of Contents**

**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.

**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.

**Table of Contents**

**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, 2007 and 2006, 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, 2007. 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, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

We were not engaged to examine management's assertion about the effectiveness of First Interstate BancSystem's internal control over financial reporting as of December 31, 2007 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 14, 2008

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

| December 31,                                                                                                    | 2007        | 2006        |
|-----------------------------------------------------------------------------------------------------------------|-------------|-------------|
| <i>Assets</i>                                                                                                   |             |             |
| Cash and due from banks                                                                                         | \$ 181,743  | \$ 187,555  |
| Federal funds sold                                                                                              | 60,635      | 55,427      |
| Interest bearing deposits in banks                                                                              | 6,868       | 12,809      |
| Total cash and cash equivalents                                                                                 | 249,246     | 255,791     |
| Investment securities:                                                                                          |             |             |
| Available-for-sale                                                                                              | 1,014,280   | 1,012,658   |
| Held-to-maturity (estimated fair values of \$114,613 and \$112,391 at December 31, 2007 and 2006, respectively) | 114,377     | 111,940     |
| Total investment securities                                                                                     | 1,128,657   | 1,124,598   |
| Loans                                                                                                           | 3,558,980   | 3,310,363   |
| Less allowance for loan losses                                                                                  | 52,355      | 47,452      |
| Net loans                                                                                                       | 3,506,625   | 3,262,911   |
| Premises and equipment, net                                                                                     | 124,041     | 120,280     |
| Accrued interest receivable                                                                                     | 32,215      | 30,913      |
| Company owned life insurance                                                                                    | 67,076      | 64,705      |
| Mortgage servicing rights, net of accumulated amortization and impairment reserve                               | 21,715      | 22,644      |
| Goodwill                                                                                                        | 37,380      | 37,380      |
| Core deposit intangible, net of accumulated amortization                                                        | 257         | 432         |
| Net deferred tax asset                                                                                          | 6,741       | 8,297       |
| Other assets                                                                                                    | 42,844      | 46,183      |
| Total assets                                                                                                    | \$5,216,797 | \$4,974,134 |
| <i>Liabilities and Stockholders' Equity</i>                                                                     |             |             |
| Deposits:                                                                                                       |             |             |
| Noninterest bearing                                                                                             | \$ 836,753  | \$ 888,694  |
| Interest bearing                                                                                                | 3,162,648   | 2,819,817   |
| Total deposits                                                                                                  | 3,999,401   | 3,708,511   |
| Securities sold under repurchase agreements                                                                     | 604,762     | 731,548     |
| Accrued interest payable                                                                                        | 21,104      | 18,872      |
| Accounts payable and accrued expenses                                                                           | 30,117      | 36,295      |
| Other borrowed funds                                                                                            | 8,730       | 5,694       |
| Long-term debt                                                                                                  | 5,145       | 21,601      |

Edgar Filing: FIRST INTERSTATE BANCSYSTEM INC - Form 10-K

|                                                                                                                                                                           |             |             |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|-------------|
| Subordinated debentures held by subsidiary trusts                                                                                                                         | 103,095     | 41,238      |
| Total liabilities                                                                                                                                                         | 4,772,354   | 4,563,759   |
| Stockholders' equity:                                                                                                                                                     |             |             |
| Nonvoting noncumulative preferred stock without par value; authorized 100,000 shares, no shares issued or outstanding as of December 31, 2007 and 2006                    |             |             |
| Common stock without par value; authorized 20,000,000 shares; issued and outstanding 8,006,041 shares and 8,144,788 shares as of December 31, 2007 and 2006, respectively | 29,773      | 45,477      |
| Retained earnings                                                                                                                                                         | 416,425     | 372,039     |
| Accumulated other comprehensive loss, net                                                                                                                                 | (1,755)     | (7,141)     |
| Total stockholders' equity                                                                                                                                                | 444,443     | 410,375     |
| Total liabilities and stockholders' equity                                                                                                                                | \$5,216,797 | \$4,974,134 |

*See accompanying notes to consolidated financial statements.*

-50-

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

| Year Ended December 31,                                       | 2007       | 2006       | 2005       |
|---------------------------------------------------------------|------------|------------|------------|
| Interest income:                                              |            |            |            |
| Interest and fees on loans                                    | \$ 272,482 | \$ 245,435 | \$ 195,431 |
| Interest and dividends on investment securities:              |            |            |            |
| Taxable                                                       | 42,660     | 40,991     | 30,255     |
| Exempt from federal taxes                                     | 4,686      | 4,441      | 4,384      |
| Interest on deposits in banks                                 | 1,307      | 360        | 1,021      |
| Interest on federal funds sold                                | 4,422      | 2,196      | 2,766      |
| Total interest income                                         | 325,557    | 293,423    | 233,857    |
| Interest expense:                                             |            |            |            |
| Interest on deposits                                          | 99,549     | 73,267     | 45,587     |
| Interest on federal funds purchased                           | 267        | 1,649      | 26         |
| Interest on securities sold under repurchase agreements       | 21,212     | 25,278     | 12,602     |
| Interest on other borrowed funds                              | 161        | 709        | 122        |
| Interest on long-term debt                                    | 467        | 1,576      | 2,480      |
| Interest on subordinated debentures held by subsidiary trusts | 4,298      | 3,481      | 2,732      |
| Total interest expense                                        | 125,954    | 105,960    | 63,549     |
| Net interest income                                           | 199,603    | 187,463    | 170,308    |
| Provision for loan losses                                     | 7,750      | 7,761      | 5,847      |
| Net interest income after provision for loan losses           | 191,853    | 179,702    | 164,461    |
| Noninterest income:                                           |            |            |            |
| Other service charges, commissions and fees                   | 24,221     | 21,906     | 19,392     |
| Technology services revenues                                  | 19,080     | 15,845     | 13,304     |
| Service charges on deposit accounts                           | 17,787     | 17,581     | 17,294     |
| Wealth management revenues                                    | 11,734     | 11,176     | 10,121     |
| Income from the origination and sale of loans                 | 11,245     | 9,611      | 8,619      |
| Investment securities gains (losses), net                     | 59         | (722)      | (3,677)    |
| Gain on sale of equity method investee                        |            | 19,801     |            |
| Other income                                                  | 8,322      | 6,921      | 5,829      |
| Total noninterest income                                      | 92,448     | 102,119    | 70,882     |
| Noninterest expense:                                          |            |            |            |
| Salaries, wages and employee benefits                         | 98,134     | 88,889     | 80,029     |
| Furniture and equipment                                       | 16,229     | 16,333     | 15,912     |
| Occupancy, net                                                | 14,741     | 13,300     | 13,412     |
| Mortgage servicing rights amortization                        | 4,441      | 4,024      | 4,614      |
| Mortgage servicing rights impairment expense (recovery)       | 1,702      | 1,694      | (2,187)    |



Edgar Filing: FIRST INTERSTATE BANCSYSTEM INC - Form 10-K

|                                      |           |           |           |
|--------------------------------------|-----------|-----------|-----------|
| Professional fees                    | 3,338     | 3,167     | 2,844     |
| Outsourced technology services       | 3,116     | 3,151     | 2,290     |
| Core deposit intangible amortization | 174       | 772       | 1,013     |
| Other expenses                       | 36,992    | 33,383    | 33,391    |
| Total noninterest expense            | 178,867   | 164,713   | 151,318   |
| Income before income tax expense     | 105,434   | 117,108   | 84,025    |
| Income tax expense                   | 36,793    | 41,499    | 29,310    |
| Net income                           | \$ 68,641 | \$ 75,609 | \$ 54,715 |
| Basic earnings per share             | \$ 8.45   | \$ 9.32   | \$ 6.84   |
| Diluted earnings per share           | 8.25      | 9.11      | 6.71      |

*See accompanying notes to consolidated financial statements.*

-51-

---

**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)*

|                                                                                                                                  | Common<br>Shares | Common<br>Stock | Retained<br>Earnings | Unearned<br>Compensation<br>-<br>Restricted<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total<br>Stockholders'<br>Equity |
|----------------------------------------------------------------------------------------------------------------------------------|------------------|-----------------|----------------------|------------------------------------------------------|-----------------------------------------------------------|----------------------------------|
| Balance at<br>December 31, 2004                                                                                                  | 7,980,300        | \$36,803        | \$275,172            | \$ (425)                                             | \$ (3,224)                                                | \$308,326                        |
| Comprehensive income:                                                                                                            |                  |                 |                      |                                                      |                                                           |                                  |
| Net income                                                                                                                       |                  |                 | 54,715               |                                                      |                                                           | 54,715                           |
| Unrealized losses on<br>available-for-sale<br>investment securities,<br>net of income tax<br>benefit of \$4,703                  |                  |                 |                      |                                                      | (7,241)                                                   | (7,241)                          |
| Less reclassification<br>adjustment for losses<br>included in net income,<br>net of income tax<br>benefit of \$1,447             |                  |                 |                      |                                                      | 2,230                                                     | 2,230                            |
| Other comprehensive<br>loss                                                                                                      |                  |                 |                      |                                                      |                                                           | (5,011)                          |
| Total comprehensive<br>income                                                                                                    |                  |                 |                      |                                                      |                                                           | 49,704                           |
| Common stock<br>transactions:                                                                                                    |                  |                 |                      |                                                      |                                                           |                                  |
| Common shares retired                                                                                                            | (52,021)         | (3,296)         |                      |                                                      |                                                           | (3,296)                          |
| Common shares issued                                                                                                             | 99,638           | 6,468           |                      |                                                      |                                                           | 6,468                            |
| Restricted shares issued                                                                                                         | 1,500            | 87              |                      | (87)                                                 |                                                           |                                  |
| Restricted shares<br>cancelled                                                                                                   | (1,000)          | (65)            |                      | 65                                                   |                                                           |                                  |
| Stock options exercised,<br>net of 11,311 shares<br>tendered in payment of<br>option price and income<br>tax withholding amounts | 70,516           | 2,770           |                      |                                                      |                                                           | 2,770                            |
| Tax benefit of stock<br>options                                                                                                  |                  | 677             |                      |                                                      |                                                           | 677                              |
| Amortization of<br>restricted stock awards                                                                                       |                  |                 |                      | 242                                                  |                                                           | 242                              |
| Remeasurement of<br>restricted stock awards                                                                                      |                  | 125             |                      | (125)                                                |                                                           |                                  |
| Cash dividends<br>declared:                                                                                                      |                  |                 | (15,044)             |                                                      |                                                           | (15,044)                         |

Common (\$1.88 per share)

|                                                                                                                      |           |         |          |       |         |          |
|----------------------------------------------------------------------------------------------------------------------|-----------|---------|----------|-------|---------|----------|
| Balance at                                                                                                           |           |         |          |       |         |          |
| December 31, 2005                                                                                                    | 8,098,933 | 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:                                                                                           |           |         |          |       |         |          |
| Common shares retired                                                                                                | (128,305) | (9,593) |          |       |         | (9,593)  |
| Common shares issued                                                                                                 | 76,140    | 5,829   |          |       |         | 5,829    |
| Restricted shares issued                                                                                             | 1,000     |         |          |       |         |          |
| Stock options exercised, net of 32,467 shares tendered in payment of option price and income tax withholding amounts | 97,020    | 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) |

-52-

**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)*

|                                                                                                                      | Common<br>Shares | Common    | Retained  | Unearned<br>Compensation<br>-<br>Restricted<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total<br>Stockholders<br>Equity |
|----------------------------------------------------------------------------------------------------------------------|------------------|-----------|-----------|------------------------------------------------------|-----------------------------------------------------------|---------------------------------|
|                                                                                                                      | Outstanding      | Stock     | Earnings  | Stock                                                | (Loss)                                                    | Equity                          |
| Balance at December 31, 2006                                                                                         | 8,144,788        | \$ 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:                                                                                           |                  |           |           |                                                      |                                                           |                                 |
| Common shares retired                                                                                                | (294,760)        | (25,887)  |           |                                                      |                                                           | (25,887)                        |
| Common shares issued                                                                                                 | 17,248           | 1,497     |           |                                                      |                                                           | 1,497                           |
| Stock options exercised, net of 21,309 shares tendered in payment of option price and income tax withholding amounts | 138,765          | 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:                                                                                             |                  |           | (24,255)  |                                                      |                                                           | (24,255)                        |

Common (\$2.97 per  
share)

|                                 |           |           |           |    |            |           |
|---------------------------------|-----------|-----------|-----------|----|------------|-----------|
| Balance at December 31,<br>2007 | 8,006,041 | \$ 29,773 | \$416,425 | \$ | \$ (1,755) | \$444,443 |
|---------------------------------|-----------|-----------|-----------|----|------------|-----------|

*See accompanying notes to consolidated financial statements.*

-53-

---

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

| Year Ended December 31,                                                           | 2007        | 2006        | 2005        |
|-----------------------------------------------------------------------------------|-------------|-------------|-------------|
| Cash flows from operating activities:                                             |             |             |             |
| Net income                                                                        | \$ 68,641   | \$ 75,609   | \$ 54,715   |
| Adjustments to reconcile net income to net cash provided by operating activities: |             |             |             |
| Equity in undistributed earnings of joint ventures                                | (243)       | 176         | (492)       |
| Provisions for loan losses                                                        | 7,750       | 7,761       | 5,847       |
| Depreciation                                                                      | 14,145      | 13,327      | 13,716      |
| Amortization of core deposit intangibles                                          | 174         | 772         | 1,013       |
| Amortization of mortgage servicing rights                                         | 4,441       | 4,024       | 4,614       |
| Net discount accretion on investment securities                                   | (2,393)     | (7,825)     | (541)       |
| Net loss (gain) on sale of investment securities                                  | (59)        | 722         | 3,677       |
| Gain on sale of other real estate owned                                           | (133)       | (12)        | (276)       |
| Gain on sale of mortgage servicing rights                                         | (996)       |             |             |
| Gain on sale of investment in unconsolidated equity method joint venture          |             | (19,801)    |             |
| Loss on disposal of premises and equipment                                        | 286         | 19          | 326         |
| Write-down of other real estate pending sale/disposal                             | 164         | 72          |             |
| Increase (decrease) in valuation reserve for mortgage servicing rights            | 1,702       | 1,694       | (2,187)     |
| Deferred income taxes                                                             | (2,180)     | (5,723)     | 1,882       |
| Increase in cash surrender value of company-owned life insurance                  | (2,371)     | (2,158)     | (1,902)     |
| Stock-based compensation expense                                                  | 1,093       | 1,328       | 280         |
| Excess tax benefits from stock-based compensation                                 | (2,508)     | (1,344)     |             |
| Changes in operating assets and liabilities:                                      |             |             |             |
| Decrease (increase) in loans held for sale                                        | (720)       | (6,293)     | 2,188       |
| Increase in accrued interest receivable                                           | (1,302)     | (4,811)     | (5,535)     |
| Decrease (increase) in other assets                                               | 4,758       | (10,634)    | (2,618)     |
| Increase in accrued interest payable                                              | 2,232       | 5,699       | 3,656       |
| Increase (decrease) in accounts payable and accrued expenses                      | (3,185)     | 9,566       | 11,171      |
| Net cash provided by operating activities                                         | 89,296      | 62,168      | 89,534      |
| Cash flows from investing activities:                                             |             |             |             |
| Purchases of investment securities:                                               |             |             |             |
| Held-to-maturity                                                                  | (17,995)    | (19,589)    | (9,301)     |
| Available-for-sale                                                                | (1,936,961) | (4,644,632) | (1,973,342) |
| Proceeds from maturities, paydowns and calls of investment securities:            |             |             |             |
| Held-to-maturity                                                                  | 15,300      | 10,899      | 6,317       |
| Available-for-sale                                                                | 1,947,408   | 4,507,790   | 1,641,837   |

Edgar Filing: FIRST INTERSTATE BANCSYSTEM INC - Form 10-K

|                                                                                                                |           |           |           |
|----------------------------------------------------------------------------------------------------------------|-----------|-----------|-----------|
| Proceeds from sales of available-for-sale investment securities                                                |           | 49,774    | 170,325   |
| Net decrease (increase) in cash equivalent mutual funds classified as available-for-sale investment securities | 37        | (31)      | 175       |
| Purchases and originations of mortgage servicing rights                                                        | (6,821)   | (6,246)   | (6,919)   |
| Proceeds from sale of mortgage servicing rights                                                                | 2,603     |           |           |
| Extensions of credit to customers, net of repayments                                                           | (254,240) | (275,801) | (305,768) |
| Recoveries of loans charged-off                                                                                | 2,361     | 2,451     | 1,913     |
| Proceeds from sales of other real estate owned                                                                 | 705       | 850       | 2,987     |
| Disposition of banking offices, net of cash and cash equivalents                                               |           | (2,540)   |           |
| Proceeds from sale of unconsolidated equity method joint venture                                               |           | 19,853    |           |
| Capital expenditures, net of sales                                                                             | (17,957)  | (13,109)  | (10,123)  |
| Capital contributions to unconsolidated subsidiaries and joint ventures                                        | (1,857)   |           | (2,800)   |
| Net cash used in investing activities                                                                          | (267,417) | (370,331) | (484,699) |

-54-

**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries  
Consolidated Statements of Cash Flows (continued)***(In thousands)*

| Year Ended December 31,                                                      | 2007       | 2006       | 2005       |
|------------------------------------------------------------------------------|------------|------------|------------|
| Cash flows from financing activities:                                        |            |            |            |
| Net increase in deposits                                                     | \$ 290,890 | \$ 163,991 | \$ 225,909 |
| Net increase (decrease) in federal funds purchased and repurchase agreements | (126,786)  | 211,330    | 70,519     |
| Net increase (decrease) in other borrowed funds                              | 3,036      | (1,801)    | (500)      |
| Borrowings of long-term debt                                                 |            | 4,100      | 15,000     |
| Repayment of long-term debt                                                  | (16,456)   | (37,153)   | (22,272)   |
| Net decrease in debt issuance costs                                          | 98         | 37         | 41         |
| Proceeds from issuance subordinated debentures held by subsidiary trusts     | 61,857     |            |            |
| Proceeds from issuance of common stock                                       | 6,571      | 9,135      | 9,877      |
| Excess tax benefits from stock-based compensation                            | 2,508      | 1,344      |            |
| Purchase and retirement of common stock                                      | (25,887)   | (9,593)    | (3,296)    |
| Dividends paid to stockholders                                               | (24,255)   | (18,413)   | (15,044)   |
| Net cash provided by financing activities                                    | 171,576    | 322,977    | 280,234    |
| Net increase (decrease) in cash and cash equivalents                         | (6,545)    | 14,814     | (114,931)  |
| Cash and cash equivalents at beginning of year                               | 255,791    | 240,977    | 355,908    |
| Cash and cash equivalents at end of year                                     | \$ 249,246 | \$ 255,791 | \$ 240,977 |

*See accompanying notes to consolidated financial statements.*

-55-



**Table of Contents**

**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 subsidiary, provides a full range of banking services to individuals, businesses, municipalities and other entities throughout Montana and Wyoming. 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 subsidiary and technology services through a nonbank subsidiary. The Company is subject to competition from other financial institutions, nonbank financial companies and technology service providers, and is also subject to the regulations of various government agencies and undergoes periodic examinations by those regulatory authorities.

As described in Note 25-Subsequent Events, the Company completed the acquisition of two banks and a related data services company on January 10, 2008. The acquired entities provide a full range of banking services to individuals, businesses, municipalities and other entities in western South Dakota.

**Basis of Presentation.** The Company's consolidated financial statements include the accounts of the Parent Company and its operating subsidiaries: First Interstate Bank ( FIB ); i\_Tech Corporation ( i\_Tech ); FI Reinsurance Ltd.; 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 2006 and 2005 to conform to the 2007 presentation.

**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 ) and FI Capital Trust IV ( Trust IV ), are variable interest entities for which the Company is not a primary beneficiary. Accordingly, the accounts of FIST, Trust I, Trust II, Trust III and Trust IV 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.

**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.

The Company maintained compensating balances of approximately \$30,000 with the Federal Reserve Bank to reduce service charges for check clearing services at December 31, 2007 and 2006.

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

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

**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, and declines in value judged to be other-than-temporary, are included in investment securities gains (losses). 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 noninterest 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 outstanding investor commitments or, in the absence of such commitments, current investor yield requirements. Residential mortgages held for sale were \$26,080 and \$25,360 as of December 31, 2007 and 2006, 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.

**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



**Table of Contents**

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

**Notes to Consolidated Financial Statements**

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

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, 2007 and 2006, all goodwill is attributable to the Company's community banking operating segment. No impairment losses were recognized during 2007, 2006 or 2005.

**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 useful lives of the related deposits of 10 years. Accumulated core deposit intangibles amortization was \$11,735 as of December 31, 2007 and \$11,561 as of December 31, 2006. Amortization expense related to core deposit intangibles recorded as of December 31, 2007 is expected to total \$126, \$83, \$34, \$10 and \$5 in 2008, 2009, 2010, 2011 and 2012, 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.

**Company Owned Life Insurance.** Company owned life insurance policies are recorded at their cash surrender value. Increases in cash surrender value of the policies, as well as insurance proceeds received, are recorded as other noninterest 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 2007, 2006 or 2005.

**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 \$928 and \$529 as of December 31, 2007 and 2006, 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 \$12,746 as of December 31, 2007 and 2006, are included in other assets at par value.

## Table of Contents

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

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

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

**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 2004.

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

**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 debit card processing, item proof and capture, wide area network services and system support.

**Advertising Costs.** Advertising costs are expensed as incurred. Advertising expense was \$2,892, \$2,728 and \$2,675 in 2007, 2006 and 2005, 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.



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

**Stock-Based Compensation.** Effective January 1, 2006, the Company adopted the provisions of Financial Accounting Standards Board ( FASB ) Statement of Financial Accounting Standard ( SFAS ) No. 123 (revised), Share-Based Payment, using the modified prospective method of transition. Under the modified prospective method of transition, compensation expense is recognized for all unvested stock options granted prior to January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 and for all share-based payments awarded after January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123 (revised). Stock-based compensation expense of \$1,093, \$1,328 and \$289 for the years ended December 31, 2007, 2006 and 2005, 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, 2007, 2006 and 2005 were \$418, \$508 and \$111, respectively. In accordance with the modified prospective transition method, prior periods have not been restated to reflect the impact of adopting SFAS No. 123 (revised). Therefore, the results for fiscal 2005 are not directly comparable to 2006 and 2007.

The provisions of SFAS No. 123 (revised) also require that tax benefits resulting from tax deductions in excess of compensation costs recognized for stock options exercised ( excess tax benefits ) be classified as financing cash flows. Prior to the adoption of SFAS No. 123 (revised), these excess tax benefits were classified as operating cash flows. Prior to the adoption of SFAS 123 (revised), the Company accounted for share-based payments to employees using the intrinsic value method under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB 25 ). Under the provisions of APB 25, restricted stock awards were accounted for using variable plan accounting whereby compensation expense or benefit was recorded each period from the date of grant to the measurement date based on the fair value of the Company's common stock at the end of each period. Stock option awards were accounted for using fixed plan accounting whereby the Company recognized no compensation expense for stock option awards because the exercise price of options granted was equal to the fair value of the common stock at the date of grant.

As a result of adopting the provisions of SFAS No. 123 (revised) on January 1, 2006, the Company recognized additional share-based compensation expense of \$879, or \$543 net of income tax benefit, in 2006. This increase in share-based compensation expense resulted in a \$0.07 decrease in both basic and diluted earnings per share in 2006. The following table sets forth pro forma net income and earnings per share for the year ended December 31, 2005, as if the Company had applied the fair value recognition provisions of SFAS No. 123 (revised) to awards granted under the Company's share-based compensation plans prior to the adoption of this standard.

|                                                                                                                           |           |
|---------------------------------------------------------------------------------------------------------------------------|-----------|
| December 31,                                                                                                              | 2005      |
| Net income as reported                                                                                                    | \$ 54,715 |
| Deduct: total share-based employee compensation expense determined under a fair value method for all awards, net of taxes | 439       |
| Pro forma net income                                                                                                      | \$ 54,276 |
| Basic earnings per share, as reported                                                                                     | \$ 6.84   |
| Pro forma basic earnings per share                                                                                        | \$ 6.78   |
| Diluted earnings per share, as reported                                                                                   | \$ 6.71   |
| Pro forma diluted earnings per share                                                                                      | \$ 6.66   |

**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, 2007, 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, 2007 and 2006 are presented in the following table:

|                            | Actual<br>Amount | Ratio | Adequately Capitalized<br>Amount | Ratio | Well Capitalized<br>Amount | Ratio |
|----------------------------|------------------|-------|----------------------------------|-------|----------------------------|-------|
| <i>As of December 31,</i>  |                  |       |                                  |       |                            |       |
| <i>2007:</i>               |                  |       |                                  |       |                            |       |
| Total risk-based capital:  |                  |       |                                  |       |                            |       |
| Consolidated               | \$557,278        | 13.6% | \$326,755                        | 8.0%  | Not Applicable             |       |
| 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   | Not Applicable             |       |
| 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   | Not Applicable             |       |
| FIB                        | 389,921          | 7.6   | 161,586                          | 4.0   | \$242,380                  | 5.0%  |

|                            | Actual<br>Amount | Ratio | Adequately Capitalized<br>Amount | Ratio | Well Capitalized<br>Amount | Ratio |
|----------------------------|------------------|-------|----------------------------------|-------|----------------------------|-------|
| <i>As of December 31,</i>  |                  |       |                                  |       |                            |       |
| <i>2006:</i>               |                  |       |                                  |       |                            |       |
| Total risk-based capital:  |                  |       |                                  |       |                            |       |
| Consolidated               | \$464,821        | 11.9% | \$311,732                        | 8.0%  | Not Applicable             |       |
| FIB                        | 433,298          | 11.2  | 307,914                          | 8.0   | \$387,393                  | 10.0% |
| Tier 1 risk-based capital: |                  |       |                                  |       |                            |       |
| Consolidated               | 417,369          | 10.7  | 155,866                          | 4.0   | Not Applicable             |       |
| FIB                        | 385,846          | 10.0  | 154,957                          | 4.0   | \$232,436                  | 6.0%  |
| Leverage capital ratio:    |                  |       |                                  |       |                            |       |
| Consolidated               | 417,369          | 8.6   | 155,866                          | 4.0   | Not Applicable             |       |



|     |         |     |         |     |           |      |
|-----|---------|-----|---------|-----|-----------|------|
| FIB | 385,846 | 8.0 | 154,957 | 4.0 | \$232,436 | 5.0% |
|-----|---------|-----|---------|-----|-----------|------|

-61-

---

**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:

*Available-for-Sale*

|                                         | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|-----------------------------------------|-------------------|------------------------------|-------------------------------|----------------------------|
| December 31, 2007                       |                   |                              |                               |                            |
| Obligations of U.S. Government agencies | \$ 451,079        | \$1,714                      | \$ (173)                      | \$ 452,620                 |
| Other 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                |

*Held-to-Maturity*

|                                        | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|----------------------------------------|-------------------|------------------------------|-------------------------------|----------------------------|
| December 31, 2007                      |                   |                              |                               |                            |
| 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 sale of available-for-sale securities in 2007. No gross losses were realized on the sale of available-for-sale investment securities in 2007.

*Available-for-Sale*

|                                         | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|-----------------------------------------|-------------------|------------------------------|-------------------------------|----------------------------|
| December 31, 2006                       |                   |                              |                               |                            |
| Obligations of U.S. Government agencies | \$ 567,018        | \$ 14                        | \$ (2,876)                    | \$ 564,156                 |
| Other mortgage-backed securities        | 457,382           | 363                          | (9,283)                       | 448,462                    |
| Mutual funds                            | 40                |                              |                               | 40                         |
| Total                                   | \$1,024,440       | \$377                        | \$(12,159)                    | \$1,012,658                |

*Held-to-Maturity*

|                                        | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|----------------------------------------|-------------------|------------------------------|-------------------------------|----------------------------|
| December 31, 2006                      |                   |                              |                               |                            |
| State, county and municipal securities | \$111,022         | \$852                        | \$(401)                       | \$111,473                  |

|                  |            |        |         |            |
|------------------|------------|--------|---------|------------|
| Other securities | 918        |        |         | 918        |
| Total            | \$ 111,940 | \$ 852 | \$(401) | \$ 112,391 |

Gross gains of \$28 and gross losses of \$750 were realized on the sale of available-for-sale securities in 2006.

-62-

---

**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, 2007 and 2006.

*Available-for-Sale*

|                                         | Less than 12 Months |            | 12 Months or More |            | Total     |            |
|-----------------------------------------|---------------------|------------|-------------------|------------|-----------|------------|
|                                         | Fair                | Gross      | Fair              | Gross      | Fair      | Gross      |
| December 31, 2007                       | Value               | Unrealized | Value             | Unrealized | Value     | Unrealized |
|                                         |                     | Losses     |                   | Losses     |           | Losses     |
| 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*

|                                        | Less than 12 Months |            | 12 Months or More |            | Total    |            |
|----------------------------------------|---------------------|------------|-------------------|------------|----------|------------|
|                                        | Fair                | Gross      | Fair              | Gross      | Fair     | Gross      |
| December 31, 2007                      | Value               | Unrealized | Value             | Unrealized | Value    | Unrealized |
|                                        |                     | Losses     |                   | Losses     |          | Losses     |
| State, county and municipal securities | \$19,206            | \$(187)    | \$21,065          | \$(287)    | \$40,271 | \$(474)    |

*Available-for-Sale*

|                                         | Less than 12 Months |            | 12 Months or More |            | Total     |            |
|-----------------------------------------|---------------------|------------|-------------------|------------|-----------|------------|
|                                         | Fair                | Gross      | Fair              | Gross      | Fair      | Gross      |
| December 31, 2006                       | Value               | Unrealized | Value             | Unrealized | Value     | Unrealized |
|                                         |                     | Losses     |                   | Losses     |           | Losses     |
| Obligations of U.S. Government agencies | \$315,208           | \$(149)    | \$208,937         | \$ (2,727) | \$524,145 | \$ (2,876) |
| Other mortgage-backed securities        | 67,486              | (600)      | 319,137           | (8,683)    | 386,623   | (9,283)    |
| Total                                   | \$382,694           | \$(749)    | \$528,074         | \$(11,410) | \$910,768 | \$(12,159) |

*Held-to-Maturity*

|  | Less than 12 Months |            | 12 Months or More |            | Total |            |
|--|---------------------|------------|-------------------|------------|-------|------------|
|  | Fair                | Gross      | Fair              | Gross      | Fair  | Gross      |
|  |                     | Unrealized |                   | Unrealized |       | Unrealized |

Edgar Filing: FIRST INTERSTATE BANCSYSTEM INC - Form 10-K

| December 31, 2006                      | Value    | Losses  | Value    | Losses  | Value    | Losses  |
|----------------------------------------|----------|---------|----------|---------|----------|---------|
| State, county and municipal securities | \$18,867 | \$(183) | \$10,374 | \$(218) | \$29,241 | \$(401) |

-63-

---

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

The investment portfolio is evaluated quarterly for other-than-temporary declines in the market value of each individual investment security. Consideration is given to the length of time and the extent to which the fair value has been less than 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, 2007 and 2006 related primarily to fluctuations in the current interest rates. As of December 31, 2007, the Company had the intent and ability to hold these investment securities for a period of time sufficient to allow for an anticipated recovery. No impairment losses were recorded during 2007, 2006 or 2005.

Maturities of investment securities at December 31, 2007 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, 2007                     |                    |                         |                   |                         |
| Within one year                       | \$ 282,112         | \$ 281,497              | \$ 11,489         | \$ 11,555               |
| After one but within five years       | 480,955            | 480,492                 | 39,783            | 40,150                  |
| After five years but within ten years | 157,447            | 156,806                 | 18,760            | 18,849                  |
| After ten years                       | 96,149             | 95,482                  | 44,345            | 44,059                  |
| Total                                 | 1,016,663          | 1,014,277               | 114,377           | 114,613                 |
| Mutual funds with no stated maturity  | 3                  | 3                       |                   |                         |
| Total                                 | \$1,016,666        | \$1,014,280             | \$114,377         | \$114,613               |

At December 31, 2007, the Company had investment securities callable within one year with amortized costs and estimated fair values of \$169,743 and \$170,418, respectively. These investment securities are primarily classified as available-for-sale and included in the after one 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, 2007 and 2006, the Company had variable rate securities with amortized costs of \$466 and \$603, respectively.

There are no significant concentrations of investments at December 31, 2007, (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 \$909,241 and \$1,040,274 at December 31, 2007 and 2006, respectively, were pledged to secure public deposits and securities sold under repurchase agreements. The approximate fair value of securities pledged at December 31, 2007 and 2006 was \$907,007 and \$1,028,738, 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.

**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,                       | 2007        | 2006        |
|------------------------------------|-------------|-------------|
| Real estate loans:                 |             |             |
| Residential                        | \$ 419,001  | \$ 402,468  |
| Agricultural                       | 142,256     | 137,659     |
| Commercial                         | 1,018,831   | 937,695     |
| Construction                       | 664,272     | 579,603     |
| Mortgage loans originated for sale | 26,080      | 25,360      |
| Total real estate loans            | 2,270,440   | 2,082,785   |
| Consumer:                          |             |             |
| Indirect consumer loans            | 373,457     | 370,016     |
| Credit card loans                  | 68,136      | 60,569      |
| Other consumer loans               | 166,409     | 175,273     |
| Total consumer loans               | 608,002     | 605,858     |
| Commercial                         | 593,669     | 542,325     |
| Agricultural                       | 81,890      | 76,644      |
| Other loans, including overdrafts  | 4,979       | 2,751       |
| Total loans                        | \$3,558,980 | \$3,310,363 |

At December 31, 2007, the Company had no concentrations of loans which exceeded 10% of total loans other than the categories disclosed above.

Nonaccrual loans were \$31,552 and \$14,764 at December 31, 2007 and 2006, respectively. If interest on nonaccrual loans had been accrued, such income would have approximated \$1,712, \$1,135 and \$1,179 during the years ended December 31, 2007, 2006 and 2005, respectively. Loans contractually past due ninety days or more aggregating \$2,171 on December 31, 2007 and \$1,769 on December 31, 2006 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,                              | 2007                        |                                   | 2006                        |                                   |
|-------------------------------------------|-----------------------------|-----------------------------------|-----------------------------|-----------------------------------|
|                                           | 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 | \$ 7,492                    | \$2,831                           | \$ 3,782                    | \$1,855                           |

Edgar Filing: FIRST INTERSTATE BANCSYSTEM INC - Form 10-K

|                                              |          |         |          |         |
|----------------------------------------------|----------|---------|----------|---------|
| With no specific loan loss reserves assigned | 24,471   |         | 11,002   |         |
| Total impaired loans                         | \$31,963 | \$2,831 | \$14,784 | \$1,855 |
|                                              | -65-     |         |          |         |

---



**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, 2007, 2006 and 2005 was approximately \$22,065, \$15,335 and \$17,841, respectively. If interest on impaired loans had been accrued, interest income on impaired loans during 2007, 2006 and 2005 would have been approximately \$1,728, \$1,162 and \$1,197, respectively. At December 31, 2007, 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 and Wyoming. 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,                             | 2007     | 2006     | 2005     |
|-----------------------------------------------------|----------|----------|----------|
| Balance at beginning of year                        | \$47,452 | \$42,450 | \$42,141 |
| Provision charged to operating expense              | 7,750    | 7,761    | 5,847    |
| Less loans charged-off                              | (5,208)  | (5,210)  | (7,451)  |
| Add back recoveries of loans previously charged-off | 2,361    | 2,451    | 1,913    |
| Balance at end of year                              | \$52,355 | \$47,452 | \$42,450 |

**(6) PREMISES AND EQUIPMENT**

Premises and equipment and related accumulated depreciation are as follows:

| December 31,                  | 2007       | 2006       |
|-------------------------------|------------|------------|
| Land                          | \$ 18,279  | \$ 18,277  |
| Buildings and improvements    | 122,853    | 114,776    |
| Furniture and equipment       | 73,352     | 68,874     |
|                               | 214,484    | 201,927    |
| Less accumulated depreciation | (90,443)   | (81,647)   |
| Premises and equipment, net   | \$ 124,041 | \$ 120,280 |

The Parent Company and a FIB branch office lease premises from an affiliated partnership (see Note 22).

**(7) MORTGAGE SERVICING RIGHTS**

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

| Year ended December 31,                   | 2007     | 2006     | 2005     |
|-------------------------------------------|----------|----------|----------|
| Balance at beginning of year              | \$26,788 | \$24,581 | \$22,292 |
| Sales of mortgage servicing rights        | (1,607)  |          |          |
| Purchases of mortgage servicing rights    | 311      | 1,660    | 1,578    |
| Originations of mortgage servicing rights | 6,510    | 4,586    | 5,341    |
| Amortization expense                      | (4,441)  | (4,024)  | (4,614)  |
| Write-off of permanent impairment         |          | (15)     | (16)     |

Edgar Filing: FIRST INTERSTATE BANCSYSTEM INC - Form 10-K

|                        |          |          |          |
|------------------------|----------|----------|----------|
| Balance at end of year | 27,561   | 26,788   | 24,581   |
| Less valuation reserve | (5,846)  | (4,144)  | (2,465)  |
| Balance at end of year | \$21,715 | \$22,644 | \$22,116 |

-66-

---

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

At December 31, 2007, the estimated fair value and weighted average life of the Company's mortgage servicing rights were \$23,538 and 5.6 years, respectively. The fair value of mortgage servicing rights was determined using discount rates ranging from 9.00% to 21.00% and monthly prepayment speeds ranging from 0.7% to 2.9% depending upon the risk characteristics of the underlying loans. The Company recorded as other expense impairment charges of \$1,702 and \$1,694 in 2007 and 2006, respectively, and impairment reversals of \$2,187 in 2005. Permanent impairment of \$15 and \$16 was charged against the carrying value of mortgage servicing rights in 2006 and 2005, respectively. No permanent impairment was recorded in 2007.

Principal balances of mortgage loans underlying mortgage servicing rights of approximately \$1,938,180 and \$2,045,437 at December 31, 2007 and 2006, 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,                         | 2007     | 2006     |
|--------------------------------------|----------|----------|
| Key executive, principal shareholder | \$ 4,224 | \$ 4,124 |
| Key executive split dollar           | 3,968    | 3,856    |
| Group life                           | 58,884   | 56,725   |
| Total                                | \$67,076 | \$64,705 |

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 \$4,224 and \$4,124 at December 31, 2007 and 2006, respectively.

The Company also has life insurance policies covering selected other key officers. The net cash surrender value of these policies was \$3,968 and \$3,856 at December 31, 2007 and 2006, 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.

The Company has a group life insurance policy covering selected officers of FIB. The net cash surrender value of the policy was \$58,884 and \$56,725 at December 31, 2007 and 2006, 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.

**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)***(9) DEPOSITS**

Deposits are summarized as follows:

| December 31,               | 2007        | 2006        |
|----------------------------|-------------|-------------|
| Noninterest bearing demand | \$ 836,753  | \$ 888,694  |
| Interest bearing:          |             |             |
| Demand                     | 1,019,208   | 964,312     |
| Savings                    | 992,571     | 798,497     |
| Time, \$100 and over       | 464,560     | 408,813     |
| Time, other                | 686,309     | 648,195     |
| Total interest bearing     | 3,162,648   | 2,819,817   |
| Total deposits             | \$3,999,401 | \$3,708,511 |

Maturities of time deposits at December 31, 2007 are as follows:

|            | Time, \$100<br>and Over | Total Time  |
|------------|-------------------------|-------------|
| 2008       | \$407,417               | \$ 934,690  |
| 2009       | 34,433                  | 122,570     |
| 2010       | 10,136                  | 42,119      |
| 2011       | 4,776                   | 17,668      |
| 2012       | 7,798                   | 33,819      |
| Thereafter |                         | 3           |
| Total      | \$464,560               | \$1,150,869 |

Interest expense on time deposits of \$100 or more was \$21,634, \$15,291 and \$10,694 for the years ended December 31, 2007, 2006 and 2005, respectively.

**(10) INCOME TAXES**

Income tax expense consists of the following:

| Year ended December 31, | 2007      | 2006     | 2005     |
|-------------------------|-----------|----------|----------|
| Current:                |           |          |          |
| Federal                 | \$ 34,669 | \$42,014 | \$24,385 |
| State                   | 4,304     | 5,208    | 3,043    |
| Total current           | 38,973    | 47,222   | 27,428   |
| Deferred:               |           |          |          |
| Federal                 | (2,031)   | (5,005)  | 1,698    |

Edgar Filing: FIRST INTERSTATE BANCSYSTEM INC - Form 10-K

|                        |          |          |          |
|------------------------|----------|----------|----------|
| State                  | (149)    | (718)    | 184      |
| Total deferred         | (2,180)  | (5,723)  | 1,882    |
| Balance at end of year | \$36,793 | \$41,499 | \$29,310 |

-68-

---

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

Total income tax expense differs from the amount computed by applying the statutory federal income tax rate of 35 percent in 2007, 2006 and 2005 to income before income taxes as a result of the following:

| Year ended December 31,                             | 2007     | 2006     | 2005     |
|-----------------------------------------------------|----------|----------|----------|
| Tax expense at the statutory tax rate               | \$36,902 | \$40,988 | \$29,409 |
| Increase (decrease) in tax resulting from:          |          |          |          |
| Tax-exempt income                                   | (3,434)  | (2,915)  | (2,651)  |
| State income tax, net of federal income tax benefit | 2,632    | 2,919    | 2,098    |
| Amortization of nondeductible intangibles           | 28       | 28       | 28       |
| Other, net                                          | 665      | 479      | 426      |
| Tax expense at effective tax rate                   | \$36,793 | \$41,499 | \$29,310 |

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,                                                                                                  | 2007      | 2006      |
|---------------------------------------------------------------------------------------------------------------|-----------|-----------|
| Deferred tax assets:                                                                                          |           |           |
| Loans, principally due to allowance for loan losses                                                           | \$ 18,182 | \$ 16,938 |
| Employee benefits                                                                                             | 3,693     | 3,126     |
| Investment securities, unrealized losses                                                                      | 904       | 4,640     |
| Other                                                                                                         | 329       | 556       |
| Deferred tax assets                                                                                           | 23,108    | 25,260    |
| Deferred tax liabilities:                                                                                     |           |           |
| Fixed assets, principally differences in bases and depreciation                                               | (3,127)   | (4,718)   |
| Investment in joint venture partnership, principally due to differences in depreciation of partnership assets | (902)     | (969)     |
| Prepaid amounts                                                                                               | (1,333)   | (958)     |
| Government agency stock dividends                                                                             | (2,051)   | (2,046)   |
| Goodwill and core deposit intangibles                                                                         | (3,214)   | (2,780)   |
| Mortgage servicing rights                                                                                     | (5,156)   | (5,000)   |
| Other                                                                                                         | (584)     | (492)     |
| Deferred tax liabilities                                                                                      | (16,367)  | (16,963)  |
| Net deferred tax assets                                                                                       | \$ 6,741  | \$ 8,297  |

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 receivable of \$1,711 at December 31, 2007 and income taxes payable of \$6,679 at December 31, 2006, which are included in accrued expenses.

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement 109, ( FIN 48 ) effective January 1, 2007. Adoption of FIN 48 did not have a significant impact on the Company's financial statements.

-69-

---

**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,                                                                                                                                            | 2007    | 2006     |
|---------------------------------------------------------------------------------------------------------------------------------------------------------|---------|----------|
| Subsidiaries:                                                                                                                                           |         |          |
| 3.01% note payable to FHLB, principal and interest due monthly through March 5, 2010                                                                    | 3,237   | 4,666    |
| Various notes payable to FHLB, principal and interest due monthly at various rates and maturities (weighted average rate of 2.96% at December 31, 2006) |         | 15,000   |
| 8.00% capital lease obligation with term ending October 25, 2029                                                                                        | 1,908   | 1,935    |
| Total long-term debt                                                                                                                                    | \$5,145 | \$21,601 |

Maturities of long-term debt at December 31, 2007 are as follows:

|            |         |
|------------|---------|
| 2008       | \$1,458 |
| 2009       | 1,460   |
| 2010       | 415     |
| 2011       | 37      |
| 2012       | 40      |
| Thereafter | 1,735   |
| Total      | \$5,145 |

The Company's long-term debt agreements contain various covenants that, among other things, establish minimum capital and financial performance ratios; and, place certain restrictions on capital expenditures, indebtedness, the sale and issuance of common stock, and the amount of dividends payable to shareholders. The Company was in compliance with all such covenants as of December 31, 2007.

The Company has a \$25,000 unsecured revolving term loan with its primary lender. As of December 31, 2007 and 2006, there were no advances on the loan. The revolving facility was terminated on January 10, 2008. See Note 25-Subsequent Events for additional information.

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 \$166,014 subject to collateral availability. As of December 31, 2007 and 2006, FHLB advances totaled \$3,237 and \$19,666, respectively.

The Company has a capital lease obligation on a banking office. The balance of the obligation was \$1,908 and \$1,935 as of December 31, 2007 and 2006, 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.



**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, all of which mature within one year:

| December 31,                                                                                                                                   | 2007     | 2006     |
|------------------------------------------------------------------------------------------------------------------------------------------------|----------|----------|
| Interest bearing demand notes issued to the United States Treasury, secured by investment securities (3.6% interest rate at December 31, 2007) | \$ 8,730 | \$ 5,694 |

The Company has federal funds lines of credit with third parties amounting to \$181,750, subject to funds availability. These lines are subject to cancellation without notice.

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

The Company sponsors five wholly-owned business trusts, FIST, Trust I, Trust II, Trust III and Trust IV (collectively, the Trusts). The Trusts were formed for the exclusive purpose of issuing an aggregate of \$100,000 of 30-year floating rate mandatorily redeemable capital trust preferred securities ( Trust Preferred Securities ) to third-party investors. The Trusts also issued, in aggregate, \$3,095 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, |          |
|---------------------------------------------------------|-------------------|-------------------------------------------------|----------|
|                                                         |                   | 2007                                            | 2006     |
| March 2003                                              | March 26, 2033    | \$ 41,238                                       | \$41,238 |
| October 2007                                            | January 1, 2038   | 10,310                                          |          |
| November 2007                                           | December 15, 2037 | 15,464                                          |          |
| December 2007                                           | December 15, 2037 | 20,619                                          |          |
| December 2007                                           | April 1, 2038     | 15,464                                          |          |
| Total subordinated debentures held by subsidiary trusts |                   | \$ 103,095                                      | \$41,238 |

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, 2007 and 2006, interest rate on the Subordinated Debentures was 8.01% and 8.52%, respectively.

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, 2007, the interest rate on the Subordinated Debentures was 7.21%.

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.

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, 2007, the interest rate on the Subordinated Debentures was 7.64%.

-71-

---

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

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

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.

In January 2008, the Company formed two additional business trusts for the exclusive purpose of issuing Trust Preferred Securities and using the proceeds to purchase Subordinated Debentures issued by the Parent Company. See Note 25 Subsequent Events for additional information.

**(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 (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.

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, 2007, there were 585,524 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 \$996, \$935 and \$47 was included in salaries, wages and benefits expense on the Company's consolidated income statements for the years ended December 31, 2007, 2006 and 2005, respectively.

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

The weighted average grant date fair value of options granted was \$7.89, \$5.95 and \$6.03 during the years ended December 31, 2007, 2006 and 2005, 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,            | 2007  | 2006  | 2005  |
|-------------------------------------|-------|-------|-------|
| Expected volatility                 | 5.23% | 5.87% | 8.40% |
| Expected dividend yield             | 2.95% | 3.01% | 3.05% |
| Risk-free interest rate             | 4.80% | 4.51% | 4.19% |
| Expected life of options (in years) | 6.2   | 6.2   | 8.5   |

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 in 2007 and 2006 and the contractual option term in 2005.

The following table summarizes stock option activity under the Company's active stock option plans for the year ended December 31, 2007:

|                                              | Number of<br>Shares | Weighted-Average<br>Exercise Price | Weighted-Average<br>Remaining<br>Contract Life |
|----------------------------------------------|---------------------|------------------------------------|------------------------------------------------|
| Outstanding options, beginning of year       | 840,199             | \$ 50.00                           |                                                |
| Granted                                      | 153,343             | 83.16                              |                                                |
| Exercised                                    | (160,074)           | 43.31                              |                                                |
| Forfeited                                    | (3,412)             | 72.52                              |                                                |
| Expired                                      | (187)               | 76.68                              |                                                |
| Outstanding options, end of year             | 829,869             | \$ 57.33                           | 5.98 years                                     |
| Outstanding options exercisable, end of year | 633,326             | \$ 52.10                           | 5.21 years                                     |

The total intrinsic value of fully-vested stock options outstanding as of December 31, 2007 was \$22,594. The total intrinsic value of options exercised was \$6,631, \$3,630 and \$1,752 during the years ended December 31, 2007, 2006 and 2005, respectively. The actual tax benefit realized for the tax deduction from option exercises totaled \$2,536, \$1,368 and \$677 for the years ended December 31, 2007, 2006 and 2005, respectively. Cash received from stock option exercises during the years ended December 31, 2007, 2006 and 2005 was \$5,074, \$3,306 and \$2,770, respectively.

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

Information with respect to the Company's nonvested stock options as of and for the year ended December 31, 2007 follows:

|                                            | Number of<br>Shares | Weighted-Average<br>Grant Date Fair<br>Value |
|--------------------------------------------|---------------------|----------------------------------------------|
| Nonvested stock options, beginning of year | 180,399             | \$ 5.76                                      |
| Granted                                    | 107,281             | 7.89                                         |
| Vested                                     | (87,725)            | 6.40                                         |
| Forfeited                                  | (3,412)             | 6.87                                         |
| Nonvested stock options, end of year       | 196,543             | \$ 6.97                                      |

As of December 31, 2007, there was \$796 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 0.8 years. The total fair value of shares vested during 2007 was \$854.

**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.

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 \$97, \$393 and \$242 was included in salaries, wages and benefits expense on the Company's consolidated statements of income for the years ended December 31, 2007, 2006 and 2005, respectively.

The following table presents information regarding the Company's restricted stock as of December 31, 2007:

|                                     | Number of<br>Shares | Weighted-Average<br>Measurement<br>Date<br>Fair Value |
|-------------------------------------|---------------------|-------------------------------------------------------|
| Restricted stock, beginning of year | 11,500              | \$ 68.57                                              |
| Vested                              | (9,500)             | 82.50                                                 |
| Restricted stock, end of year       | 2,000               | \$ 65.00                                              |

As of December 31, 2007, there was \$52 of unrecognized compensation cost related to nonvested restricted stock awards expected to be recognized over a weighted-average period of 1.7 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 \$2,816, \$3,097 and \$2,048 in 2007, 2006 and 2005, respectively.

-74-

---

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

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

**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 \$3,243, \$2,947 and \$2,736 in 2007, 2006 and 2005, 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. Prior to May 2005, contributions by retired Plan participants were based solely on the average per capita cost of benefit coverage for retired participants only. As such, no postretirement benefit obligation existed prior to 2005.

As of December 31, 2007, the Company adopted the recognition provisions of SFAS No. 158, Employers' Accounting for Defined Benefits Pension and Other Postretirement Plans-and amendment of FASB Statements No. 87, 88, 106 and 132(R). The effect of the adoption of SFAS No. 158 on individual consolidated balance sheet line items at December 31, 2007 was not significant. The Plan's unfunded benefit obligation of \$926 and \$836 at December 31, 2007 and 2006, respectively, is included in accounts payable and accrued expenses in the Company's consolidated balance sheets. Net periodic benefit costs of \$130 and \$174 for the years ended December 31, 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, 2007 and 2006, 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 \$91, \$94, \$102, \$97, \$85 and \$366 for 2008, 2009, 2010, 2011, 2012, and 2013 through 2017, respectively.

At December 31, 2007, the Company had accumulated other comprehensive loss related to the adoption of SFAS No. 158 of \$439, or \$274 net of related income tax benefit, comprised of net actuarial gains of \$309 and unamortized transition asset of \$748. The Company estimates \$40 will be amortized from accumulated other comprehensive loss into net period benefit costs in 2008.

**(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 \$1,713 and \$2,084 as of December 31, 2007 and 2006, respectively.

The Company leases certain premises and equipment from third parties under operating leases. Total rental expense to third parties was \$3,224 in 2007, \$3,166 in 2006 and \$3,358 in 2005.

**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 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, 2007, are as follows:

|                                  | Third<br>Parties | Related<br>Partnership<br>(See Note 22) | Total    |
|----------------------------------|------------------|-----------------------------------------|----------|
| For the year ending December 31: |                  |                                         |          |
| 2008                             | \$ 2,115         | \$ 1,989                                | \$ 4,104 |
| 2009                             | 2,118            | 1,906                                   | 4,024    |
| 2010                             | 1,787            | 1,726                                   | 3,513    |
| 2011                             | 1,629            | 1,649                                   | 3,278    |
| 2012                             | 1,276            | 1,538                                   | 2,814    |
| Thereafter                       | 7,825            | 3,997                                   | 11,822   |
| Total                            | \$16,750         | \$ 12,805                               | \$29,555 |

**(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 existing and new 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. Commitments to extend credit to existing and new borrowers approximated \$1,027,710 at December 31, 2006, which included \$297,481 on unused credit card lines and \$270,624 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, 2007 and 2006, the Company had outstanding stand-by letters of credit of \$105,667 and \$93,046, respectively. The estimated fair value of the obligation undertaken by the Company in issuing standby letters of credit is included in other liabilities in the Company's consolidated balance sheets.

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



At December 31, 2007, 90.6% of common shares held by shareholders are 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 by officers, directors and employees are subject to repurchase under certain conditions.

-76-

---

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

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.

**(18) EARNINGS PER SHARE**

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

| For the year ended December 31,      | 2007      | 2006      | 2005      |
|--------------------------------------|-----------|-----------|-----------|
| Net income basic and diluted         | \$ 68,641 | \$ 75,609 | \$ 54,715 |
| Average outstanding shares basic     | 8,126,804 | 8,112,610 | 8,001,682 |
| Add effect of dilutive stock options | 195,676   | 191,380   | 147,655   |
| Average outstanding shares diluted   | 8,322,480 | 8,303,990 | 8,149,337 |
| Basic earnings per share             | \$ 8.45   | \$ 9.32   | \$ 6.84   |
| Diluted earnings per share           | \$ 8.25   | \$ 9.11   | \$ 6.71   |

The Company had 137,092 and 10,732 stock options outstanding that were antidilutive as of December 31, 2007 and 2006, respectively. There were no outstanding stock options that were antidilutive for the year ended December 31, 2005.

**(19) ACQUISITIONS AND DISPOSITIONS**

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.

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. Indemnity Escrow funds in excess of claims will be recognized as income when the Company becomes entitled to them, with final distribution of remaining Indemnity Escrow funds to occur no later than March 7, 2008. As of December 31, 2007, no loss claims had been received.

On September 18, 2007, the Company entered into an agreement to purchase all of the outstanding stock of two banks and a related data services company. The acquisition was completed in January 2008. See Note 25 Subsequent Events for additional information.



**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)***(20) CONDENSED FINANCIAL INFORMATION (PARENT COMPANY ONLY)**

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

| December 31,                                               | 2007      | 2006      |          |
|------------------------------------------------------------|-----------|-----------|----------|
| <i>Condensed balance sheets:</i>                           |           |           |          |
| Cash and cash equivalents                                  | \$ 8,443  | \$ 29,305 |          |
| Investment securities available-for-sale                   | 99,977    |           |          |
| Investment in subsidiaries, at equity:                     |           |           |          |
| Bank subsidiary                                            | 424,108   | 417,528   |          |
| Nonbank subsidiaries                                       | 8,454     | 7,779     |          |
| Total investment in subsidiaries                           | 432,562   | 425,307   |          |
| Premises and equipment                                     | 1,765     | 1,991     |          |
| Other assets                                               | 20,400    | 18,423    |          |
| Total assets                                               | \$563,147 | \$475,026 |          |
| Other liabilities                                          | \$ 8,923  | \$ 17,256 |          |
| Advances from nonbank subsidiaries, net                    | 6,686     | 6,157     |          |
| Long-term debt                                             |           |           |          |
| Subordinated debentures held by subsidiary trusts          | 103,095   | 41,238    |          |
| Total liabilities                                          | 118,704   | 64,651    |          |
| Stockholders' equity                                       | 444,443   | 410,375   |          |
| Total liabilities and stockholders' equity                 | \$563,147 | \$475,026 |          |
| Years Ended December 31,                                   | 2007      | 2006      | 2005     |
| <i>Condensed statements of income:</i>                     |           |           |          |
| Dividends from subsidiaries                                | \$74,548  | \$28,866  | \$27,550 |
| Other interest income                                      | 71        | 172       | 35       |
| Other income, primarily management fees from subsidiaries  | 9,625     | 8,155     | 6,380    |
| Gain on sale of unconsolidated equity method joint venture |           | 19,801    |          |
| Total income                                               | 84,244    | 56,994    | 33,965   |
| Salaries and benefits                                      | 10,687    | 10,052    | 7,580    |
| Interest expense                                           | 4,588     | 4,031     | 3,673    |
| Other operating expenses, net                              | 6,475     | 6,399     | 6,134    |
| Total expenses                                             | 21,750    | 20,482    | 17,387   |

Edgar Filing: FIRST INTERSTATE BANCSYSTEM INC - Form 10-K

|                                                      |          |          |          |
|------------------------------------------------------|----------|----------|----------|
| Earnings before income tax benefit                   | 62,494   | 36,512   | 16,578   |
| Income tax expense (benefit)                         | (4,812)  | 2,522    | (4,192)  |
| Income before undistributed earnings of subsidiaries | 67,306   | 33,990   | 20,770   |
| Undistributed earnings of subsidiaries               | 1,335    | 41,619   | 33,945   |
| Net income                                           | \$68,641 | \$75,609 | \$54,715 |

-78-

---

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

| Years Ended December 31,                                                      | 2007      | 2006      | 2005      |
|-------------------------------------------------------------------------------|-----------|-----------|-----------|
| <i>Condensed statements of cash flows:</i>                                    |           |           |           |
| Cash flows from operating activities:                                         |           |           |           |
| Net income                                                                    | \$ 68,641 | \$ 75,609 | \$ 54,715 |
| Adjustments to reconcile net income to cash provided by operating activities: |           |           |           |
| Undistributed earnings of subsidiaries                                        | (1,335)   | (41,619)  | (33,945)  |
| Depreciation and amortization                                                 | 227       | 245       | 242       |
| Provision for deferred income taxes                                           | (539)     | (59)      | 220       |
| Stock-based compensation expense                                              | 1,093     | 1,239     | 234       |
| Excess tax benefits from stock-based compensation                             | (2,485)   | (1,344)   |           |
| Gain on sale of unconsolidated equity method joint venture                    |           | (19,801)  |           |
| Other, net                                                                    | (8,286)   | 7,102     | (1,212)   |
| Net cash provided by operating activities                                     | 57,316    | 21,372    | 20,254    |
| Cash flows from investing activities:                                         |           |           |           |
| Purchases of available-for-sale investment securities                         | (99,931)  |           |           |
| Capital expenditures, net of sales                                            | (47)      | (8)       |           |
| Capitalization of subsidiaries                                                | (2,117)   | (400)     | (180)     |
| Disposition of unconsolidated equity method joint venture                     |           | 19,853    |           |
| Net cash provided by (used in) investing activities                           | (102,095) | 19,445    | (180)     |
| Cash flows from financing activities:                                         |           |           |           |
| Net increase (decrease) in advances from nonbank subsidiaries                 | 529       | 2,219     | (312)     |
| Borrowings of long-term debt                                                  |           | 4,100     | 11,500    |
| Repayments of long-term debt                                                  |           | (8,700)   | (17,320)  |
| Proceeds from issuance subordinated debentures                                | 61,857    |           |           |
| Debt issuance costs, net                                                      | 98        | 37        | 41        |
| Excess tax benefits from stock-based compensation                             | 2,485     | 1,344     |           |
| Dividends paid on common stock                                                | (24,255)  | (18,413)  | (15,044)  |
| Payments to retire common stock                                               | (25,887)  | (9,593)   | (3,296)   |
| Proceeds from issuance of common stock                                        | 9,090     | 10,503    | 9,877     |
| Net cash provided by (used in) financing activities                           | 23,917    | (18,503)  | (14,554)  |
| Net change in cash and cash equivalents                                       | (20,862)  | 22,314    | 5,520     |
| Cash and cash equivalents, beginning of year                                  | 29,305    | 6,991     | 1,471     |
| Cash and cash equivalents, end of year                                        | \$ 8,443  | \$ 29,305 | \$ 6,991  |

*Noncash Investing and Financing Activities* During 2005, the Company transferred \$9 from accrued liabilities to common stock in conjunction with exercise of stock options. There were no noncash investing or financing activities

in 2007 or 2006.

**(21) SUPPLEMENTAL DISCLOSURES TO THE CONSOLIDATED STATEMENTS OF CASH FLOWS**

The Company paid cash of \$45,233, \$42,984 and \$23,079 for income taxes during 2007, 2006 and 2005, respectively. The Company paid cash of \$123,722, \$100,273 and \$59,893 for interest during 2007, 2006 and 2005, respectively.

The Company transferred loans of \$1,135, \$348 and \$1,284 to other real estate owned in 2007, 2006 and 2005, respectively.

-79-

---

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

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

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.

During 2005, the Company transferred accrued liabilities of \$9 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.

**(22) 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 \$24,974 at December 31, 2007 and \$22,183 at December 31, 2006. During 2007, new loans and advances on existing loans of \$28,204, were funded and loan repayments totaled \$25,713. 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 2007, loans of \$300 were added due to changes in related parties from the prior year.

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. Total rent, including common area maintenance, paid to the partnership was \$1,911 in 2007, \$1,829 in 2006 and \$1,776 in 2005.

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 \$340, \$357, and \$349 in 2007, 2006 and 2005, respectively.

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 \$325, \$246 and \$228 in 2007, 2006 and 2005, respectively. In addition to paying the third-party operating expenses, the Company paid \$168, \$68 and \$36 for use of the aircraft and received reimbursement of \$161, \$77 and \$32 from the chairman for his personal use of the aircraft during 2007, 2006 and 2005, 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 \$384, \$336 and \$365 in 2007, 2006 and 2005, respectively. Services provided for the Company's benefit include majority shareholder education and communication, strategic enterprise planning and corporate governance consultation.

-80-



**Table of Contents**

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

**Notes to Consolidated Financial Statements**

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

**(23) FAIR VALUE OF FINANCIAL INSTRUMENTS**

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the entire holdings of a particular instrument. Because no quoted market exists for a significant portion of the financial instruments, fair value estimates are based on judgments regarding comparable market interest rates, future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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. The methods and significant assumptions used to estimate fair values for the various other financial instruments are set forth below.

**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 available-for-sale and 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. Fair values of mortgage servicing rights are based on a discounted cash flow pricing model using prevailing financial market information.

**Financial Liabilities.** The fair values of demand deposits, savings accounts, 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 loan, floating rate subordinated debentures, and unsecured demand notes bear interest at floating market rates and, as such, carrying amounts are deemed to reflect fair values. The fair values of notes payable to the FHLB, fixed rate subordinated debentures and capital lease obligations are estimated by discounting future cash flows using current rates for advances with similar characteristics.

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

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

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

| As of December 31,                                | 2007            |                      | 2006            |                      |
|---------------------------------------------------|-----------------|----------------------|-----------------|----------------------|
|                                                   | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| Financial assets:                                 |                 |                      |                 |                      |
| Cash and cash equivalents                         | \$ 249,246      | \$ 249,246           | \$ 255,791      | \$ 255,791           |
| Investment securities available-for-sale          | 1,014,280       | 1,014,280            | 1,012,658       | 1,012,658            |
| Investment securities held-to-maturity            | 114,377         | 114,613              | 111,940         | 112,391              |
| Net loans                                         | 3,506,625       | 3,489,199            | 3,262,911       | 3,221,291            |
| Accrued interest receivable                       | 32,215          | 32,215               | 30,913          | 30,913               |
| Mortgage servicing rights, net                    | 21,715          | 23,538               | 22,644          | 23,378               |
| Total financial assets                            | \$4,938,458     | \$4,923,091          | \$4,696,857     | \$4,656,422          |
| Financial liabilities:                            |                 |                      |                 |                      |
| Total deposits, excluding time deposits           | \$2,848,532     | \$2,848,532          | \$2,651,503     | \$2,651,503          |
| Time deposits                                     | 1,150,869       | 1,151,572            | 1,057,008       | 1,052,256            |
| Securities sold under repurchase agreements       | 604,762         | 604,762              | 731,548         | 731,548              |
| Accrued interest payable                          | 21,104          | 21,104               | 18,872          | 18,872               |
| Other borrowed funds                              | 8,730           | 8,730                | 5,694           | 5,694                |
| Long-term debt                                    | 5,145           | 5,470                | 21,601          | 22,177               |
| Subordinated debentures held by subsidiary trusts | 104,410         | 103,095              | 41,238          | 41,238               |
| Total financial liabilities                       | \$4,743,552     | \$4,743,265          | \$4,527,464     | \$4,523,288          |

**Table of Contents****First Interstate BancSystem, Inc. and Subsidiaries****Notes to Consolidated Financial Statements***(Dollars in thousands, except share and per share data)***(24) SEGMENT REPORTING**

Selected operating segment information as of and for the years ended December 31, 2007, 2006 and 2005 follows.

The Other category includes the net funding cost and other expenses of the Parent Company, the operational results of consolidated nonbank subsidiaries (except Technology Services) and intercompany eliminations.

| For the year ended December 31, 2007                             | Community<br>Banking | Technology<br>Services | Other      | Total       |
|------------------------------------------------------------------|----------------------|------------------------|------------|-------------|
| Net interest income (expense)                                    | \$ 202,653           | \$ 190                 | \$ (3,240) | \$ 199,603  |
| Provision for loan losses                                        | 7,750                |                        |            | 7,750       |
| Net interest income after provision                              | 194,903              | 190                    | (3,240)    | 191,853     |
| Noninterest income:                                              |                      |                        |            |             |
| External sources                                                 | 72,681               | 19,080                 | 687        | 92,448      |
| Internal sources                                                 | 1                    | 12,675                 | (12,676)   |             |
| Total noninterest income                                         | 72,682               | 31,755                 | (11,989)   | 92,448      |
| Noninterest expense                                              | 157,199              | 25,805                 | (4,137)    | 178,867     |
| Income (loss) before taxes                                       | 110,386              | 6,140                  | (11,092)   | 105,434     |
| Income tax expense (benefit)                                     | 39,142               | 2,434                  | (4,783)    | 36,793      |
| Net income (loss)                                                | \$ 71,244            | \$ 3,706               | \$ (6,309) | \$ 68,641   |
| Depreciation and core deposit intangibles<br>amortization (1)    | \$ 14,092            | \$                     | \$ 227     | \$ 14,319   |
| Total assets as of December 31, 2007                             | \$5,091,252          | \$ 7,120               | \$118,425  | \$5,216,797 |
| Investment in equity method investees as of<br>December 31, 2007 | \$ 5,772             | \$                     | \$         | \$ 5,772    |

**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      | Total       |
|------------------------------------------------------------------|----------------------|------------------------|------------|-------------|
| Net interest income (expense)                                    | \$ 191,073           | \$ 162                 | \$ (3,772) | \$ 187,463  |
| Provision for loan losses                                        | 7,761                |                        |            | 7,761       |
| Net interest income after provision                              | 183,312              | 162                    | (3,772)    | 179,702     |
| Noninterest income:                                              |                      |                        |            |             |
| External sources                                                 | 65,341               | 15,845                 | 20,933     | 102,119     |
| Internal sources                                                 | 1                    | 13,535                 | (13,536)   |             |
| Total noninterest income                                         | 65,342               | 29,380                 | 7,397      | 102,119     |
| Noninterest expense                                              | 145,504              | 23,317                 | (4,108)    | 164,713     |
| Income before taxes                                              | 103,150              | 6,225                  | 7,733      | 117,108     |
| Income tax expense                                               | 36,459               | 2,464                  | 2,576      | 41,499      |
| Net income                                                       | \$ 66,691            | \$ 3,761               | \$ 5,157   | \$ 75,609   |
| Depreciation and core deposit intangibles<br>amortization (1)    | \$ 13,853            | \$                     | \$ 246     | \$ 14,099   |
| Total assets as of December 31, 2006                             | \$4,949,955          | \$ 7,141               | \$ 17,038  | \$4,974,134 |
| Investment in equity method investees as of<br>December 31, 2006 | \$ 5,439             | \$                     | \$         | \$ 5,439    |
| For the year ended December 31, 2005                             | Community<br>Banking | Technology<br>Services | Other      | Total       |
| Net interest income (expense)                                    | \$ 173,777           | \$ 101                 | \$ (3,570) | \$ 170,308  |
| Provision for loan losses                                        | 5,847                |                        |            | 5,847       |
| Net interest income after provision                              | 167,930              | 101                    | (3,570)    | 164,461     |
| Noninterest income:                                              |                      |                        |            |             |
| External sources                                                 | 56,856               | 13,304                 | 722        | 70,882      |
| Internal sources                                                 | 2                    | 13,910                 | (13,912)   |             |
| Total noninterest income                                         | 56,858               | 27,214                 | (13,190)   | 70,882      |
| Noninterest expense                                              | 136,312              | 20,371                 | (5,365)    | 151,318     |

|                                                               |             |          |            |             |
|---------------------------------------------------------------|-------------|----------|------------|-------------|
| Income (loss) before taxes                                    | 88,476      | 6,944    | (11,395)   | 84,025      |
| Income tax expense (benefit)                                  | 30,726      | 2,751    | (4,167)    | 29,310      |
| Net income (loss)                                             | \$ 57,750   | \$ 4,193 | \$ (7,228) | \$ 54,715   |
| Depreciation and core deposit intangibles amortization (1)    | \$ 14,487   | \$       | \$ 242     | \$ 14,729   |
| Total assets as of December 31, 2005                          | \$4,540,307 | \$ 5,293 | \$ 16,713  | \$4,562,313 |
| Investment in equity method investees as of December 31, 2005 | \$ 5,457    | \$       | \$ 500     | \$ 5,957    |

(1) The Technology Services line of business does not record depreciation or amortization expense as it leases all equipment from the Community Banking line of business.

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

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

**(25) SUBSEQUENT EVENTS**

On January 10, 2008, the Company completed the acquisition of all of the outstanding stock of The First Western Bank Sturgis, Sturgis, South Dakota, First Western Bank, Wall, South Dakota, and First Western Data, Inc., a South Dakota corporation, from Christen Group, Inc., formerly known as First Western Bancorp, Inc. As of the acquisition date, the historical carrying values of total assets, total loans and total deposits acquired were \$908,241, \$728,777 and \$809,990, respectively. Consideration for the acquisition of \$248,081, consisted of cash of \$198,081 and 5,000 shares of newly issued 6.75% Series A noncumulative redeemable preferred stock ( Series A Preferred Stock ) with an aggregate value of \$50,000.

The Series A Preferred Stock was sold to the Christen Group, Inc., 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. 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.

Funding of the cash portion of the purchase price was partially accomplished through debt financing as follows:

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 ). 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 at an initial rate of 7.25%. Under the terms of the Credit Agreement, the Company also borrowed \$9,000 on a \$25,000 revolving credit facility maturing on January 10, 2011 with interest payable quarterly at an initial rate of 7.25%.

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.

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.

On January 8, 2008, the Company issued an aggregate of \$20,000 of Trust Preferred Securities through two wholly-owned, deconsolidated business trusts, FI Statutory Trust V ( Trust V ) and FI Statutory Trust VI ( Trust VI ). Trust V and Trust VI were formed for the exclusive purpose of issuing Trust Preferred Securities to third-party investors and using the proceeds to purchase Subordinated Debentures issued by the Parent Company. The Company issued to Trust V \$10,310 of Subordinated Debentures bearing 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. The Company issued to Trust VI \$10,310 of Subordinated Debentures bearing a variable interest rate equal to LIBOR plus 2.75% per annum, or 7.40% on the date of issue. The Subordinated Debentures mature April 1, 2038, but may be redeemed, subject to approval by the Federal Reserve Bank, at the Company's option on or after April 1, 2013, or at any time in the event of unfavorable changes in laws or regulations.

-85-

---

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

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

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.

During 2007, the Company completed a series of four financings involving the sale of Trust Preferred Securities to third party investors and the issuance of Subordinated Debentures to wholly-owned business trusts. Proceeds from these transactions were used to fund a portion of the acquisition price. See Note 12 Subordinated Debentures Held by Subsidiary Trusts for information regarding these issuances.

**(26) RECENT ACCOUNTING PRONOUNCEMENTS**

**Statements of Financial Accounting Standards.** In December 2007, FASB issued SFAS No. 141 (revised 2007) ( SFAS No. 141(R) ). SFAS No. 141(R) replaces SFAS 141, Business Combinations, and applies to all transactions and other events in which one entity obtains control over one or more other businesses. SFAS 141(R) requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under SFAS 141 whereby the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their estimated fair value. SFAS 141(R) requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS 141. Under SFAS 141(R), the requirements of SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities, would have to be met in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of SFAS 5, Accounting for Contingencies. SFAS 141(R) is expected to have a significant impact on the Company's accounting for business combinations closing on or after January 1, 2009.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140, requiring entities to evaluate and identify whether interests in securitized financial assets are freestanding derivatives, hybrid financial instruments that contain an embedded derivative requiring bifurcation, or hybrid financial instruments that contain embedded derivatives that do not require bifurcation. Adoption of SFAS No. 155 on January 1, 2007, did not impact the consolidated financial statements, results of operations or liquidity of the Company.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140, requiring the separate recognition of servicing assets or liabilities. Under SFAS No. 156, all separately recognized servicing assets or liabilities are initially measured at fair value with subsequent measurements of each class of separately recognized servicing assets and liabilities using either the amortization method or a fair value measurement method. The Company elected to continue to follow the amortization method for subsequent measurement of servicing assets. Adoption of SFAS No. 156 on January 1, 2007, did not impact the consolidated financial statements, results of operations or liquidity of the Company.



In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but applies under other existing accounting pronouncements that require or permit fair value measurements. SFAS No. 157 is effective for the Company on January 1, 2008 with earlier adoption permitted. The Company does not expect adoption to have a significant impact on its consolidated financial statements, results of operations or liquidity.

-86-

---

## **Table of Contents**

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

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

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

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*—an amendment of FASB Statements No. 87, 88, 106 and 132(R). SFAS No. 158 requires employers to recognize the overfunded or underfunded status of defined benefit postretirement benefit plans as an asset or a liability in the statement of financial position. The funded status is measured as the difference between plan assets at fair value and the benefit obligation (the projected benefit obligation for pension plans or the accumulated benefit obligation for other postretirement benefit plans). An employer is also required to measure the funded status of a plan as of the date of its year-end statement of financial position with changes in the funded status recognized through comprehensive income. SFAS 158 also requires certain disclosures regarding the effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of gains or losses, prior service costs or credits, and the transition asset or obligation. Adoption of the recognition provisions of SFAS No. 158 in December 31, 2007 did not have a significant impact on the Company's consolidated financial statements, results of operations or liquidity. See Note 14—Employee Benefit Plans for additional information regarding the Company's defined benefit postretirement benefit plan. The requirement to measure plan assets and benefit obligations as of the date of the year-end statement of financial position is effective for the Company's financial statements beginning December 31, 2009. The Company currently measures its defined benefit postretirement benefit plan assets and obligations as of its fiscal year end.

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, permitting entities to choose to measure certain financial instruments and certain other items at fair value to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently. Unrealized gains and losses on instruments measured at fair value are recognized in earnings at each reporting date. SFAS No. 159 is effective for the Company on January 1, 2008. The adoption of SFAS No. 159 will not have a significant 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 No. 51, establishing accounting and reporting standards for a noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a non-controlling interest in a subsidiary, which is sometimes referred to as minority interest, is an ownership interest in the consolidated entity that should be reported as a component of equity in the consolidated financial statements. Among other requirements, SFAS 160 requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated income statement, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. SFAS No. 160 is effective for the Company on January 1, 2009, with earlier adoption prohibited. The Company does not expect adoption of SFAS No. 160 to have a significant impact on its consolidated financial statements, results of operations or liquidity.

**Financial Accounting Standards Board Staff Positions and Interpretations.** In June 2006, the FASB issued FIN 48. Under FIN 48, 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 shall initially and subsequently be measured as the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with the tax authority assuming full knowledge of the position and all relevant facts. The adoption of FIN 48 on January 1, 2007 did not significantly impact the Company's consolidated financial statements, results of operations or liquidity.

In May, 2007, the FASB issued FASB Staff Position No. 48-1, *Definition of Settlement in FASB Interpretation No. 48* (FSP 48-1). FSP 48-1 provides guidance on how to determine whether a tax position is effectively settled

for the purpose of recognizing previously unrecognized tax benefits. FSP 48-1 was effective retroactively to January 1, 2007 and did not significantly impact the Company's consolidated financial statements, results of operations or liquidity.

**Emerging Issues Task Force.** In September 2006, the Emerging Issues Task Force ( 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

-87-

---

**Table of Contents**

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

**Notes to Consolidated Financial Statements**

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

liability and related compensation expense for endorsement split-dollar life insurance policies that provide a benefit to an employee that extends to postretirement periods. Under EITF 06-4, life insurance policies purchased for the purpose of providing such benefits do not effectively settle an entity's obligation to the employee. Accordingly, the entity must recognize a liability and related compensation expense during the employee's active service period based on the future cost of insurance to be incurred during the employee's retirement. If the entity has agreed to provide the employee with a death benefit, then the liability for the future death benefit should be recognized by following the guidance in SFAS 106, *Employer's Accounting for Postretirement Benefits Other Than Pensions*. The provisions of EITF 06-4 are effective for the Company on January 1, 2008, and will be applied as a change in accounting principle through a cumulative-effect adjustment to retained earnings. The amount of the cumulative-effect adjustment to retained earnings is not expected to be significant.

In September 2006, the EITF reached a final consensus on Issue No. 06-5 ( EITF 06-5 ), *Accounting for Purchase of Life Insurance Determining the Amount That Could be Realized in Accordance with FASB Technical Bulletin No. 85-4*, requiring that the cash surrender value and any amounts provided by the contractual terms of an insurance policy that are realizable at the balance sheet date be considered in determining the amount that could be realized under Technical Bulletin No. 85-4. The adoption of EITF 06-5 on January 1, 2007 did not impact the Company's consolidated financial statements, results of operations or liquidity.

In March 2007, the EITF reached a final consensus on Issue No. 06-10 ( EITF 06-10 ), *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements*. EITF 06-10 requires employers to recognize a liability for the post-retirement benefit related to collateral assignment split-dollar life insurance arrangements in accordance with SFAS No. 106 or APB Opinion No. 12. EITF 06-10 also requires employers to recognize and measure an asset based on the nature and substance of the collateral assignment split-dollar life insurance arrangement. The provisions of EITF 06-10 are effective for the Company on January 1, 2008, and are to be applied as a change in accounting principle either through a cumulative-effect adjustment to retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption; or as a change in accounting principle through retrospective application to all prior periods. Adoption of EITF 06-10 on January 1, 2008, will not impact the Company's consolidated financial statements, results of operations or liquidity.

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 to be applied prospectively to the income tax benefits resulting from dividends declared in fiscal years beginning after December 15, 2007. The Company does not expect adoption of EITF 06-11 to have a significant impact on its consolidated financial statements, results of operations or 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 is applied on a prospective basis to derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. SAB 109 is not expected to have a significant impact on the Company's consolidated financial statements, results of operations or liquidity.



**Table of Contents**

(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 Articles of Amendment to Restated Articles of Incorporation dated January 9, 2008.
- 3.6(6) Restated Bylaws of First Interstate BancSystem, Inc. dated July 29, 2004
- 4.1(7) Specimen of common stock certificate of First Interstate BancSystem, Inc.
- 4.2 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(8) Shareholder s Agreement for non-Scott family members dated August 24, 2001
- 4.5(9) Shareholder s Agreement for non-Scott family members dated August 19, 2002
- 4.6(10) First Interstate Stockholders Agreements with Scott family members dated January 11, 1999
- 4.7(10) 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(2) Security Agreement dated as of January 10, 2008, between First Interstate BancSystem, Inc. and Wells Fargo Bank, National Association, as Administrative Agent.
- 10.3(2) Credit Agreement Re: Subordinated Term Note dated as of January 10, 2008, between First Interstate BancSystem, Inc. and First Midwest Bank.

Edgar Filing: FIRST INTERSTATE BANCSYSTEM INC - Form 10-K

|            |                                                                                                                     |
|------------|---------------------------------------------------------------------------------------------------------------------|
| 10.4(3)    | Lease Agreement Between Billings 401 Joint Venture and First Interstate Bank Montana and addendum thereto           |
| 10.5(3)    | Stock Option and Stock Appreciation Rights Plan of First Interstate BancSystem, Inc., as amended                    |
| 10.6(11)   | 2001 Stock Option Plan                                                                                              |
| 10.7(12)   | Employee Stock Purchase Plan of First Interstate BancSystem, Inc., as amended and restated effective April 30, 2003 |
| 10.8(13)   | Trademark License Agreements between Wells Fargo & Company and First Interstate BancSystem, Inc.                    |
| 10.9(14)   | Employment Agreement between First Interstate BancSystem, Inc. and Lyle R. Knight                                   |
| 10.10 (14) | First Interstate BancSystem, Inc. Executive Non-Qualified Deferred Compensation Plan dated November 20, 1998        |
| 10.11(15)  | First Interstate BancSystem s Deferred Compensation Plan dated December 6, 2000                                     |
| 10.12(8)   | First Interstate BancSystem, Inc. 2004 Restricted Stock Award Plan                                                  |
| 10.13(16)  | Form of First Interstate BancSystem, Inc. Restricted Stock Award Agreement                                          |
| 10.14(16)  | Form of First Interstate BancSystem, Inc. Restricted Stock Award Notice of Restricted Stock Award                   |
| 10.15(17)  | First Interstate BancSystem, Inc. 2006 Equity Compensation Plan                                                     |

**Table of Contents**

|          |                                                                                                                                  |
|----------|----------------------------------------------------------------------------------------------------------------------------------|
| 12.1     | Statement Regarding Computation of Ratio of Earnings to Fixed Charges                                                            |
| 14.1(18) | Code of Ethics for Chief Executive Officer and Senior Finance Officers of First Interstate BancSystem, Inc.                      |
| 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 Registrant's Post-Effective Amendment No. 4 to Registration Statement of Form S-8, No. 333-76825.
- (7) Incorporated by reference to the Registrant's Registration Statement on Form S-1, No. 333-3250.
- (8) Incorporated by reference to the Registrant's Post-Effective Amendment No. 1 to Registration Statement on Form S-8, No. 333-76825.
- (9) Incorporated by reference to the Registrant's Post-Effective Amendment No. 2 to Registration Statement on Form S-8, No. 333-76825.

- (10) Incorporated by reference to the Registrant's Registration Statement on Form S-8, No. 333-76825.
- (11) Incorporated by reference to the Registrant's Registration Statement on Form S-8, No. 333-106495.
- (12) Incorporated by reference to the Registrant's Post-Effective Amendment No. 3 to Registration Statement on Form S-8, No. 333-76825.
- (13) Incorporated by reference to the Registrant's Registration Statement on Form S-1, No. 333-25633.
- (14) Incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 1999.
- (15) Incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 2002.

- (16) Incorporated by reference to Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2004.
- (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 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.

**Table of Contents**

**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 14, 2008

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 14, 2008

Thomas W. Scott, Chairman of the Board

Date

By: /s/ JAMES R. SCOTT

March 14, 2008

James R. Scott, Vice Chairman of the Board

Date

By: /s/ JONATHAN R. SCOTT

March 14, 2008

Jonathan R. Scott, Director

Date

By: /s/ JULIE A. SCOTT

March 14, 2008

Julie A. Scott, Director

Date

By: /s/ RANDALL I. SCOTT

March 14, 2008

Randall I. Scott, Director

Date

By: /s/ SANDRA A. SCOTT SUZOR

March 14, 2008

Sandra A. Scott Suzor, Director

Date

By: /s/ ELOUISE C. COBELL

March 14, 2008

Elouise C. Cobell, Director

Date

By: /s/ DAVID H. CRUM

March 14, 2008

David H. Crum, Director

Date

By: /s/ RICHARD A. DORN

March 14, 2008

Richard A. Dorn, Director

Date

By: /s/ WILLIAM B. EBZERY

March 14, 2008

|                               |                |
|-------------------------------|----------------|
| William B. Ebzery, Director   | Date           |
| By: /s/ JAMES W. HAUGH        | March 14, 2008 |
| James W. Haugh, Director      | Date           |
| By: /s/ CHARLES M. HEYNEMAN   | March 14, 2008 |
| Charles M. Heyneman, Director | Date           |
| By: /s/ ROBERT L. NANCE       | March 14, 2008 |
| Robert L. Nance, Director     | Date           |
| By: /s/ TERRY W. PAYNE        | March 14, 2008 |
| Terry W. Payne, Director      | Date           |

-91-

---

**Table of Contents**

|                                                                                                   |                |
|---------------------------------------------------------------------------------------------------|----------------|
| By: /s/ MICHAEL J. SULLIVAN                                                                       | March 14, 2008 |
| Michael J. Sullivan, Director                                                                     | Date           |
| By: /s/ MARTIN A. WHITE                                                                           | March 14, 2008 |
| Martin A. White, Director                                                                         | Date           |
| By: /s/ LYLE R. KNIGHT                                                                            | March 14, 2008 |
| Lyle R. Knight                                                                                    | Date           |
| President, Chief Executive Officer and Director (Principal executive officer)                     |                |
| By: /s/ TERRILL R. MOORE                                                                          | March 14, 2008 |
| Terrill R. Moore                                                                                  | Date           |
| Executive Vice President and Chief Financial Officer (Principal financial and accounting officer) |                |

-92-

---

**Table of Contents**

**Exhibit Index**

| Exhibit No. | Description                                                                                                                                                                                 |
|-------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 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         | Articles of Amendment to Restated Articles of Incorporation dated January 9, 2008.                                                                                                          |
| 3.6(6)      | Restated Bylaws of First Interstate BancSystem, Inc. dated July 29, 2004                                                                                                                    |
| 4.1(7)      | Specimen of common stock certificate of First Interstate BancSystem, Inc.                                                                                                                   |
| 4.2         | 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(8)      | Shareholder s Agreement for non-Scott family members dated August 24, 2001                                                                                                                  |
| 4.5(9)      | Shareholder s Agreement for non-Scott family members dated August 19, 2002                                                                                                                  |
| 4.6(10)     | First Interstate Stockholders Agreements with Scott family members dated January 11, 1999                                                                                                   |
| 4.7(10)     | 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(2)     | Security Agreement dated as of January 10, 2008, between First Interstate BancSystem, Inc. and Wells Fargo Bank, National Association, as Administrative Agent.                             |
| 10.3(2)     | Credit Agreement Re: Subordinated Term Note dated as of January 10, 2008, between First Interstate BancSystem, Inc. and First Midwest Bank.                                                 |
| 10.4(3)     | Lease Agreement Between Billings 401 Joint Venture and First Interstate Bank Montana and addendum thereto                                                                                   |
| 10.5(3)     | Stock Option and Stock Appreciation Rights Plan of First Interstate BancSystem, Inc., as amended                                                                                            |

|            |                                                                                                                     |
|------------|---------------------------------------------------------------------------------------------------------------------|
| 10.6(11)   | 2001 Stock Option Plan                                                                                              |
| 10.7(12)   | Employee Stock Purchase Plan of First Interstate BancSystem, Inc., as amended and restated effective April 30, 2003 |
| 10.8(13)   | Trademark License Agreements between Wells Fargo & Company and First Interstate BancSystem, Inc.                    |
| 10.9(14)   | Employment Agreement between First Interstate BancSystem, Inc. and Lyle R. Knight                                   |
| 10.10 (14) | First Interstate BancSystem, Inc. Executive Non-Qualified Deferred Compensation Plan dated November 20, 1998        |
| 10.11(15)  | First Interstate BancSystem's Deferred Compensation Plan dated December 6, 2000                                     |
| 10.12(8)   | First Interstate BancSystem, Inc. 2004 Restricted Stock Award Plan                                                  |
| 10.13(16)  | Form of First Interstate BancSystem, Inc. Restricted Stock Award Agreement                                          |
| 10.14(16)  | Form of First Interstate BancSystem, Inc. Restricted Stock Award Notice of Restricted Stock Award                   |
| 10.15(17)  | First Interstate BancSystem, Inc. 2006 Equity Compensation Plan                                                     |



**Table of Contents**

| Exhibit No. | Description                                                                                                                      |
|-------------|----------------------------------------------------------------------------------------------------------------------------------|
| 12.1        | Statement Regarding Computation of Ratio of Earnings to Fixed Charges                                                            |
| 14.1(18)    | Code of Ethics for Chief Executive Officer and Senior Finance Officers of First Interstate BancSystem, Inc.                      |
| 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 Registrant's Post-Effective Amendment No. 4 to Registration Statement of Form S-8, No. 333-76825.
- (7) Incorporated by reference to the Registrant's Registration Statement on Form S-1, No. 333-3250.
- (8) Incorporated by reference to the Registrant's Post-Effective Amendment No. 1 to Registration Statement on Form S-8, No. 333-76825.
- (9) Incorporated by reference to the Registrant's Post-Effective Amendment No. 2 to Registration Statement on Form S-8,

No. 333-76825.

- (10) Incorporated by reference to the Registrant's Registration Statement on Form S-8, No. 333-76825.
- (11) Incorporated by reference to the Registrant's Registration Statement on Form S-8, No. 333-106495.
- (12) Incorporated by reference to the Registrant's Post-Effective Amendment No. 3 to Registration Statement on Form S-8, No. 333-76825.
- (13) Incorporated by reference to the Registrant's Registration Statement on Form S-1, No. 333-25633.
- (14) Incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31, 1999.
- (15) Incorporated by reference to the Registrant's Form 10-K for the fiscal year ended December 31,

2002.

- (16) Incorporated by reference to Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2004.
- (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 Form 10-K for the fiscal year ended December 31, 2004.

-94-