FIRST INTERSTATE BANCSYSTEM INC
Form 10-K
March 14, 2006

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

(Mark One)

þ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended December 31, 2005, or

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

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

Montana	**81-0331430**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
401 North 31st Street	**59116**
Billings, Montana	(Zip Code)
(Address of principal executive offices)	

(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.
o Yes þ 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.
o Yes þ 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. þ Yes o 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. o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule
12b-2 of the Exchange Act).

o Large accelerated filer   o Accelerated filer   þ Non-accelerated filer

Indicate by check mark if the registrant is a shell company (as defined in Rule 12b-2 of the Act.) o Yes þ No
Aggregate market value (appraised minority 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, June 30, 2005, was $38,100,106.
The number of shares outstanding of the registrant s common stock as of February 28, 2006 was 8,137,319.

Documents Incorporated by Reference

The registrant intends to file a definitive Proxy Statement for the Annual Meeting of Shareholders scheduled to be held May 5, 2006. The information required by Part III of this Form 10-K is incorporated by reference from such Proxy Statement.

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PART I

Item 1. Business

Cautionary Note Regarding Forward-Looking Statements

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 the Company s 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 suc would, should, could, might, may or similar expressions. Forward-looking statements involve known and unkno 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: (i) credit risk; (ii) credit concentration and economic conditions in Montana and Wyoming; (iii) declines in real estate values; (iv) changes in interest rates; (v) inability to meet liquidity requirements; (vi) availability of capital; (vii) competition; (viii) dependence on technology; (ix) ineffective internal operational controls; (x) difficulties in execution of business strategy; (xi) disruption of vital infrastructure; (xii) changes in or noncompliance with governmental regulations; (xiii) restrictions on dividends and stock redemptions; (xiv) capital required to support the Company s bank subsidiary; and (xv) 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 the Company undertakes 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.

The Company

First Interstate BancSystem, Inc. (FIBS) is a financial and bank holding company headquartered in Billings, Montana. FIBS was incorporated in Montana in 1971 and is the largest banking organization in Montana and Wyoming. As of December 31, 2005, FIBS and its subsidiaries (collectively, the Company) had assets of $4.6 billion, deposits of $3.5 billion and total stockholders equity of $350 million.

FIBS principal asset is a wholly-owned bank subsidiary, First Interstate Bank (FIB or the Bank), with 53 banking offices in 30 Montana and Wyoming communities. The Bank, a Montana corporation organized in 1916, delivers a comprehensive range of banking products and services, including demand and savings deposits; commercial, consumer, agricultural and real estate loans; mortgage loan origination and servicing; and, trust, investment and insurance services. The Bank serves individuals, businesses and municipalities throughout its market areas.

The Company also conducts other financial activities through wholly-owned nonbank subsidiaries. The Company s principal consolidated nonbank subsidiaries include the following companies:

i_Tech Corporation (i_Tech) provides technology services to the Bank and other non-affiliated customers in Montana, Wyoming and seven additional states, and provides processing support for 2,130 ATM locations in 37 states.

FIBCT, LLC provides internet-based products and services to financial institutions and small to medium-sized businesses, including web page design, development and hosting; logo design; domain registration; development of internet-based training, marketing and e-commerce products; and, software development.

First Interstate Insurance Agency, Inc. (FI Insurance) provides insurance products to individual and business customers of the Bank.

FI Reinsurance, Ltd., 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 perpetual trademark license agreement granting it an exclusive, nontransferable license to use the First Interstate name and logo in Montana, Wyoming and surrounding states.

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Business

The Company derives its income principally from interest charged on loans, and to a lesser extent, from interest and dividends earned on investments. The Company also derives income from noninterest sources such as fees received in connection with various lending and deposit services; trust, 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. The Company s principal expenses include interest expense on deposits and borrowings, operating expenses, provisions for loan losses and income tax expense.

Strategic Vision

The banking industry continues to experience change with respect to regulatory matters, consolidation, consumer needs and economic and market conditions. The Company believes it can best address this changing environment through its Strategic Vision. The Company s Strategic Vision is to maintain and enhance its leadership in the financial and social fabric of the communities it serves through a commitment to customer satisfaction, creative management, productive employees and community involvement.

Business Strategy

The Company s strategy has been to profitably grow its business through organic growth and selective acquisitions. During 2004 and 2005, the Company focused on efficiency and the identification of new opportunities to generate noninterest income. During 2006, the Company plans to continue its primary strategic focus 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. Longer-term, management expects the Company will continue looking for profitable expansion opportunities in existing and contiguous markets.

The Company s profitability, market share and asset size have been enhanced in recent years through organic loan and deposit growth in market areas served by the Company s existing banking offices, and to a lesser extent, through the acquisition of banking offices in contiguous market areas. During the previous five years, the Company has utilized de novo banking offices located in the Company s existing market areas to better serve existing customers and to attract new customers.

During 2005, the Company made a strategic decision to discontinue the operation of nine banking offices located inside Wal-Mart stores. As of December 31, 2005, operations at five of the nine Wal-Mart in-store banking offices had been discontinued and customer loan and deposit accounts had been transferred to existing banking offices located in the same communities. In January 2006, three additional Wal-Mart in-store banking offices were consolidated with existing banking offices in the same communities and the assets and liabilities of the remaining Wal-Mart in-store banking office were sold.

Operating Segments

The Company is managed along two reportable operating segments, Community Banking and Technology Services. The Company s principal operating segment, Community Banking, encompasses commercial and consumer banking services provided through the Bank, primarily the acceptance of deposits; extensions of credit; mortgage loan origination and servicing; and, trust, investment and insurance 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.

For additional information regarding the Company s operating segments, see Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Operating Segment Results included in Part II, Item 7 and Notes to Consolidated Financial Statements Segment Reporting included in Part IV, Item 15.

Community Banking

The Company s banking offices are located in communities of approximately 1,000 to 100,000 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, retail, and professional and medical services.

The Company s community banking philosophy emphasizes providing customers with commercial and consumer banking products and services at a local level using a personalized service approach and strengthening the communities in the Bank s market areas 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.

Centralized Services

Certain operational activities have been centralized to provide consistent service levels to customers company-wide, to gain efficiency in management of those activities and to ensure regulatory compliance. Centralized operational activities generally support the Company s banking offices in the delivery of products and services to customers and include marketing, credit review, mortgage loan sales and servicing and other operational activities. Additionally, FIBS provides centralized policy and management direction and specialized staff support services for the Bank to enable it to serve its markets more effectively. These services include credit administration, finance, accounting, human resource management and other support services.

The Company s technology subsidiary, i_Tech, provides centralized technology support services to the Bank, 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 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 by the Bank and leased to i_Tech and software licensed by i_Tech.

Lending Activities

FIBS has comprehensive credit policies establishing company-wide underwriting and documentation standards to assist Bank management in the lending process and to limit risk to the Company. The credit policies establish lending guidelines based on the experience level and authority of the personnel located in each branch and market. The policies also establish thresholds at which loan requests must be recommended by the Company s credit committee and/or approved by the Bank s board of directors.

The Bank offers short and long-term real estate, consumer, commercial, agricultural and other loans to individuals and 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 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 generally 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. The Bank s consumer loans include personal loans, credit card loans and 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 individual and business customers in the Company s market areas. Lines of credit are generally floating rate loans that are unsecured or secured by personal property. Approximately 59% 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 primarily used for crops, livestock, equipment and general operating purposes. 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.

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; and, short-term borrowings from the Federal Home Loan Bank of Seattle (FHLB). 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 customers under an agreement to repurchase the investment securities at a specified time or on demand. The Company does not, however, physically transfer the investment securities. As of December 31, 2005, 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 Financial Condition Federal Funds Purchased and Securities Sold Under Repurchase Agreements, included in Part II, Item 7.

Competition

Commercial banking is highly competitive. The Bank competes with other financial institutions located in Montana and Wyoming and adjoining states for deposits, loans and trust, investment and insurance accounts; and, with savings and loan associations, savings banks and credit unions for deposits and loans. In addition, the Bank competes 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.

The Company generally competes 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, brokerage and insurance services.

Employees

At December 31, 2005, the Company employed 1,576 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.

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 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. Because FIBS is a public company, it is also subject to the disclosure and regulatory requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934 (Exchange Act) as administered by the Securities and Exchange Commission (SEC).

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 obligation 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.

Under the Gramm-Leach-Bliley Act of 1999 (the GLB Act), FIBS, as a financial holding company, 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, FIBS must notify the Federal Reserve of its financial activities within a specified time period following its 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, FIBS must receive the prior approval of the Federal Reserve before engaging in the activity.

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. If FIBS fails to meet the well-capitalized or well-managed regulatory standards, it may be required to cease its financial holding company activities or, in certain circumstances, to divest of the Bank. FIBS does not currently engage in significant financial holding company businesses or activities not otherwise permitted to bank holding companies generally.

Under the GLB Act, if FIBS engages in certain financial activities currently authorized to financial holding companies, FIBS, or its affiliates, may become subject to additional laws and regulations relating to the particular activity, such as certain state and federal securities laws and regulations. FIBS may also become subject to supervision or examination by additional regulatory agencies granted regulatory authority over the activity under the GLB Act, such as the SEC and state securities regulatory authorities. Although FIBS is subject to SEC regulation as a public company, neither FIBS nor any subsidiary engages in any securities brokerage or other investing activity which is subject to the regulatory authority of the SEC or any state securities regulatory authority.

The GLB Act also imposes customer privacy requirements on any company engaged in financial activities. Under these requirements, a financial company is required to protect the security and confidentiality of customer nonpublic personal information. In addition, for customers who obtain a financial product such as a loan for personal, family or household purposes, a financial company is required to disclose its privacy policy to the customer at the time the relationship is established and annually thereafter. The financial company must also disclose its policies concerning the sharing of the customer s nonpublic personal information with affiliates and third parties. Finally, a financial company is prohibited from disclosing an account number or similar item to a third party for use in telemarketing, direct mail marketing or marketing through electronic mail.

FI Insurance is a wholly-owned subsidiary of FIBS and employs persons holding insurance licenses in the states of Montana and Wyoming. FI Insurance, and its employees, are subject to laws and regulations affecting the insurance industry generally. FI Insurance is subject to supervision by the Montana State Auditor s Office and subject to regulations issued by the Auditor s Office.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 generally establishes a comprehensive framework to modernize and reform the oversight of public company auditing, improve the quality and transparency of financial reporting by public companies and strengthen the independence of auditors. Among other things, the legislation (i) created a public company accounting oversight board which is empowered to set auditing, quality control and ethics standards, to inspect registered public accounting firms, to conduct investigations and to take disciplinary actions, subject to SEC oversight and review; (ii) strengthened auditor independence from corporate management by, among other things, limiting the scope of consulting services that auditors can offer their public company audit clients; (iii) heightened the responsibility of public company directors and senior managers for the quality of the financial reporting and disclosure made by their companies; (iv) adopted a number of provisions to deter wrongdoing by corporate management; (v) imposed a number of new corporate disclosure requirements; (vi) adopted provisions which generally seek to limit and expose to public view possible conflicts of interest affecting securities analysts; and, (vii) imposed a range of new criminal penalties for fraud and other wrongful acts, as well as extended the period during which certain types of lawsuits can be brought against a company or its insiders. In response to the Sarbanes-Oxley Act, the Company has implemented various measures designed to ensure compliance, including formation of a disclosure committee whose members include the Chief Executive Officer, the Chief Financial Officer and other senior executive and financial officers. In 2005, the Company began implementation of a program designed to comply with Section 404 of the Sarbanes-Oxley Act dealing with internal control over financial reporting, which includes the identification of significant processes and accounts, documentation of the design of control effectiveness over process and entity level controls, and testing of the operating effectiveness of key controls. The Company incurs substantial costs relating to compliance with the Sarbanes-Oxley Act and related rules and regulations promulgated by the SEC. See Part II, Item 9A, Controls and Procedures for the Company s evaluation of its disclosure controls and procedures.

The Bank

The Bank is subject to numerous laws and regulations generally applicable to financial institutions and financial services. The extensive regulation of the Bank limits both the activities in which the Bank may engage and the conduct of the permitted activities. Further, the laws and regulations impose reporting and information collection obligations on the Bank. The Bank incurs significant costs relating to compliance with the various laws and regulations and the collection and retention of information.

The Bank is subject to the supervision of and regular examination by its primary banking regulators, the Federal Reserve and 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 determine 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 could result in a revocation of the Bank s charter.

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 below. The Bank is subject to the Federal Deposit Insurance Act (FDIA) and FDIC regulations relating to the deposit insurance. The Bank may also be subject to supervision and examination by the FDIC, in addition to the regular supervision and examination by the Bank s primary state and federal banking regulators.

Restrictions on Transfers of Funds to FIBS and the Bank

Large portions of FIBS 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 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.

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 debt instruments if the Bank fails to meet specified regulatory capital ratios.

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. Federal Reserve 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.

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 U.S. Congress has temporarily renewed the USA Patriot Act and is expected to consider permanent renewal early in 2006.

Effect of Economic Conditions, 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 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 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, among other things, to 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, 2005, 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. Generally, neither the Bank nor FIBS is subject to a minimum capital requirement other than those applicable to banks or bank holding companies.

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 Liquidity Management and Notes to Consolidated Financial Statements Regulatory Capital included in Part IV, Item 15.

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 (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.

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.

Premiums for Deposit Insurance

Deposits in the Bank 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. 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

The Bank is 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 (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 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 rati its most recent published examination. Although the Bank s 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. Bank management responds proactively to correct all instances of non-compliance and implement procedures to prevent further violations from occurring.

Recent Regulatory Developments

The U.S. Congress approved deposit insurance reform at the beginning of February 2006. Under the new program, the Bank Insurance Fund and the Savings Association Insurance Fund will be merged. In addition, the FDIC may from time to time adjust the minimum reserve ratio, currently fixed at 1.25%, within a range between 1.15% percent and 1.50%, and may adopt a risk-based premium system. Certain retirement accounts may receive coverage up to $250,000, and the FDIC may adjust coverage levels for inflation commencing in 2010.

The Basel Committee on Banking Supervision presented its Basel II regulatory capital guidelines in July 2004, which would require changes by large internationally-active banks in the way in which their risk-based capital requirements are calculated. Federal banking regulators are considering the extent and timing of application of the guidelines to such large U.S. depository institutions.

On the basis of preliminary regulatory pronouncements, it does not appear that we would meet the asset size criteria to be included among the U.S. banking organizations affected by Basel II. In October 2005, however, U.S. banking regulators issued an advance rulemaking notice that contemplated possible modifications to the Basel I risk-based capital framework applicable to domestic banking organizations that would not be affected by Basel II. These possible modifications, which would be designed to avoid future competitive inequalities between Basel I and Basel II organizations and which would likely be applicable to us, include increasing the number of risk-weight categories; expanding the use of external ratings for credit risk; expanding the range of collateral and guarantees to qualify for a lower risk weight; and, basing residential mortgage risk ratings on loan-to-value ratios.

The banking regulators indicated an intention to publish proposed rules for implementation of Basel I and Basel II, presumptively during 2006.

Website Access to SEC Filings

All reports filed electronically by the Company 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 the Company s website at 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. 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. The Company s website and the information contained therein or connected thereto are not intended to be incorporated into this report and should not be considered a part of this report.

Item 1A. Risk Factors

When we refer to we, our, and us in this section of this report, we mean First Interstate BancSystem, Inc. collectively with its subsidiaries (referred to as the Company elsewhere in this report), unless the context indicates that we refer only to the parent holding company, First Interstate BancSystem, Inc. (referred to as FIBS elsewhere in this report). When we refer to the Bank in this section of this report, we mean First Interstate Bank, our bank subsidiary.

Like other financial and bank holding companies, we are subject to a number of risks, many of which are outside of our control, including: (1) credit risks; (2) market risks; (3) liquidity risks; and, (4) operational risks. In addition, investors who purchase 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 and on-going process of credit 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 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 non-performance and the value of available collateral, monitoring loan performance and diversifying our credit portfolio. These procedures provide us with the information necessary 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. For further discussion about our management of credit risk, see Business Lending Activities above and Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Financial Condition Loans.

Our loans and deposits are focused in two states, and adverse economic conditions in those states could negatively impact our results from operations, cash flows, and financial condition.

Concentration of credit risk arises with respect to loans when the borrowers are located in the same geographical region. Our customers with loan and/or deposit balances at December 31, 2005 were located predominantly in Montana and Wyoming. Because of the concentration of loans and deposits in these states, in the event of adverse economic conditions in Montana or Wyoming, 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, may delay or prevent borrowers from repaying their loans, reduce demand for credit or fee-based products and could negatively affect real estate and other collateral values, interest rate levels, and the availability of credit to refinance loans at or prior to maturity.

Declines in real estate values in our markets could adversely impact our business.

Like all banks, we are subject to the effects of any economic downturn, and in particular, a significant decline in real estate property values in our markets could have a negative effect on results of operations. At December 31, 2005, we had $1.9 billion of commercial, agricultural, construction, residential and other real estate loans representing 61.7% of our total loan portfolio. A significant decline in real estate values could lead to higher charge-offs in the event of defaults in our real estate loan portfolio.

(2) Market Risks:

Changes in interest rates could negatively impact our financial condition and results of operations.

Our results of operations depend substantially on net interest income, which is the difference between interest earned on interest-earning assets (such as investments and loans) and interest paid on interest-bearing liabilities (such as deposits and borrowings). Interest rates are highly sensitive to many factors, including governmental monetary policies and domestic and international economic and political conditions. Conditions such as inflation, recession, unemployment, money supply, and other factors beyond our control may also affect interest rates. In both rising and declining interest rate environments, our net interest income could be adversely impacted.

Changes in interest rates also can affect customers demand for our products and services and, correspondingly, the value of loans and other assets, including mortgage servicing rights, and our ability to realize gains on the sale of assets. A portion of our earnings result from transactional income. An example of this type of transactional income is gain on sales of loans and investment securities. This type of income can vary significantly from quarter-to-quarter and year-to-year based on a number of different factors, including the interest rate environment. 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 have a material, adverse effect on 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. For further discussion, see Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Critical

Accounting Estimates and Significant Accounting Policies Valuation of Mortgage Servicing Rights.

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(3) Liquidity Risks:

If we are unable to borrow funds through core deposits or additional debt, we may not be able to meet the cash flow requirements of our depositors and borrowers, or satisfy the cash needs to continue expansion of our business or fund operations.

Liquidity is the ability to meet current and future cash flow needs on a timely basis at a reasonable cost. The liquidity of the Bank is used to make loans and to repay deposit liabilities as they become due or are demanded by customers. The Bank s ALCO regularly monitors the overall liquidity position of the Bank and the parent company 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 unsecured 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 Bank may also be able to borrow through the Federal Reserve s discount window.

If we were unable to access any of these funding sources when needed, we might be unable to meet customers needs, continue expansion of our business or fund operations. Inadequate liquidity could also prevent us from paying dividends and repurchasing stock and would adversely impact our financial condition and level of regulatory-qualifying capital. For further discussion, see Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Capital Resources and Liquidity Management.

(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.

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

We depend 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 attack or other technological difficulties or failures. Our wholly-owned subsidiary, i_Tech, provides technology services to the Bank 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 have a material adverse effect on our business, financial condition, results of operations or liquidity.

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 may occur. These losses are recorded as noninterest expense. Any future losses related to internal operating control systems could have a material adverse effect on our business, financial condition, results of operations or liquidity.

We may encounter unforeseen difficulties executing our business strategy, including unanticipated integration problems, business disruption in connection with expansions and loss of key personnel.

Our financial performance and profitability will depend on our ability to execute our business strategy and manage our anticipated future growth. We may experience unforeseen problems as we integrate new banking offices and expand into new markets. In addition, any future acquisitions or other future growth may present operating and other problems that could have a material adverse effect on our business, financial condition, results of operations or liquidity. Our financial performance will also depend on our ability to maintain profitable operations through implementation of our Strategic Vision. Decisions to sell or close units or otherwise change the business mix may adversely impact our financial performance.

Our success depends to a significant extent on the management skills of our existing 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, Robert A. Jones, Executive Vice President and Chief Administrative Officer, or Edward Garding, Executive Vice President and Chief Credit Officer, could have a material adverse effect on our ability to operate our business or execute our business strategy. See Part III, Item 10, Directors and Executive Officers of the Registrant.

An extended disruption of vital infrastructure could negatively impact our business, results of operations and financial condition.

Our operations depend upon, among other things, our infrastructure, including equipment and facilities. Extended disruption of vital infrastructure by fire, power loss, natural disaster, telecommunications failure, computer hacking or viruses, technology failure, terrorist activity or the domestic and foreign response to such activity, or other events outside of our control could have a material adverse impact on the financial services industry as a whole and on our business, results of operations, cash flows, and financial condition in particular. Our business recovery plan may not work as intended or may not prevent significant interruptions of our operations.

New or changes in existing tax, accounting, and regulatory rules and interpretations could significantly impact strategic initiatives, results of operations, cash flows and financial condition.

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 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 material impact on our business and results of operations. 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. During the last year, several banking institutions have received large fines for non-compliance with these laws and regulations.

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 the Bank; the issuance of a cease and desist order that can be judicially enforced; the termination of the Bank s 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.

In 2004, the Federal Reserve required us to adopt a resolution requiring the Bank to develop and implement a comprehensive action plan designed to enhance our policies, procedures and data processing systems used in identifying and verifying the identity of our customers and in reporting suspicious activities in accordance with the USA Patriot and Bank Secrecy Acts. The resolution requires us to have the enhanced policies, procedures and data processing systems fully operational in 2006. Under the resolution, we are required to submit written progress reports to the Federal Reserve. Although our implementation is on schedule, there can be no assurance that we will successfully complete the implementation in 2006 as required. Failure to successfully implement our action plan could result in the assessment of substantial penalties and/or corrective measures that could have a material adverse impact on our business, results of operations, cash flows and financial condition.

Regulators may impose dividend payment and other restrictions on the Bank which would impact our ability to pay dividends to shareholders or repurchase stock.

The Federal Reserve and the State of Montana, Division of Banking and Financial Institutions are the primary regulatory agencies that examine the Bank and its 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 its parent 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%. If the Bank were unable to pay dividends to the parent company, it would impact our ability to pay dividends to shareholders or repurchase stock.

For further discussion, see Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Financial Condition Capital Resources and Liquidity Management and Notes to Consolidated Financial Statements Regulatory Capital included in Part IV, Item 15.

The Federal Reserve may require us to commit capital resources to support the Bank.

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.

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(5) Investment Risks:

Our common stock is not publicly traded, and there are significant resale limitations.

Shares of our common stock are not traded in any market. Our common stock is not listed on any securities exchange or traded on any automated quotation system. In the event shareholders desire to sell or otherwise dispose of their shares, they may not be able to do so.

Shares of our common stock are subject to contractual transfer restrictions, and we have no obligation to repurchase outstanding shares of common stock.

With respect to our outstanding common stock, 90.4% 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 established for our employees are not subject to contractual transfer restrictions set forth in shareholder agreements due to requirements of the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code (IRC). Since the savings plan does not allow distributions in kind, distributions from participants savings plan accounts require the 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, by contract, policy or otherwise, to purchase restricted or unrestricted shares of our common stock, except in very limited circumstances involving members of the Scott family. 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, 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 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.

Existing shareholders will be diluted by future issuances of common 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 herein 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 61.3% of our outstanding common stock. Many of these directors and executive officers are members of the Scott family, which collectively owns 76.0% 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.

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Item 1B. Unresolved Staff Comments

The Company is 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 of 1933, and has not received written comments from the SEC staff regarding its periodic or current reports filed under the Exchange Act.

Item 2. Properties

The Company s principal executive offices and a banking office are anchor tenants in a 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. As of December 31, 2005, the Company leased approximately 86,931 square feet of space in the building.

As of December 31, 2005, the Company also provided banking services at 52 additional locations in Montana and Wyoming, of which 32 locations are owned by the Company and 20 locations are leased from independent third parties.

The Company leases approximately 24,368 square feet of office space for its operations center, also located in Billings, Montana, and an aggregate of approximately 59,729 square feet of office space in Montana, Colorado, Idaho and Oregon for its technology services subsidiary.

The Company believes its facilities are fully utilized, suitable and adequate to meet its current operational needs.

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 is not expected to 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

No matters were submitted to a vote of security holders during the fourth quarter of 2005.

PART II

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

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 8,098,933 shares were outstanding as of December 31, 2005, and 100,000 shares of preferred stock without par value, none of which were outstanding as of December 31, 2005.

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 therefor. 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.

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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 90.4% of the shares subject to contractual transfer restrictions set forth in shareholder agreements and 9.6% held by 17 shareholders without such restrictions, including the Company s 401(k) plan which holds 80.4% of the unrestricted shares. See also Part I, Item 1, Risk Factors Liquidity Risks.

Quarter-end minority appraisal values for the past two years, determined by an independent valuation expert, follow:

Valuation As Of	Appraised Minority Value
December 31, 2003	$ 51.00
March 31, 2004	52.50
June 30, 2004	54.50
September 30, 2004	55.50
December 31, 2004	63.00
March 31, 2005	63.50
June 30, 2005	65.50
September 30, 2005	68.00
December 31, 2005	71.00

As of December 31, 2005, options for 837,145 shares of FIBS common stock were outstanding at various exercise prices, ranging from $40.00 to $65.50. The aggregate cash proceeds to be received by FIBS upon exercise of all options outstanding at December 31, 2005, would approximate $38.5 million, or a weighted average exercise price of $45.95 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 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 17 shareholders who own an aggregate of 776,507 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 the ERISA and the IRC. 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 Financial Services division 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 750 record shareholders of FIBS as of December 31, 2005, including the Company s Savings Plan as trustee for 624,115 shares held on behalf of 1,219 individual participants in the plan. Of such participants, 373 individuals 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. The dividend amount is periodically reviewed and set by the FIBS Board of Directors. The FIBS 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.

Historical quarterly dividends for 2004 and 2005 are as follows:

Month Declared and Paid	Amount Per Share	Total Cash Dividend
January 2004	$.34	$2,689,818
April 2004	.40	3,158,260
July 2004	.40	3,154,552
October 2004	.42	3,351,829
January 2005	.42	3,346,736
April 2005	.48	3,825,415
July 2005	.48	3,824,652
October 2005	.50	4,047,869
January 2006	.50	4,051,636

The FIBS Board of Directors increased the quarterly dividend to $0.58 per common share beginning with the April 2006 dividend.

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 FIBS 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.

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. The 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

The following table provides information as of December 31, 2005, regarding the Company s equity compensation plans.

Equity Compensation Plans

Plan Category	Number of Securities To be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available For Future Issuance Under Equity Compensation Plans[1]
Equity compensation plans approved by shareholders[2]	837,145	$ 45.95	533,255

Equity compensation plans not approved by shareholders[3]	N/A	N/A	14,500

(1) Excludes number of securities to be issued upon exercise of outstanding options, warrants and rights.

(2) Represents stock options pursuant to the Company s 2001 Stock Option Plan. See Notes to Consolidated Financial Statements Employee Benefit Plans included in Part IV, Item 15.

(3) Represents restricted stock pursuant to the Company s 2004 Restricted Stock Award Plan. See Notes to Consolidated Financial Statements Employee Benefit Plans included in Part IV, Item 15.

Sales of Unregistered Securities

There were no unregistered shares of common stock issued by the Company during the three months ended December 31, 2005.

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 the Company or any affiliated purchasers (as defined in Rule 10b-18(a)(3) under the Exchange Act), of the Company s common stock during the three months ended December 31, 2005.

Purchases of Equity Securities by Issuer

Period	Total Number Of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans Or Programs[1]	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
October 2005	6,405	$ 65.50	0	Not Applicable
November 2005	3,709	67.36	0	Not Applicable
December 2005	4,469	68.00	0	Not Applicable
Total	14,583	$ 66.74	0	Not Applicable

(1) The common stock of the Company is not actively traded, and there is no established trading market for the stock. There is only one class of common stock, with 90.4% of the shares subject to contractual transfer restrictions set forth in shareholder agreements and 9.6% without such restrictions. The Company has a right of first refusal to repurchase the restricted stock. Additionally, restricted stock held by officers, directors and employees of the Company may be called by the Company under certain conditions. The Company has no obligation to purchase restricted or unrestricted stock, but has historically purchased such stock. All purchases indicated in the table above were effected pursuant to private transactions.

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, 2005 and 2004, and its results of operations for the fiscal years ended December 31, 2005, 2004 and 2003, has been derived from the audited 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. The selected consolidated financial data with respect to the Company s consolidated financial position as of December 31, 2003, 2002 and 2001, and its results of operations for the fiscal years ended December 31, 2002 and 2001, has been derived from the audited consolidated financial statements of the Company not included herein.

Five Year Summary

(Dollars in thousands except share and per share data)

Year ended December 31,	2005	2004	2003	2002	2001(1)
Operating Data:					
Interest income	$ 233,857	192,840	189,258	201,306	219,025
Interest expense	63,549	42,421	48,614	65,459	93,984
Net interest income	170,308	150,419	140,644	135,847	125,041
Provision for loan losses	5,847	8,733	9,852	9,191	7,843
Net interest income after provision for loan losses	164,461	141,686	130,792	126,656	117,198
Noninterest income	70,290	70,644	70,152	60,901	52,135
Noninterest expense	150,726	142,980	137,925	133,816	120,249
Income before income taxes	84,025	69,350	63,019	53,741	49,084
Income tax expense	29,310	23,929	22,267	19,247	17,901
Net income	$ 54,715	45,421	40,752	34,494	31,183

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Five Year Summary (continued)
(Dollars in thousands except share and per share data)

Year ended December 31,	2005	2004	2003	2002	2001[1]
Operating Data:					
Basic earnings per common share	$ 6.84	5.74	5.18	4.41	3.97
Diluted earnings per common share	6.71	5.68	5.15	4.41	3.94
Dividends per common share	1.88	1.56	1.32	1.29	1.18
Weighted average common shares outstanding diluted	8,149,337	7,997,579	7,909,947	7,830,429	7,921,694
Ratios:					
Return on average assets	1.26%	1.14	1.09	1.03	1.01
Return on average common stockholders equity	16.79	15.75	15.79	14.86	14.89
Average stockholders equity to average assets	7.52	7.22	6.93	6.91	6.80
Net interest margin	4.48	4.34	4.37	4.66	4.66
Net interest spread	4.13	4.12	4.14	4.33	4.11
Common stock dividend payout ratio[2]	27.49	27.18	25.48	29.25	29.72
Balance Sheet Data at Year End:					
Total assets	$4,562,313	4,217,293	3,879,744	3,558,968	3,278,850
Loans	3,034,354	2,739,509	2,554,899	2,236,550	2,122,102
Allowance for loan losses	42,450	42,141	38,940	36,309	34,091
Investment securities	1,019,901	867,315	799,587	799,292	693,178
Deposits	3,547,590	3,321,681	3,156,721	2,911,847	2,672,747
Other borrowed funds	7,495	7,995	7,137	7,970	8,095
Long-term debt	54,654	61,926	47,590	23,645	34,331
Subordinated debenture held by subsidiary trust/trust preferred securities	41,238	41,238	41,238	40,000	40,000
Stockholders equity	349,847	308,326	274,226	243,854	222,069
Asset Quality Ratios at Year End:					
Non-performing assets to total loans and other real estate owned (OREO[3])	0.67%	0.79	1.30	1.51	1.22
Allowance for loan losses to total loans	1.40	1.54	1.52	1.62	1.61
Allowance for loan losses to non-performing loans[4]	236.17	212.04	124.53	109.23	133.83
Net charge-offs to average loans	0.19	0.21	0.31	0.32	0.32
Regulatory Capital Ratios at Year End:					
Tier 1 risk-based capital	10.07%	9.67	9.30	9.17	8.73
Total risk-based capital	11.27	10.95	10.64	10.62	10.33
Leverage ratio	7.91	7.49	7.13	6.90	6.77

(1) On January 1, 2002, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets. Under the provisions of SFAS No. 142, goodwill is no longer amortized over an estimated useful life. Selected financial data for 2001 has not been restated to reflect the nonamortization provisions of SFAS No. 142. Goodwill amortization expense, net of income tax benefit, was $1.9 million in 2001.

(2) Dividends per common share divided by basic earnings per common share.

(3) 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.

(4) 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

Executive Overview

FIBS is a financial and bank holding company with 53 banking offices in 30 communities throughout Montana and Wyoming. The Company differentiates itself from competitors by focusing on providing superior service to its banking and technology services customers and emphasizing community service to improve the communities it serves.

The Company derives its income principally from interest charged on loans, and to a lesser extent, from interest and dividends earned on investments. The Company also derives income from noninterest sources such as fees received in connection with various lending and deposit services; trust, 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. The Company s principal expenses include interest expense on deposits and borrowings, operating expenses, provisions for loan losses and income tax expense.

Increases in the Company s earnings during recent years have been effected through a successful combination of organic loan and deposit growth in market areas served by the Company s existing banking offices, and to a lesser extent, through the acquisition of banking offices in contiguous market areas. During the previous five years, the Company used de novo banking offices to better serve existing customers and to attract new customers in existing market areas. Organic growth experienced by the Company is reflected by an increased volume of customer loans and deposits without giving effect to acquisitions. The Company s organic growth has largely been accomplished through a combination of effective offering and promotion of competitively priced products and services and the opening of de novo banking offices.

During 2005, the Company continued to focus on improving operating efficiency and identifying new opportunities to generate additional noninterest income. This strategy resulted in increased earnings in 2005. Net income of $54.7 million in 2005 exceeded 2004 earnings by 20.5%, and earnings per diluted share increased $1.03 to $6.71 in 2005. Net interest income, on a fully taxable-equivalent basis, of $173.7 million increased $20.1 million in 2005, primarily due to growth in loans and investment securities combined with higher yields on interest earning assets. Net income for 2005 was also positively impacted by lower provisions for loan losses and the reversal of prior years impairment of mortgage servicing rights. Partially offsetting these increases in net income were additional expenses related to the discontinuation of the Wal-Mart in-store banking offices; losses on sales of investment securities; and, inflationary increases in salaries, wages and benefits expenses.

The Company not only grew in terms of earnings but also in terms of asset size, surpassing $4.5 billion in total assets in 2005. Most of the increase in total assets was attributable to increases in investment securities and organic growth in loans, funded by increases in customer deposits and securities sold under repurchase agreements.

During 2006, faced with the challenges of a sustained flattened yield curve, the Company will continue to focus 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.

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

Critical Accounting Estimates and Significant Accounting Policies

The Company s 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 it operates. 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. The Company s significant accounting policies are summarized in Notes to Consolidated Financial Statements Summary of Significant Accounting Policies included in Part IV, Item 15.

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The Company s 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 the Company s 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 the Company s consolidated financial statements, results of operations or liquidity. The allowance for loan losses is maintained at an amount the Company believes is sufficient to provide for estimated losses inherent in its 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, the Company s historical experience has provided for an adequate allowance for loan losses. For additional information regarding the allowance for loan losses, its relation to the provision for loan losses and risk related to asset quality, see Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Provision for Loan Losses and Management s Discussion and Analysis of Financial Condition and Results of Operations Financial Condition Allowance for Loan Losses below, and Notes to Consolidated Financial Statements Allowance for Loan Losses included in Part IV, Item 15. See also Part I, Item 1A, Risk Factors Credit Risks.

Valuation of Mortgage Servicing Rights

The Company recognizes 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. The Company utilizes the expertise of a third-party consultant to estimate the fair value of its 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 the Company s consolidated financial statements, results of operations or liquidity.

At December 31, 2005, 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 $4.0 million and an immediate 50 basis point decrease in mortgage interest rates would result in a reduction in fair value of $8.5 million.

For additional information regarding mortgage servicing rights, see Management s Discussion and Analysis of Financial Condition and Results of Operations Financial Condition Mortgage Servicing Rights included below, and Notes to Consolidated Financial Statements Mortgage Servicing Rights, included in Part IV, Item 15. See also Part I, Item 1A, Risk Factors Market Risks.

Results of Operations

Net Interest Income

Net interest income, the largest source of the Company s 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.

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The most significant impact on the Company s 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.

The following table presents, for the periods indicated, condensed average balance sheet information for the Company, 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,								
	2005			2004			2003		
	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Av R
est earning assets:									
s[1][2]	$2,874,723	196,453	6.83%	$2,629,474	162,598	6.18%	$2,448,386	159,500	6.
and agency securities	779,369	30,054	3.86	715,363	25,272	3.53	679,064	25,347	3.
ral funds sold	83,156	2,766	3.33	69,225	1,071	1.55	49,823	545	1.
r securities	7,599	201	2.65	12,825	315	2.46	19,170	540	2.
exempt securities[2]	103,364	6,744	6.53	95,376	6,489	6.80	88,913	6,236	7.
est bearing deposits in banks	31,325	1,021	3.26	14,411	281	1.95	1,272	19	1.
l interest earning assets	3,879,536	237,239	6.12	3,536,674	196,026	5.54	3,286,628	192,187	5.
earning assets	454,545			460,327			436,866		
l assets	$4,334,081			$3,997,001			$3,723,494		
est bearing liabilities:									
and deposits	$ 667,668	4,795	0.72%	$ 576,909	1,618	0.28%	$ 534,070	1,697	0.
ngs deposits	902,749	11,151	1.24	898,631	6,664	0.74	820,762	6,512	0.
e deposits	1,013,159	29,641	2.93	1,027,096	26,022	2.53	1,058,793	33,178	3.
owings[3]	507,131	12,750	2.51	387,609	3,814	0.98	324,754	2,325	0.
-term debt	61,055	2,480	4.06	52,732	2,329	4.42	48,869	2,374	4.
rdinated debenture held by subsidiary /trust preferred securities	41,238	2,732	6.62	41,238	1,974	4.79	44,132	2,528	5.
l interest bearing liabilities	3,193,000	63,549	1.99	2,984,215	42,421	1.42	2,831,380	48,614	1.
nterest bearing deposits	780,427			693,705			600,276		
r liabilities	34,854			30,655			33,796		
kholders equity	325,800			288,426			258,042		

l liabilities and stockholders equity	$4,334,081			$3,997,001			$3,723,494	
TE interest income		$173,690			$153,605			$143,573
FTE adjustments[2]		(3,382)			(3,186)			(2,929)
nterest income from consolidated ments of income		$170,308			$150,419			$140,644
est rate spread			4.13%			4.12%		4.
TE yield on interest earning assets[4]			4.48%			4.34%		4.

(1) Average loan balances include nonaccrual loans. Interest income on loans includes amortization of loan fees, which is not material.

(2) Interest income and average rates for tax exempt loans and securities are presented on a fully-taxable equivalent (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 yield on interest earning assets 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.

Net interest income on a fully taxable-equivalent (FTE) basis increased $20.1 million, or 13.1%, to $173.7 million in 2005 from $153.6 in 2004, and the net FTE yield on interest earning assets increased 14 basis points to 4.48% in 2005, as compared to 4.34% in 2004. Improvements in net FTE interest income and net FTE yield in 2005, as compared to 2004, are partly attributable to growth in average earning assets in 2005. Additionally, noninterest-bearing deposits and common equity comprised a larger share of the funding base in 2005, as compared to 2004, allowing the Company to be less reliant on higher costing funding sources, such as time deposits, in 2005. Further contributing to the improvements in net FTE interest income and net FTE yield were decreases in non-earning assets as a percentage of total assets while earning assets grew as a percentage of total assets in 2005.

Net FTE interest income increased $10.0 million, or 7.0%, to $153.6 million in 2004, from $143.6 million in 2003, primarily due to the combined effect of increases in the average balances of interest earning assets, primarily loans and investment securities, as well as a decrease in interest expense on interest bearing liabilities resulting from declines in market interest rates. The net FTE yield on interest earning assets decreased 3 basis points to 4.34% in 2004 as compared to 4.37% in 2003 primarily due to decreases in the spread between rates earned on interest earning assets and rates paid on interest bearing liabilities combined with the impact of reinvesting funds received through prepayments and repricing on loans, investment securities and borrowings at current market interest rates.

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)

	December 31, 2005 compared with December 31, 2004			December 31, 2004 compared with December 31, 2003			December 31, 2003 compared with December 31, 2002		
Year ended	Volume	Rate	Net	Volume	Rate	Net	Volume	Rate	Net
Interest earning assets:									
Loans[1]	$ 15,165	18,690	33,855	11,797	(8,699)	3,098	19,611	(24,132)	(4,521)
U.S. and agency securities	2,261	2,521	4,782	1,355	(1,429)	(74)	6,292	(11,686)	(5,394)
Federal funds sold	216	1,479	1,695	212	314	526	(497)	(285)	(782)
Other securities [2]	(128)	14	(114)	(179)	(46)	(225)	(1,066)	(284)	(1,350)
Tax exempt securities[1][2]	543	(288)	255	453	(201)	252	432	(204)	228
Interest bearing deposits in banks	343	397	740	192	70	262	(286)	(1)	(287)
Total change	18,400	22,813	41,213	13,830	(9,991)	3,839	24,486	(36,592)	(12,106)
Interest bearing liabilities:									
Demand deposits	255	2,922	3,177	136	(215)	(79)	411	(2,400)	(1,989)
Savings deposits	30	4,457	4,487	618	(466)	152	1,220	(5,747)	(4,527)
Time deposits	(353)	3,972	3,619	(993)	(6,164)	(7,157)	1,270	(9,618)	(8,348)
Borrowings[3]	1,176	7,760	8,936	450	1,040	1,490	799	(2,108)	(1,309)
Long-term debt	368	(217)	151	188	(233)	(45)	1,206	(877)	329
Subordinated debenture held by by subsidiary		758	758	(166)	(388)	(554)	365	(1,366)	(1,001)

trust/trust preferred securities									
Total change	1,476	19,652	21,128	233	(6,426)	(6,193)	5,271	(22,116)	(16,845)
Increase (decrease) in FTE net interest income [1]	$ 16,924	3,161	20,085	13,597	(3,565)	10,032	19,215	(14,476)	4,739
-									

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

The provision for loan losses decreased 33.0% to $5.8 million in 2005, from $8.7 million in 2004, and 11.4% to $8.7 million in 2004, from $9.9 million in 2003. The Company reduced its provision for loan losses due to lower levels of non-performing loans, net charge-offs and internally classified loans in 2005 and 2004.

Noninterest Income

Principal sources of noninterest income include other service charges, commissions and fees; service charges on deposit accounts; technology services revenues; income from the origination and sale of loans; and, income from fiduciary activities, comprised principally of fees earned on trust assets. Noninterest income decreased less than 1%, to $70.3 million in 2005, from $70.6 million in 2004, and increased less than 1% to $70.6 million in 2004, from $70.2 million in 2003. 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 17.2% to $22.5 million in 2005, from $19.2 million in 2004, and 20.4% to $19.2 million in 2004, from $16.0 million in 2003. These increases are primarily attributable 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 balance of loans serviced. Higher investment service revenues also contributed to the increase in 2004 as compared to 2003.

Service charges on deposit accounts decreased 8.5% to $17.3 million in 2005, from $18.9 million in 2004, primarily due to fewer overdrafts. In addition, service charges on cash management deposit accounts decreased during 2005, as compared to 2004, primarily due to higher earnings credit rates. The earnings credit rate, which is based on market interest rates, reflects the value of deposit balances maintained by cash management customers. The earnings credit is used to offset service charges incurred by cash management customers. Because market interest rates have trended upward since mid-2004, the earnings credit offset to service charges on cash management deposits is higher relative to 2004.

Service charges on deposit accounts increased 7.2% to $18.9 million in 2004, from $17.6 million in 2003, primarily due to increases in service fee rates for account overdraft processing and stopping check payments that became effective during the second and third quarters of 2003 and the implementation of an automated overdraft processing system during the first quarter of 2004. Additionally, declining interest rates reduced earnings credits on business checking accounts resulting in increased check processing revenues in 2004.

Technology services revenues increased 5.8% to $13.3 million in 2005, from $12.6 million in 2004, primarily due to increases in the number of core data service customers and the volume of transactions processed. Technology services revenues increased 9.4% to $12.6 million in 2004, from $11.5 million in 2003, primarily due to the acquisition of the assets of a small technology services provider in June 2004, which increased revenues by approximately $742,000 during the last half of 2004. The remaining increase in 2004 from 2003 was primarily due to higher fee income resulting from increases in the number of customers using the Company s item processing services and higher ATM transaction volumes.

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 2.9% to $8.6 million in 2005, from $8.4 million in 2004, and decreased 45.4% to $8.4 million in 2004, from $15.3 million in 2003.

Income from fiduciary activities increased 11.4% to $6.4 million in 2005, from $5.7 million in 2004 and 11.6% to $5.7 million in 2004, from $5.1 million in 2003, primarily due to higher asset management fees resulting from improved market performance of underlying trust account assets and the addition of new trust customers.

The Company recorded net losses of $3.7 million on sales of investment securities during 2005, as compared to $797,000 in 2004, and $75,000 in 2003. During 2005, lower yielding U.S. government agency securities were sold and the proceeds were reinvested in higher yielding mortgage-backed and U.S. government agency securities. During 2004, the Company used investment securities gains and losses to offset temporary mortgage servicing rights valuation changes. Valuations of investment securities generally react to interest rate changes in an opposite direction from changes in mortgage servicing rights valuations.

Other income primarily includes increases in company-owned life insurance revenues, check printing income, agency stock dividends and gains on sales of assets other than investment securities. Exclusive of a $1.7 million gain on the sale of a banking office recorded during third quarter 2004, other income increased 17.9% to $5.8 million in 2005, from $4.9 million in 2004, primarily due to increases in check printing income, higher earnings on securities held in trust under deferred compensation plans and gains on the sale of other real estate owned. Other income increased 42.2% to $6.6 million in 2004, from $4.7 million in 2003, primarily due to a $1.7 million gain on the sale of a banking office recorded during third quarter 2004.

Noninterest Expense

Noninterest expense increased 5.4% to $150.7 million in 2005, from $143.0 million in 2004, and 3.7% to $143.0 million in 2004, from $137.9 million in 2003. Significant components of these increases are discussed below.

During 2005, the Company recorded expenses of $1.1 million directly related to the discontinuation of operations of the Wal-Mart in-store banking offices, including lease termination fees and estimated costs to restore leased facilities to their original condition of $375,000; acceleration of depreciation on leasehold improvements and equipment attached to the premises of $620,000; and, accruals for employment incentive awards of $92,000 .

Salaries, wages and employee benefits expense increased 8.2% to $80.0 million in 2005, from $74.0 million in 2004. Exclusive of deferred costs related to the origination of loans, salaries, wages and employee benefits expense increased 6.5% to $86.4 million in 2005, from $81.1 million in 2004, primarily due to inflationary wage increases and higher incentive compensation and profit sharing contributions reflective of operating results in 2005.

Salaries, wages and employee benefits expense increased 5.7% to $74.0 million in 2004, from $70.0 million in 2003, primarily due to inflationary wage increases. Exclusive of deferred costs related to the origination of loans, salaries, wages and employee benefits expenses increased 4.2% to $81.1 million in 2004, from $77.8 million in 2003. The Company s focus on internal efficiencies during 2004 resulted in a reduction of 43 full time equivalent employees as compared to 2003. Savings due to employee reductions were offset primarily by increased group insurance costs.

Furniture and equipment expense increased 5.7% to $15.9 million in 2005, from $15.1 million in 2004, and 14.9% to $15.1 million in 2004, from $13.1 million in 2003. The Company accelerated the depreciation of equipment at Wal-Mart in-store banking offices to the date of their expected discontinuation resulting in additional expense of $150,000 in 2005. The remaining 2005 increase and the increase in 2004 are primarily due to expenses associated with furnishing new facilities and upgrading existing facilities.

Occupancy expense increased 12.4% to $13.4 million in 2005, from $11.9 million in 2004, and 10.4% to $11.9 million in 2004, from $10.8 million in 2003. The Company accelerated the depreciation of leasehold improvements at Wal-Mart in-store banking offices to the date of their expected discontinuation resulting in additional expense of $470,000 in 2005. The remaining 2005 increase and the 2004 increase are primarily due to depreciation and other expenses associated with the addition of new facilities and higher depreciation expense associated with upgrades of existing facilities.

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 15.8% to $4.6 million in 2005, from $4.0 million in 2004, and 1.9% to $4.0 million in 2004, from $3.9 million in 2003.

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. The Company reversed previously recorded impairment of $2.2 million and $263,000 in 2005 and 2004, respectively, and recorded impairment charges of $1.0 million in 2003.

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Professional fees decreased 10.5% to $2.8 million in 2005, from $3.2 million in 2004, primarily due to additional fees incurred in 2004 related to the implementation of automated overdraft processing and account reconciliation systems. Professional fees increased 16.3% to $3.2 million in 2004, from $2.7 million in 2003 primarily due to outsourcing of certain customer service functions by the Company s technology subsidiary and fees related to the implementation of automated overdraft processing and account reconciliation systems in 2004.

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 3.6% to $32.8 million in 2005, from $31.7 million in 2004, primarily due to recognition of approximately $430,000 of expense related to multi-year donations made by the Company in 2005; recognition of a $313,000 loss on the disposal of obsolete mainframe equipment; and, inflationary increases in other expenses. These increases were partially offset by lower Federal Reserve service fees resulting from implementation of electronic item submission to accelerate item clearing and lower required compensating balances.

Other expenses decreased 3.4% to $31.7 million in 2004, from $32.8 million in 2003. During 2003, the Company expensed unamortized debt issuance costs of $1.9 million and recorded fraud losses of $561,000. These decreases in other expenses were partially offset by increases in fees paid to directors and inflationary increases in other expenses.

Income Tax Expense

The Company s effective federal tax rate was 31.0%, 30.6% and 29.8% for the years ended December 31, 2005, 2004 and 2003, respectively. State income tax applies primarily to pretax earnings generated within Montana, Colorado, Idaho and Oregon. The Company s effective state tax rate was 3.8%, 3.9% and 5.6% for years ended December 31, 2005, 2004 and 2003, respectively. The decrease in the state tax rate for 2005 and 2004, as compared to 2003, reflects the recognition of state tax benefits from prior years.

Operating Segment Results

The Company s primary operating segment is Community Banking, which encompasses commercial and consumer banking services offered to individuals, businesses and municipalities. The Community Banking segment represented over 90% of the combined revenues and income of the Company during 2005, 2004 and 2003, and consolidated assets of the Company as of December 31, 2005 and 2004.

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 and capture, wide area network services and system support.

Included in Other is the net funding cost and other expenses of the parent holding company, compensation expense or benefit related to equity-based employee compensation, the operational results of consolidated nonbank subsidiaries (except i_Tech) and intercompany eliminations.

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

Operating Segment Results

(Dollars in thousands)

	Net Income (Loss)		
Year ended December 31,	2005	2004	2003
Community Banking	$ 57,144	47,579	44,255
Technology Services	4,193	3,962	4,410
Other	(6,622)	(6,120)	(7,913)
Consolidated	$ 54,715	45,421	40,752

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

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Summary of Quarterly Results

The following table presents the Company s unaudited quarterly results of operations for the fiscal years ended December 31, 2005 and 2004.

Quarterly Results

(Dollars in thousands except per share data)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Year Ended December 31, 2005:					
Interest income	$51,967	55,544	61,423	64,923	233,857
Interest expense	12,634	14,672	16,806	19,437	63,549
Net interest income	39,333	40,872	44,617	45,486	170,308
Provision for loan losses	1,625	1,365	1,375	1,482	5,847
Net interest income after provision for loan losses	37,708	39,507	43,242	44,004	164,461
Noninterest income	16,949	17,840	17,462	18,039	70,290
Noninterest expense	36,396	37,643	37,142	39,545	150,726
Income before income taxes	18,261	19,704	23,562	22,498	84,025
Income tax expense	6,302	6,824	8,288	7,896	29,310
Net income	$11,959	12,880	15,274	14,602	54,715
Basic earnings per common share	$ 1.50	1.62	1.91	1.78	6.84
Diluted earnings per common share	1.48	1.59	1.88	1.77	6.71
Dividends per common share	0.42	0.48	0.48	0.50	1.88
Year Ended December 31, 2004:					
Interest income	$46,567	47,046	48,143	51,084	192,840
Interest expense	10,084	9,993	10,589	11,755	42,421
Net interest income	36,483	37,053	37,554	39,329	150,419
Provision for loan losses	2,418	2,541	2,387	1,387	8,733
Net interest income after provision for loan losses	34,065	34,512	35,167	37,942	141,686
Noninterest income	16,482	17,269	19,421	17,472	70,644
Noninterest expense	35,569	32,302	37,560	37,549	142,980
Income before income taxes	14,978	19,479	17,028	17,865	69,350
Income tax expense	5,260	6,907	5,942	5,820	23,929

Net income	$ 9,718	12,572	11,086	12,045	45,421
Basic earnings per common share	$ 1.23	1.59	1.41	1.51	5.74
Diluted earnings per common share	1.22	1.58	1.39	1.49	5.68
Dividends per common share	0.34	0.40	0.40	0.42	1.56

Financial Condition

Total assets increased 8.2% to $4,562 million as of December 31, 2005, from $4,217 million as of December 31, 2004, primarily due to organic loan growth and increases in available-for-sale investment securities. Asset growth was primarily funded by increases in customer deposits and securities sold under repurchase agreements.

Loans

The Company s 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 served by the Company. While each loan originated 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.

Total loans increased 10.8% to $3,034 million as of December 31, 2005, from $2,740 million as of December 31, 2004. All significant loan categories, except commercial loans, demonstrated growth with the most significant growth occurring in real estate loans, which, in aggregate, constituted 61.7% of the total loan portfolio as of December 31, 2005. Management attributes the Company s loan growth to its strategic focus on organic growth within the Company s market areas. Total loans increased 7.2% to $2,740 million as of December 31, 2004, from $2,555 million as of December 31, 2003, primarily due to organic growth, particularly in loans secured by commercial real estate and construction loans.

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

Loans Outstanding

(Dollars in thousands)

	As of December 31,									
	2005	Percent	2004	Percent	2003	Percent	2002	Percent	2001	Percent
Loans										
Real estate:										
Commercial	$ 907,041	29.8%	$ 838,858	30.6%	$ 753,551	29.4%	$ 652,606	29.1%	$ 595,034	28.0%
Residential	427,808	14.1	379,998	13.9	348,901	13.7	287,996	12.9	263,218	12.4
Construction	403,751	13.3	296,773	10.8	244,784	9.6	127,102	5.7	93,209	4.4
Other	135,469	4.5	129,600	4.7	149,963	5.9	147,026	6.6	149,833	7.1
Consumer	587,895	19.4	514,045	18.8	491,938	19.3	470,668	21.0	483,636	22.8
Commercial	494,848	16.3	500,611	18.3	480,725	18.8	460,536	20.6	434,330	20.5
Agricultural	74,561	2.5	74,303	2.7	82,634	3.2	87,144	3.9	95,513	4.5
Other loans	2,981	0.1	5,321	0.2	2,403	0.1	3,472	0.2	7,329	0.3
Total loans	3,034,354	100.0%	2,739,509	100.0%	2,554,899	100.0%	2,236,550	100.0%	2,122,102	100.0%
Less allowance for loan losses	42,450		42,141		38,940		36,309		34,091	
Net loans	$ 2,991,904		$ 2,697,368		$ 2,515,959		$ 2,200,241		$ 2,088,011	
Ratio of allowance to total loans		1.40%		1.54%		1.52%		1.62%		1.61%

Construction loans increased 36.0% to $404 million as of December 31, 2005, as compared to $297 million as of December 31, 2004. Construction loans are primarily to commercial builders for 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 2005 was primarily the result of strong demand for housing in the Company s market areas.

Consumer loans increased 14.4% to $588 million as of December 31, 2005, from $514 million as of December 31, 2004, primarily due to increases in indirect consumer loans, the result of a strategic management decision to implement a centralized approach to indirect lending decisions and product pricing.

The following table presents the maturity distribution of the Company s loan portfolio and the sensitivity of the loans to changes in interest rates as of December 31, 2005:

Maturities and Interest Rate Sensitivities

(Dollars in thousands)

	Within One Year	One Year to Five Years	After Five Years	Total
Real estate	$ 794,459	724,126	355,484	1,874,069
Consumer	304,338	266,336	17,221	587,895
Commercial	394,955	92,870	7,023	494,848
Agricultural	67,391	7,145	25	74,561
Other loans	2,981			2,981
	$1,564,124	1,090,477	379,753	3,034,354
Loans at fixed interest rates	$ 600,239	883,877	159,115	1,643,231
Loans at variable interest rates	946,743	206,600	220,638	1,373,981
Nonaccrual loans	17,142			17,142
	$1,564,124	1,090,477	379,753	3,034,354

For additional information concerning the Company s loan portfolio and its credit administration policies, see Part I, Item 1, Business Lending Activities.

Investment Securities

The Company s investment portfolio is managed to obtain the highest yield possible, while meeting the Company s 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 17.6% to $1,020 million as of December 31, 2005, from $867 million as of December 31, 2004. As of December 31, 2005, investment securities with amortized costs and fair values of $916 million and $903 million, respectively, were pledged to secure public deposits and securities sold under repurchase agreements. During 2005, the Company 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 27 basis points to 4.16% in 2005, from 3.89% in 2004. Proceeds from sales of lower yielding available-for-sale U.S. agency investment securities during 2005 were reinvested in higher-yielding mortgage-backed and U.S. agency investment securities. For additional information concerning securities sold under repurchase agreements, see Federal Funds Purchased and Securities Sold Under Repurchase Agreements included herein.

Investment securities increased 8.5% to $867 million as of December 31, 2004, from $800 million as of December 31, 2003, due to investment of funds primarily generated through organic deposit growth. The weighted average yield on investment securities decreased 19 basis points to 3.89% in 2004, from 4.08% in 2003, primarily due to the investment of funds received through deposit growth and early repayment of mortgage-backed investment securities in shorter duration U.S. agency securities in anticipation of market interest rate increases.

The following table sets forth the book value, percentage of total investment securities and average yield for the Company s investment securities as of December 31, 2005:

Securities Maturities and Yield

(Dollars in thousands)

	Book Value	% of Total Investment Securities	Weighted Average Yield(1)
U.S. Government agency securities			
Maturing within one year(2)	$ 205,090	20.1%	4.09%
Maturing in one to five years	306,779	30.1	4.18
Mark-to-market adjustments on securities available-for-sale	(4,660)		
Total	507,209	49.7	4.15
Mortgage-backed securities			
Maturing within one year	81,538	8.0	4.54
Maturing in one to five years	273,893	26.9	4.28
Maturing in five to ten years	29,276	2.9	4.22
Maturing after 10 years	33,452	3.3	4.84
Mark-to-market adjustments on securities available-for-sale	(8,927)		
Total	409,232	40.1	4.41
Tax exempt securities			
Maturing within one year	9,655	1.0	5.93
Maturing in one to five years	51,368	5.0	6.61
Maturing in five to ten years	23,208	2.3	6.74
Maturing after ten years	18,194	1.8	6.21
Total	102,425	10.1	6.53
Other securities (3)			
Maturing within one year		0.0	0.00
Maturing in one to five years	75	0.0	0.00
Maturing in five to ten years	419	0.0	0.00
Maturing after ten years	532	0.1	0.00

Total	1,026	0.1	0.00
Mutual funds with no stated maturity	9	0.0	3.56
Total	9	0.0	3.56
Total	$1,019,901	100.0%	4.16%

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

(2) Includes investment securities with amortized costs of $175 million that mature January 6, 2006 used to collateralize securities sold under repurchase agreements.

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

The maturities noted above reflect $290 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 to the Company 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, 2005.

There were no significant concentrations of investments at December 31, 2005, (greater than 10% of stockholders equity) in any individual security issuer, except for U.S. Government or agency-backed securities.

As of December 31, 2004, the Company had U.S. Government agency securities, tax exempt securities, corporate securities, mortgage-backed securities and mutual funds with carrying values of $356 million, $100 million, $11 million, $401 million, and $183,000, respectively. During 2004, weighted average yields on U.S. Government agency securities, tax exempt securities, other securities, mortgage-backed securities and mutual funds were 3.13%, 6.58%, 2.78%, 4.31% and 1.58%, respectively.

As of December 31, 2003, the Company had U.S. Government agency securities, tax exempt securities, corporate securities, mortgage-backed securities, and mutual funds with carrying values of $241 million, $92 million, $11 million, $456 million, and $101,000, respectively. During 2003, weighted average yields on U.S. Government agency securities, tax exempt securities, corporate securities, mortgage-backed securities and mutual funds were 2.90%, 6.68%, 2.90%, 4.30% and 2.08%, respectively.

The Company evaluates its 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, 2005, the Company had investment securities with fair values of $323 million that had been in a continuous loss position more than twelve months. Gross unrealized losses on these securities totaled $9 million as of December 31, 2005, and were primarily attributable to changes in interest rates. The Company recorded no impairment losses during 2005, 2004 or 2003.

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

Mortgage Servicing Rights

The Company recognizes the rights to service mortgage loans for others whether acquired or internally originated. Net mortgage servicing rights increased 25.5% to $22 million as of December 31, 2005, from $18 million as of December 31, 2004, and 22.3% to $18 million as of December 31, 2004, from $14 million as of December 31, 2003, primarily due to internal loan origination. Impairment reserves for mortgage servicing rights were $2 million as of December 31, 2005, and $5 million as of December 31, 2004 and 2003. For additional information regarding the Company s mortgage servicing rights, see Notes to Consolidated Financial Statements Mortgage Servicing Rights included in Part IV, Item 15.

Deposits

The Company emphasizes developing total client relationships with its customers in order to increase its core deposit base, which is the Company s primary funding source. The Company s deposits consist of noninterest-bearing and interest-bearing demand, savings, individual retirement and time deposit accounts.

Deposits increased 6.8% to $3,548 million as of December 31, 2005, from $3,322 as of December 31, 2004, primarily due to organic growth, particularly in interest bearing and noninterest-bearing demand deposits. During 2005, the Company experienced a slight shift in the mix of deposits from interest-bearing savings deposits to interest-bearing demand deposits. Deposits increased 5.2% to $3,322 as of December 31, 2004, from $3,157 as of December 31, 2003, despite the sale of a banking office with $33 million of deposits in 2004. This increase was due to organic growth, primarily in noninterest-bearing demand, interest-bearing demand and savings deposits. During 2004, the Company experienced a shift in the mix of deposits from time deposits to interest bearing demand and savings deposits.

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

Other Borrowed Funds

Other borrowed funds decreased 6.3% to $7 million as of December 31, 2005, from $8 million as of December 31, 2004, and increased 12.0% to $8 million as of December 31, 2004, from $7 million as of December 31, 2003. 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, 2005 and 2004, see Notes to Consolidated Financial Statements Long-Term Debt and Other Borrowed Funds included in Part IV, Item 15.

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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,	2005	2004	2003
Federal funds purchased:			
Balance at period end	$ 1,500		
Average balance	836	3,437	4,028
Maximum amount outstanding at any month-end	1,500	42,885	55,490
Average interest rate:			
During the year	3.11%	1.00%	1.18%
At period end	3.81%		
Securities sold under repurchase agreements:			
Balance at period end	$518,718	449,699	323,406
Average balance	502,177	378,839	316,084
Maximum amount outstanding at any month-end	539,838	453,651	336,589
Average interest rate:			
During the year	2.51%	0.98%	0.70%
At period end	3.46%	1.68%	0.59%

Long-Term Debt

The Company s long-term debt is comprised principally of fixed rate notes with the FHLB, an unsecured revolving term loan, unsecured subordinated notes and obligations under capital leases. Long-term debt decreased 11.7% to $55 million as of December 31, 2005, from $62 million as of December 31, 2004, primarily due to scheduled debt repayments in 2005. Long-term debt increased 30.1% to $62 million as of December 31, 2004, from $48 million as of December 31, 2003, primarily due to a $25 million advance on a five year, fixed rate borrowing from the FHLB. This advance is subject to immediate repayment at quarterly intervals beginning October 1, 2005 if the three-month London Interbank Offered Rate (LIBOR) equals or exceeds 5.00%. During 2004, increases in FHLB advances were offset by principal reductions on the Company s revolving line and subordinated notes. For additional information on long-term debt as of December 31, 2005 and 2004, see Notes to Consolidated Financial Statements Long-Term Debt and Other Borrowed Funds included in Part IV, Item 15.

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, 2005.

Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses increased $11 million, or 66.2%, to $28 million as of December 31, 2005, from $17 million as of December 31, 2004, and decreased $2 million, or 12.1%, to $17 million as of December 31, 2004, from $19 million as of December 31, 2003, primarily due to timing of corporate income tax payments. Additionally, during 2005, the Company accrued accumulated post-retirement benefit obligations of $1 million and increased accruals for incentive bonuses and profit sharing contributions to reflect 2005 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. Management generally places 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 $1.2 million, $1.4 million, $1.7 million, $1.7 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, 2005, 2004, 2003, 2002 and 2001, respectively.

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Restructured loans are loans on which the Company has 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. The Company initially records 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.

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,	2005	2004	2003	2002	2001
Non-performing loans:					
Nonaccrual loans	$17,142	17,585	24,298	28,616	18,273
Accruing loans past due 90 days or more	1,001	905	5,558	4,625	7,200
Restructured loans	1,089	1,384	1,414		
Total non-performing loans	19,232	19,874	31,270	33,241	25,473
OREO	1,091	1,828	1,999	458	414
Total non-performing assets	$20,323				