FIRST INTERSTATE BANCSYSTEM INC
Form 10-K/A
April 04, 2003

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

Amendment No. 1 to
Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the fiscal year ended December 31, 2002

Commission File Number: 000-49733

FIRST INTERSTATE BANCSYSTEM, INC.
(Exact name of registrant as specified in its charter)

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

401 North 31st Street	
Billings, Montana	**59116**
(Address of principal executive offices)	(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 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. [ü] 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. [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). [ ] Yes [ü] No

The aggregate market value (appraised minority value) of the common stock of the registrant held by non-affiliates as of the last business day of the registrant's most recently completed second fiscal quarter, June 30, 2002, was $13,769,624.

The number of shares outstanding of the registrant s common stock as of February 28, 2003 was 7,878,977.

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, 2003. The information required by Part III of this Form 10-K is incorporated by reference from such Proxy Statement.

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Explanatory Note

This Amendment No. 1 on Form 10-K/A to First Interstate BancSystem, Inc. s Annual Report on Form 10-K for the year ended December 31, 2002 filed with the Securities and Exchange Commission on March 19, 2003, is filed to make a typographical correction to Notes to Consolidated Financial Statements Subsequent Events Acquisitions included in Part IV, Item 15.

PART I

Item 1. Business

The Company

First Interstate BancSystem, Inc. (FIBS and collectively with its subsidiaries, the Company), incorporated in Montana in 1971, is a financial holding company registered under the Bank Holding Company Act of 1956, as amended. FIBS is headquartered in Billings, Montana. As of December 31, 2002, the Company had assets of $3.6 billion, deposits of $2.9 billion and total stockholders equity of $244 million, making it the largest banking organization in Montana.

FIBS operates a wholly-owned bank subsidiary, First Interstate Bank (the Bank), with 57 banking offices in 30 Montana and Wyoming communities. The Bank, a Montana corporation organized in 1916, delivers a comprehensive range of loan, deposit and investment products and mortgage banking and trust services to meet the needs of individual customers, businesses, and municipalities.

The Company conducts various other financial-related business activities through wholly-owned non-bank subsidiaries. i_Tech Corporation (i_Tech) provides technology services to the Bank and other non-affiliated customers in Montana, Wyoming, Idaho, Washington, Oregon, South Dakota and Colorado. Additionally, i_Tech s ATM network provides processing support for over 2,093 ATM locations in 32 states. FIB Capital Trust (FIB Capital), incorporated under Delaware law in 1997, was formed for the exclusive purpose of issuing mandatorily redeemable trust preferred securities (trust preferred securities) and using the proceeds to purchase junior subordinated debentures (subordinated debentures) issued by FIBS. FI Reinsurance, Ltd. (FIR), domiciled in Nevis Island, West Indies, was formed in 2001 to underwrite, as reinsurer, credit-related life and disability insurance.

The Company is the licensee under a trademark license agreement granting it an exclusive, nontransferable license to use the First Interstate name and logo in Montana, Wyoming and surrounding states.

Community Banking Philosophy

The banking industry continues to experience change with respect to regulatory matters, consolidation, consumer needs and economic and market conditions. The Company believes that it can best address this changing environment through its Strategic Vision. The Company s Strategic Vision emphasizes providing its customers full service commercial and consumer banking at a local level using a personalized service approach, while serving and strengthening the communities in which the Bank is located through community service activities.

The Company grants significant autonomy to its banking offices in delivering and pricing products at a local level in response to market considerations and customer needs. This autonomy enables the banking offices to remain competitive and enhances the relationships between the banking offices and the customers they serve. The Company also emphasizes 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 level. The Company believes this combination of autonomy and accountability allows the banking offices to provide personalized customer service while remaining attentive to financial performance.

The Company has centralized certain products and business activities to provide consistent service levels to customers Company-wide, to gain efficiency in management of those products and activities and to ensure regulatory compliance. Centralized products and activities include trust, investment, wire transfer, escrow, credit card, technology and escrow services; mortgage servicing; and selected operational activities.

Growth Strategy

The Company s growth strategy includes growing internally and expanding into new and complementary markets when appropriate opportunities arise. The Company believes it has an infrastructure in place that will allow for growth and provide economies of scale into the future.

The Company has opened 19 new banking offices in Montana and Wyoming since 1999. Among these new offices are 11 full service banking offices located inside retail establishments. The Company intends to continue to expand its presence in the Montana and Wyoming markets through the opening of new banking offices; however, future growth through de novo banking offices is likely to occur at a slower rate than the Company has experienced during the previous three years.

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In January 2003, the Company acquired Silver Run Bancorporation, Inc. (SRBI), a bank holding company with one banking office. At the date of acquisition, SRBI had loans of $36 million and deposits of $42 million.

The Bank

The Company s banking offices are located in communities of approximately 700 to 90,000 people, but serve larger market areas due to the limited number of financial institutions in other nearby communities. The Company believes that the communities served provide a stable core deposit and funding base, as well as economic diversification across a number of industries, including agriculture, energy, mining, timber processing, tourism, government services, education and medical services.

Centralized Services

FIBS and i_Tech provide general oversight and centralized services for the Bank to enable it to serve its markets more effectively. These services include technology services, credit administration, finance and accounting, human asset management and other support services.

Technology Services. i_Tech provides technology services to the Bank, including system support of the general ledger, investment security, loan, deposit, web banking, imaging, management reporting and cash management systems. i_Tech also manages the Company s wide-area network and the ATM network used by the Bank and provides item proof and capture services. These technology services are performed through the use of computer hardware owned and maintained by the Bank and software licensed by i_Tech.

Credit Administration. FIBS assists the Bank in identifying, measuring and monitoring loan concentrations, problem loans and loan portfolio trends. FIBS also controls the risk inherent in the Bank s loan portfolio through training of Bank personnel; evaluating and implementing periodic modifications to the Bank s loan policy and lending limits; and, assisting the Bank in determining the loan loss reserve including specific reserve allocations.

Finance and Accounting. FIBS provides financial and accounting services for the Bank, including internal and external reporting, asset/liability management, investment portfolio analysis and capital management.

Human Asset Management. Through its human asset management group, FIBS provides the Bank with incentive and employee benefit administration and compensation, training, employee recruitment and hiring services.

Other Support Services. FIBS provides the Bank with legal, compliance, internal auditing, general administration and various other support services.

Lending Activities

FIBS has comprehensive credit policies establishing Company-wide underwriting and documentation standards to assist Bank management in the lending process and limit risk to the Company. The credit policies establish lending authorities based on the experience level and authority of the lending officer, the type of loan and the type of collateral. The policies also establish thresholds at which loan requests must be approved by a Bank committee.

The Bank offers short and long-term real estate, consumer, commercial, agricultural and other loans to individuals and small to medium-sized businesses in its market areas. While each loan must meet minimum underwriting standards established in the Company s credit policies, lending officers are granted certain levels of autonomy in approving and pricing loans to assure that the banking offices are responsive to competitive issues and community needs in each market area.

Real Estate Loans. The Bank provides interim 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. The Bank originates variable and fixed rate real estate mortgages, generally in accordance with the guidelines of Fannie Mae and Federal Home Loan Mortgage Corporation. Loans originated in accordance with these guidelines are sold in the secondary market. Real estate loans not sold in the secondary market are typically secured by first liens on the financed property and generally mature in less than 15 years.

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Consumer Loans. The Bank s consumer loans include personal loans, credit card loans and equity lines of credit. Personal 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 customers in the Company s market areas. Equity lines of credit are generally floating rate, reviewed annually and secured by real property. Approximately 55% of the Company s consumer loans are indirect dealer paper that is created when the Company purchases consumer loan contracts advanced for the purchase of automobiles, boats and other consumer goods from consumer product dealers.

Commercial Loans. The Bank provides 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. The Bank s agricultural loans generally consist of short and medium-term loans and lines of credit that are generally used for crops, livestock, equipment and general operating purposes. Agricultural loans are generally 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.

For additional information about the Company s loan portfolio, see Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Financial Condition Loans.

Funding Sources

The Bank offers traditional depository products including checking, savings and time deposits. Additional funding sources include Federal funds purchased for one day periods, repurchase agreements with primarily commercial depositors, time deposits brokered outside the Company s market areas and short-term borrowings from the Federal Home Loan Bank of Seattle. Deposits at the Bank are insured by the Federal Deposit Insurance Corporation (FDIC) up to statutory limits.

Under repurchase agreements, the Company sells investment securities held by the Company to a customer under an agreement to repurchase the investment security at a specified time or on demand. The Company does not, however, physically transfer the investment securities. As of December 31, 2002, all outstanding repurchase agreements were due in one day.

For additional information on the Banks funding sources, see Management s Discussion and Analysis of Financial Condition and Results of Operations Financial Condition Deposits, Management s Discussion and Analysis of Financial Condition and Results of Operations Financial Condition Other Borrowed Funds, and Management s Discussion and Analysis of Financial Condition and Results of Operations - Federal Funds Purchased and Securities Sold Under Repurchase Agreements, included in Part II, Item 7.

Competition

Competition within Montana and Wyoming for banking and related business is strong. The Bank competes with both state and nationally chartered commercial banks for deposits, loans and trust accounts and with savings and loan associations, savings banks and credit unions for deposits and loans. In addition, there is significant competition with other institutions including personal loan companies, mortgage banking companies, finance 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.

While historically the 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, regional and local operations.

Employees

At December 31, 2002, the Company employed 1,605 full-time equivalent employees. None of the Company s employees are covered by a collective bargaining agreement. The Company considers its employee relations to be good.

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Regulation and Supervision

Financial holding companies and commercial banks are subject to extensive regulation under both federal and state law. Set forth below is a summary description of certain laws that relate to the regulation of FIBS and the Bank. The description does not purport to be complete and is qualified in its entirety by reference to the applicable laws and regulations.

First Interstate BancSystem, Inc.

As a bank holding company and financial holding company, FIBS is subject to regulation under the Bank Holding Company Act of 1956, as amended, and to supervision and regulation by the Federal Reserve.

Under Federal Reserve regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the Federal Reserve s policy that in serving as a source of strength to its subsidiary banks, a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company s failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve to be an unsafe and unsound banking practice or a violation of the Federal Reserve s regulations or both.

FIBS is required to obtain the prior approval of the Federal Reserve for the acquisition of 5% or more of the outstanding shares of any class of voting securities or substantially all of the assets of any bank or bank holding company. Prior approval of the Federal Reserve is also required for the merger or consolidation of FIBS and another bank holding company.

As a financial holding company, FIBS 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. FIBS may engage in authorized financial activities provided that it remains a financial holding company and meets certain regulatory standards of being well-capitalized and well-managed. FIBS must notify the Federal Reserve of its financial activities within a specified time period following its initial engagement in each business or activity.

The Bank

The Bank is subject to the supervision of and regular examination by the Federal Reserve, the State of Montana, Division of Banking and Financial Institutions and, with respect to its activities in Wyoming, the State of Wyoming, Department of Audit. If any of the foregoing regulatory agencies determines that the financial condition, capital resources, asset quality, earning prospects, management, liquidity or other aspects of a bank s operations are unsatisfactory or that a bank or its management is violating or has violated any law or regulation, various remedies are available to such agencies. These remedies include the power to enjoin unsafe or unsound practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in capital, to restrict the growth of a bank, to assess civil monetary penalties, to remove officers and directors and to terminate a bank s deposit insurance, which would result in a revocation of a bank s charter. The Bank has not been the subject of any such actions by regulatory agencies.

The FDIC insures the deposits of the Bank in the manner and to the extent provided by law. For this protection, the Bank pays a semiannual statutory assessment. See Premiums for Deposit Insurance herein.

Restrictions on Transfers of Funds to FIBS and the Bank

Large portions of FIBS s revenues are, and will continue to be, dividends paid by the Bank. The Bank is limited, under both state and federal law, in the amount of dividends that may be paid from time to time. In general, the Bank is limited, without the prior consent of its 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.

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

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Financial and other transactions between the Bank and FIBS or any FIBS affiliate are also limited under applicable state and federal law. Among other things, the Bank may not lend funds to, or otherwise extend credit to or for the benefit of, FIBS or FIBS affiliates, except on specified types and amounts of collateral and other terms required by state and federal law. In addition, the Federal Reserve has authority to define and limit, from time to time, the transactions between banks and their affiliates. The Federal Reserve has issued Regulation W, to be effective April 1, 2003. Regulation W imposes significant additional limitations on transactions in which the Bank may engage with FIBS or FIBS affiliates in addition to the limits under the federal statutes.

Effect of Government Policies and Legislation

Banking depends on interest rate differentials. In general, the difference between the interest rate paid by the 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 Bank. Accordingly, the earnings and potential growth of the Bank 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 increasing the cost of doing business, limiting or expanding permissible activities or affecting 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 and Wyoming legislatures and before various bank regulatory and other professional agencies. The likelihood of major legislative changes and the impact such changes might have on FIBS or the Bank are impossible to predict.

Capital Standards

The federal banking agencies have adopted minimum capital requirements for insured banks that are applicable to the Bank. In addition, the Federal Reserve has adopted minimum capital requirements that are applicable to FIBS. The capital requirements are intended to, among other things, provide a means for evaluating the capital adequacy and soundness of the institutions. The Federal banking agencies may also set higher capital requirements for particular institutions in specified circumstances under Federal laws and regulations.

At December 31, 2002, the Bank and FIBS each met the well-capitalized requirements applicable to the respective institution. The well-capitalized standard is the highest level of the minimum capital requirements established by the Federal agencies. Neither the Bank nor FIBS is subject to a minimum capital requirement other than those applicable to banks or bank holding companies generally.

For more information concerning the capital ratios of FIBS, see Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Financial Condition Capital Resources and Notes to Consolidated Financial Statements Regulatory Capital included in Part IV, Item 15.

Compliance and Safety and Soundness Standards

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 (FDICIA). These standards are designed to identify potential concerns and ensure that action is taken to address those concerns before they pose a risk to the deposit insurance fund. 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.

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Premiums for Deposit Insurance

Deposits in the Bank are insured by the FDIC in accordance with the Federal Deposit Insurance Act (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. The insurance premium charged to a bank is determined based upon risk assessment criteria, including relevant capital levels, results of bank examinations by state and federal regulators and other information. The Bank currently is assessed the most favorable deposit insurance premiums under the risk-based premium system.

Community Reinvestment Act and Fair Lending Developments

The Bank is subject to certain fair lending requirements and reporting obligations involving home mortgage lending operations and Community Reinvestment Act (CRA) activities. 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 certain fair lending laws, the federal banking agencies may take compliance with such laws and CRA into account when regulating and supervising other activities or in authorizing expansion activities by the Bank and FIBS.

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. The Bank received an outstanding rating on its most recent examination.

Risk Factors

Asset Quality

A significant source of risk for the Company arises from the possibility that losses will be sustained by the Bank because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans. The Company has adopted underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for loan losses, that management believes are appropriate to mitigate this risk by assessing the likelihood of nonperformance, monitoring loan performance and diversifying the Company s credit portfolio. Such policies and procedures, however, may not prevent unexpected losses that could have a material adverse effect on the Company s business, financial condition and results of operations. See Business Lending Activities.

Interest Rate Risk

Banking companies earnings depend largely on the relationship between the yield on earning assets, primarily loans and investments, and the cost of funds, primarily deposits and borrowings. This relationship, known as the interest rate spread, is subject to fluctuation and is affected by economic and competitive factors which influence interest rates, the volume and mix of interest earning assets and interest bearing liabilities, and the level of non-performing assets. Fluctuations in interest rates affect the demand of customers for the Company s products and services. The Company is subject to interest rate risk to the degree that its interest bearing liabilities reprice or mature more slowly or more rapidly or on a different basis than its interest earning assets. Significant fluctuations in interest rates could have a material adverse effect on the Company s business, financial condition, results of operations or liquidity.

For additional information regarding interest rate risk, see Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Financial Condition Liquidity and Cash Flow.

Economic Conditions; Limited Geographic Diversification

The Company s banking operations are located in Montana and Wyoming. As a result of the geographic concentration of its operations, the Company s results depend largely upon economic conditions in these areas. Although markets served by the Company are economically diverse, a deterioration in economic conditions could adversely impact the quality of the Company s loan portfolio and the demand for its products and services, and accordingly, could have a material adverse effect on the Company s business, financial condition, results of operations or liquidity.

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Ability of the Company to Execute Its Business Strategy

The financial performance and profitability of the Company will depend on its ability to execute its business strategy and manage its future growth. Although the Company believes that it has substantially integrated recently acquired banks into the Company s operations, there can be no assurance that unforeseen issues relating to the assimilation or prior operations of these banks, including the emergence of any material undisclosed liabilities, will not materially adversely affect the Company. In addition, any future acquisitions or other future growth may present operating and other problems that could have a material adverse effect on the Company s business, financial condition, results of operations or liquidity. The Company s financial performance will also depend on the Company s ability to maintain profitable operations through implementation of its Strategic Vision. Moreover, the Company s future performance is subject to a number of factors beyond its control, including pending and future federal and state banking legislation, regulatory changes, unforeseen litigation outcomes, inflation, lending and deposit rate changes, interest rate fluctuations, increased competition and economic conditions. Accordingly, there can be no assurance that the Company will be able to continue the growth or maintain the level of profitability it has recently experienced.

Dependence on Key Personnel

The Company s success depends to a significant extent on the management skills of its existing executive officers and directors, many of whom have held officer and director positions with the Company for many years. The loss or unavailability of any of its key executives, including Thomas W. Scott, Chief Executive Officer, Lyle R. Knight, President and Chief Operating Officer, Terrill R. Moore, Senior Vice President and Chief Financial Officer, or Ed Garding, Senior Vice President and Chief Credit Officer could have a material adverse effect on the Company s business, financial condition, results of operations or liquidity. See Part III, Item 10, Directors and Executive Officers of Registrant. In December 2002, the Company announced the beginning of a year-long management transition process. Effective January 1, 2004, Thomas W. Scott will assume the role of Chairman of the Board of Directors of the Company. Lyle R. Knight will succeed Mr. Scott as Chief Executive Officer. Mr. Scott will remain active in oversight of the Company.

Competition

Several competitors are much larger in total assets and capitalization, have greater access to capital markets and offer a broader array of financial services than the Bank. Moreover, the Riegal-Neal Interstate Banking and Branching Efficiency Act of 1994 has increased competition in the Bank s markets, particularly from larger, multi-state banks. There can be no assurance that the Company will be able to compete effectively in its markets. Furthermore, developments increasing the nature or level of competition could have a material adverse effect on the Company s business, financial condition, results of operations or liquidity. See Business Competition and Business Regulation and Supervision.

Government Regulation and Monetary Policy

The Company and the banking industry are subject to extensive regulation and supervision under federal and state laws and regulations. The restrictions imposed by such laws and regulations limit the manner in which the Company conducts its banking business, undertakes new investments and activities and obtains financing. This regulation is designed primarily for the protection of the deposit insurance funds and consumers and not to benefit holders of the Company s securities. Financial institution regulation has been the subject of significant legislation in recent years and may be the subject of further significant legislation in the future, none of which is in the control of the Company. Significant new laws or changes in, or repeals of, existing laws could have a material adverse effect on the Company s business, financial condition, results of operations or liquidity. Further, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects credit conditions for the Company, and any unfavorable change in these conditions could have a material adverse effect on the Company s business, financial condition, results of operations or liquidity. See Business-Regulation and Supervision.

Control by Affiliates

The directors and executive officers of the Company beneficially own 51.9% of the outstanding common stock of the Company. Many of these directors and executive officers are members of the Scott family, which collectively owns 80.3% of the outstanding common stock. By virtue of such ownership, these affiliates are able to control the election of directors and the determination of the Company s business, including transactions involving any merger, share exchange, sale of assets outside the ordinary course of business and dissolution.

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Lack of Trading Market; Market Prices

The common stock of FIBS is not actively traded, and there is no established trading market for the stock. There is only one class of common stock, with 91.6% of the shares subject to contractual transfer restrictions set forth in shareholder agreements and 8.4% without such restrictions. FIBS has the right of first refusal to repurchase the restricted stock at fair market value per share currently determined as the minority appraised value per share based upon the most recent quarterly appraisal available to FIBS. Additionally, restricted stock held by officers, directors and employees of the Company may be called by the Company under certain conditions. All stock not subject to such restrictions may be sold at a price per share that is acceptable to the shareholder. FIBS has no obligation to purchase unrestricted stock, but has historically purchased such stock. During 2002, the Company repurchased 22,953 shares of its unrestricted stock from participants in the Savings and Profit Sharing Plan for Employees of First Interstate BancSystem, Inc. (Savings Plan) and 55,107 shares of its restricted stock from shareholders. All shares were repurchased at the most recent minority appraised value at the repurchase date.

The appraised minority value of the FIBS common stock represents the estimated fair market valuation of a minority block of such stock, 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 the FIBS common stock in an informed, arm s-length transaction. As such, the appraised minority value is only an estimate as of a specific date, and there can be no assurance that such appraisal is an indication of the actual value holders of FIBS common stock may realize with respect to shares held by them. Moreover, the estimated fair market value of the FIBS common stock may be materially different at any date other than the valuation dates.

With limited exceptions, FIBS has no obligation, by contract, policy or otherwise to purchase stock from any shareholder desiring to sell or to create any market for the stock. Historically, it has been the practice of FIBS to repurchase common stock to maintain a shareholder base with restrictions on sale or transfer of the stock. In the last three calendar years (2000-2002), FIBS has repurchased a total of 342,618 shares of common stock, 254,706 of which were restricted by shareholder agreements. FIBS repurchased the stock at the most recent appraised minority value at the repurchase date, in accordance with the shareholder agreements. FIBS s repurchases of stock are subject to corporate law and regulatory restrictions that could prevent stock repurchases. See also Part II, Item 5, Market for Registrant s Common Equity and Related Stockholder Matters.

There is a limited public market for the trust preferred securities. Future trading prices of the trust preferred securities depend on many factors including, among other things, prevailing interest rates, the operating results and financial condition of the Company and the market for similar securities. As a result of the existence of FIBS s right to defer interest payments on or, subject to prior approval of the Federal Reserve if then required under applicable capital guidelines or policies of the Federal Reserve, shorten the stated maturity of the subordinated debentures, the market price of the trust preferred securities may be more volatile than the market prices of subordinated debentures that are not subject to such optional deferrals or reduction in maturity. There can be no assurance as to the market prices for the trust preferred securities or the subordinated debentures that may be distributed in exchange for the trust preferred securities if the Company exercises its right to dissolve FIB Capital.

Forward-Looking Statements

Certain statements contained in this document including, without limitation, statements containing the words believes, anticipates, expects, and words of similar import, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: general economic and business conditions in those areas in which the Company operates; demographic changes; competition; fluctuations in interest rates; changes in business strategy or development plans; changes in governmental regulation; credit quality; the availability of capital to fund the expected expansion of the Company s business; and, other factors referenced in this document, including, without limitation, information under the captions Risk Factors and Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations. Given these uncertainties, shareholders, trust preferred security holders and prospective investors are cautioned not to place undue reliance on such forward-looking statements. The Company disclaims any obligation to update any such factors or to publicly announce the results of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

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Website Access to United States Securities and Exchange Commission Filings

All reports filed electronically by the Company with the United States Securities Exchange Commission (SEC), including the annual report on Form 10-K, quarterly reports on Form 10-Q and current event reports on Form 8-K, as well as amendments to those reports, are accessible at no cost through the Company s website at firstinterstatebank.com. These filings are also accessible on the SEC s website at www.sec.gov.

Item 2. Properties

The Company is the anchor tenant in a commercial building in which the Company s principal executive offices are located in Billings, Montana. The building is owned by a joint venture partnership in which the Bank is one of the two partners, owning a 50% interest in the partnership. As of December 31, 2002, the Company leases approximately 68,879 square feet of space for operations in the building. The Company also leases space for operations, technology services and 24 banking offices in 31 buildings. All other banking offices are located in Company-owned facilities.

Item 3. Legal Proceedings

In the normal course of business, the Company is named or threatened to be named as a defendant in various lawsuits. In the opinion of management, following consultation with legal counsel, the pending lawsuits are without merit or, in the event the plaintiff prevails, the ultimate liability or disposition thereof will not have a material adverse effect on the Company s business, financial condition, results of operations or liquidity.

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

None.

PART II

Item 5. Market for Registrant s Common Equity and Related Stockholder Matters

Description of FIBS Capital Stock

The authorized capital stock of FIBS consists of 20,000,000 shares of common stock without par value, of which 7,799,748 shares were outstanding as of December 31, 2002, and 100,000 shares of preferred stock without par value, none of which were outstanding as of December 31, 2002.

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 of the holders of the preferred stock. Voting for directors is noncumulative.

Subject to the preferential rights of any 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 therefore. In the event of a liquidation, dissolution or winding up of the Company, 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 any 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.

The common stock of FIBS is not actively traded, and there is no established trading market for the stock. There is only one class of common stock, with 91.6% of the shares subject to contractual transfer restrictions set forth in shareholder agreements and 8.4% held by 16 shareholders without such restrictions, including the Company s 401(k) plan which holds 76.8% of the unrestricted shares. See also Part I, Item 1, Risk Factors Lack of Trading Market; Market Prices.

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Quarter-end minority appraisal values for the past two years, determined by Alex Sheshunoff & Co. Investment Banking are as follows:

Valuation As Of	Appraised Minority Value
December 31, 2000	$ 39.00
March 31, 2001	39.00
June 30, 2001	40.00
September 30, 2001	42.00
December 31, 2001	43.00
March 31, 2002	44.00
June 30, 2002	45.00
September 30, 2002	45.00
December 31, 2002	46.00

As of December 31, 2002, options for 594,151 shares of the FIBS common stock were outstanding at various exercise prices, ranging from $12.40 to $45.00. The aggregate cash proceeds to be received by FIBS upon exercise of all options outstanding at December 31, 2002 would be $24.9 million, or a weighted average exercise price of $41.96 per share.

Resale of FIBS stock may be restricted pursuant to the Securities Act of 1933 and applicable state securities laws. In addition, most shares of FIBS stock are subject to shareholder s agreements:

Members of the Scott family, as majority shareholders of FIBS, are subject to a shareholder s agreement (Scott Agreement). The Scott family, under the Scott Agreement, has agreed to limit the transfer of shares owned by members of the Scott family to family members or charities, or with FIBS s approval, to the Company s officers, directors, advisory directors or to the Company s Savings Plan.

Shareholders of the Company who are not Scott family members, with the exception of 16 shareholders who own an aggregate of 656,341 shares of unrestricted stock, are subject to shareholder s agreements (Shareholder Agreements). Stock subject to the Shareholder Agreements may not be sold or transferred without triggering the Company s option to acquire the stock in accordance with the terms of the Shareholder Agreements. In addition, the Shareholder Agreements grant the Company the right to repurchase all or some of the stock under certain conditions.

Purchases of FIBS common stock made through the Company s Savings Plan are not restricted by Shareholder Agreements, due to requirements of Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code. However, since the Savings Plan does not allow distributions in kind, any distributions from an employee s account in the Savings Plan will allow, and may require, the Trust Department of the Bank (the Plan Trustee), to sell the FIBS stock. While FIBS has no obligation to repurchase the stock, it is likely that FIBS will repurchase FIBS stock sold by the Savings Plan. Any such repurchases would be upon terms set by the Plan Trustee and accepted by FIBS.

There are 581 record shareholders of FIBS as of December 31, 2002, including the Company s Savings Plan as trustee for 503,949 shares held on behalf of 876 individual participants in the plan. 257 individuals in the Savings Plan also own shares of FIBS stock outside of the Plan. The Plan Trustee votes the shares based on the instructions of each participant. In the event the participant does not provide the Plan Trustee with instructions, the Plan Trustee votes those shares in accordance with voting instructions received from a majority of the participants in the Plan.

Dividends

It is the policy of FIBS to pay a dividend to all common shareholders quarterly. Dividends are declared and paid in the month following the calendar quarter and the amount has historically been determined based upon a percentage of net income for the calendar quarter immediately preceding the dividend payment date. Since 1996, the Company has paid dividends of approximately 30% of quarterly net income without taking into effect compensation expense or benefit related to stock options. The Board of Directors of FIBS 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.

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Historical quarterly dividends for 2001 and 2002 are as follows:

Quarter	Month Declared and Paid	Amount Per Share	Total Cash Dividend
1st quarter 2001	April 2001	$ .25	$ 1,966,110
2nd quarter 2001	July 2001	.31	2,427,846
3rd quarter 2001	October 2001	.34	2,676,300
4th quarter 2001	January 2002	.30	2,352,927
1st quarter 2002	April 2002	.34	2,658,284
2nd quarter 2002	July 2002	.33	2,574,850
3rd quarter 2002	October 2002	.32	2,497,924
4th quarter 2002	January 2003	.34	2,651,914

Dividend Restrictions

For a description of restrictions on the payment of dividends, see Regulation and Supervision Restrictions on Transfers of Funds to FIBS and the Bank.

Preferred Stock

The authorized capital stock of FIBS includes 100,000 shares of preferred stock. The FIBS 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. FIBS Board of Directors may cause FIBS 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 of control of the Company.

Securities Authorized for Issuance Under Equity Compensation Plans

Information concerning Securities Authorized for Issuance Under Equity Compensation Plans is set forth under the heading Director and Executive Compensation Executive Compensation Equity Compensation Plans in the Company s Proxy Statement and is herein incorporated by reference.

Sales of Unregistered Securities

During 2002, the Company issued 3,000 shares of its common stock to one of its former executive officers who exercised stock options. The weighted average exercise price of the options was $19.02 per share. The shares were immediately redeemed by the Company at the minority appraised value of $43.00 per share. During 2002, the Company issued 4,088 unregistered shares of its common stock to 60 senior officers valued at an aggregate of $171,696 as part of the incentive bonuses paid to them. These issuances were made in reliance upon the exemption from registration under Section 4(2) of the Securities Act of 1933.

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Item 6. Selected Consolidated Financial Data

The following selected consolidated financial data with respect to the Company s consolidated financial position as of December 31, 2002 and 2001 and its results of operations for the fiscal years ended December 31, 2002, 2001 and 2000, has been derived from the consolidated financial statements of the Company 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.

Five Year Summary

(Dollars in thousands except share and per share data)

Years ended December 31,	2002	2001[1]	2000[1]	1999[1]	1998[1]
Operating Data:					
Interest income	$ 201,306	219,025	211,797	183,362	174,715
Interest expense	65,459	93,984	101,789	83,015	81,494
Net interest income	135,847	125,041	110,008	100,347	93,221
Provision for loan losses	9,191	7,843	5,280	3,563	4,170
Net interest income after provision for loan losses	126,656	117,198	104,728	96,784	89,051
Noninterest income	60,901	52,135	44,151	37,676	34,663
Noninterest expense	133,816	120,249	101,323	91,503	83,735
Income before income taxes	53,741	49,084	47,556	42,957	39,979
Income tax expense	19,247	17,901	17,176	15,229	15,100
Net income	$ 34,494	31,183	30,380	27,728	24,879
Basic earnings per common share	$ 4.41	3.97	3.83	3.48	3.10
Diluted earnings per common share	4.41	3.94	3.78	3.42	3.08
Dividends per common share	1.29	1.18	1.11	1.07	0.94
Weighted average common shares outstanding diluted	7,830,429	7,921,694	8,044,531	8,111,316	8,087,809
Ratios:					
Return on average assets	1.03%	1.01	1.10	1.09	1.07
Return on average common stockholders equity	14.86	14.89	16.81	16.60	16.24
Average stockholders equity to average assets	6.91	6.80	6.52	6.58	6.60
Net interest margin	4.66	4.66	4.59	4.54	4.55
Net interest spread	4.33	4.11	4.00	3.97	3.90
Common stock dividend payout ratio[2]	29.25	29.72	28.98	30.75	30.32
Balance Sheet Data at Year End:					
Total assets	$ 3,558,968	3,278,850	2,933,262	2,612,663	2,479,994
Loans	2,236,550	2,122,102	1,972,323	1,722,961	1,484,459
Allowance for loan losses	36,309	34,091	32,820	29,599	28,803
Investment securities	799,292	693,178	613,708	578,647	667,935
Deposits	2,911,847	2,672,747	2,365,225	2,118,183	2,041,932
Other borrowed funds	7,970	8,095	11,138	41,875	9,828
Long-term debt	23,645	34,331	37,000	23,394	24,288
Trust preferred securities	40,000	40,000	40,000	40,000	40,000

Stockholders equity	243,854	222,069	197,986	173,638	162,275

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Five Year Summary, continued

(Dollars in thousands except share and per share data)

Years ended December 31,	2002	2001[1]	2000[1]	1999[1]	1998[1]
Asset Quality Ratios at Year End:					
Nonperforming assets to total loans and other real estate owned (OREO[3])	1.54%	1.26	1.54	1.89	1.29
Allowance for loan losses to total loans	1.62	1.61	1.66	1.72	1.94
Allowance for loan losses to nonperforming loans[4]					