

FIRST INTERSTATE BANCSYSTEM INC
Form 10-Q
November 07, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2014
OR

Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____
COMMISSION FILE NUMBER 001-34653

First Interstate BancSystem, Inc.
(Exact name of registrant as specified in its charter)

Montana (State or other jurisdiction of incorporation or organization)	81-0331430 (IRS Employer Identification No.)
401 North 31st Street, Billings, MT (Address of principal executive offices)	59116-0918 (Zip Code)
Registrant's telephone number, including area code: 406/255-5390	

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.)

Yes No

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>

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

Indicate the number of shares outstanding of each of the Registrant's classes of common stock:

September 30, 2014 – Class A common stock	21,747,983
September 30, 2014 – Class B common stock	23,924,939

FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES
 Quarterly Report on Form 10-Q
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CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

(Unaudited)

	September 30, 2014	December 31, 2013
Assets		
Cash and due from banks	\$142,119	\$141,663
Federal funds sold	737	672
Interest bearing deposits in banks	677,107	392,492
Total cash and cash equivalents	819,963	534,827
Investment securities:		
Available-for-sale	1,586,503	1,947,706
Held-to-maturity (estimated fair values of \$588,032 and \$205,926 at September 30, 2014 and December 31, 2013, respectively)	583,271	203,837
Total investment securities	2,169,774	2,151,543
Loans held for investment	4,791,444	4,303,992
Mortgage loans held for sale	62,938	40,861
Total loans	4,854,382	4,344,853
Less allowance for loan losses	74,231	85,339
Net loans	4,780,151	4,259,514
Goodwill	204,646	183,673
Premises and equipment, net of accumulated depreciation	207,181	179,690
Company-owned life insurance	152,761	122,175
Other real estate owned ("OREO")	18,496	15,504
Accrued interest receivable	30,282	26,450
Core deposit intangibles, net of accumulated amortization	14,137	4,519
Mortgage servicing rights, net of accumulated amortization and impairment reserve	13,894	13,546
Deferred tax asset, net	1,347	12,154
Other assets	68,720	61,056
Total assets	\$8,481,352	\$7,564,651
Liabilities and Stockholders' Equity		
Deposits:		
Non-interest bearing	\$1,637,151	\$1,491,683
Interest bearing	5,322,348	4,642,067
Total deposits	6,959,499	6,133,750
Securities sold under repurchase agreements	432,478	457,437
Accounts payable and accrued expenses	56,210	47,523
Accrued interest payable	5,569	4,963
Long-term debt	36,882	36,917
Other borrowed funds	1,934	3
Subordinated debentures held by subsidiary trusts	102,916	82,477
Total liabilities	7,595,488	6,763,070
Stockholders' equity:		
Nonvoting noncumulative preferred stock without par value; authorized 100,000 shares; no shares issued and outstanding as of September 30, 2014 or December 31, 2013	—	—

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Common stock	321,132	285,535
Retained earnings	572,362	532,087
Accumulated other comprehensive loss, net	(7,630)	(16,041)
Total stockholders' equity	885,864	801,581
Total liabilities and stockholders' equity	\$8,481,352	\$7,564,651

See accompanying notes to unaudited consolidated financial statements.

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Table of ContentsFIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

	Three Months Ended September		Nine Months Ended September	
	30,		30,	
	2014	2013	2014	2013
Interest income:				
Interest and fees on loans	\$61,007	\$54,901	\$170,290	\$165,247
Interest and dividends on investment securities:				
Taxable	7,259	7,660	22,208	23,377
Exempt from federal taxes	1,085	1,153	3,265	3,594
Interest on deposits in banks	374	207	830	717
Interest on federal funds sold	3	8	7	17
Total interest income	69,728	63,929	196,600	192,952
Interest expense:				
Interest on deposits	3,487	3,821	10,238	12,214
Interest on securities sold under repurchase agreements	52	58	181	232
Interest on other borrowed funds	27	—	27	—
Interest on long-term debt	482	487	1,431	1,450
Interest on preferred stock pending redemption	—	—	—	159
Interest on subordinated debentures held by subsidiary trusts	598	607	1,778	1,904
Total interest expense	4,646	4,973	13,655	15,959
Net interest income	65,082	58,956	182,945	176,993
Provision for loan losses	261	(3,000)	(6,740)	(2,125)
Net interest income after provision for loan losses	64,821	61,956	189,685	179,118
Non-interest income:				
Other service charges, commissions and fees	10,458	9,286	29,313	26,519
Income from the origination and sale of loans	7,346	7,934	18,386	28,652
Wealth management revenues	5,157	4,581	14,221	12,735
Service charges on deposit accounts	4,331	4,360	12,135	12,751
Investment securities gains (losses), net	(8)	30	80	26
Other income	2,079	1,416	5,905	5,322
Total non-interest income	29,363	27,607	80,040	86,005
Non-interest expense:				
Salaries and wages	25,914	22,806	72,796	69,681
Employee benefits	7,841	7,328	23,318	23,049
Occupancy, net	4,534	4,292	13,026	12,381
Furniture and equipment	3,338	3,147	9,696	9,362
Outsourced technology services	2,346	2,295	6,955	6,647
OREO expense, net of income	(58)	18	(211)	999
Professional fees	1,233	1,135	3,881	3,398
FDIC insurance premiums	1,172	1,205	3,381	3,938
Mortgage servicing rights amortization	591	629	1,774	2,187
Mortgage servicing rights impairment recovery	(61)	(62)	(117)	(121)
Core deposit intangibles amortization	688	355	1,396	1,064

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Other expenses	12,368	9,431	33,672	31,699
Non-core expenses	5,052	—	5,649	—
Total non-interest expense	64,958	52,579	175,216	164,284
Income before income tax expense	29,226	36,984	94,509	100,839
Income tax expense	10,071	13,172	32,884	35,478
Net income	\$19,155	\$23,812	\$61,625	\$65,361
Basic earnings per common share	\$0.43	\$0.54	\$1.39	\$1.50
Diluted earnings per common share	\$0.42	\$0.54	\$1.37	\$1.49

See accompanying notes to unaudited consolidated financial statements.

Table of ContentsFIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Net income	\$19,155	\$23,812	\$61,625	\$65,361
Other comprehensive income (loss), before tax:				
Investment securities available-for sale:				
Change in net unrealized gains/losses during period	(3,322	) 1,794	13,844	(39,547)
Reclassification adjustment for net (gains) losses included in income	8	(30)	(80)	(26)
Defined benefit post-retirement benefits plans:				
Change in net actuarial loss	33	33	103	102
Other comprehensive income (loss), before tax	(3,281	) 1,797	13,867	(39,471)
Deferred tax benefit (expense) related to other comprehensive income/loss	1,291	(707)	(5,456)	15,532
Other comprehensive income (loss), net of tax	(1,990	) 1,090	8,411	(23,939)
Comprehensive income, net of tax	\$17,165	\$24,902	\$70,036	\$41,422
See accompanying notes to unaudited consolidated financial statements.				

Table of ContentsFIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands, except share and per share data)

(Unaudited)

	Common stock	Retained earnings	Accumulated other comprehensive income (loss)	Total stockholders' equity
Balance at December 31, 2013	\$285,535	\$532,087	\$(16,041)	\$801,581
Net income	—	61,625	—	61,625
Other comprehensive income, net of tax expense	—	—	8,411	8,411
Common stock transactions:				
387,967 common shares purchased and retired	(9,736)	—	—	(9,736)
1,402,811 common shares issued	35,972	—	—	35,972
147,876 non-vested common shares issued	—	—	—	—
17,741 non-vested common shares forfeited	—	—	—	—
372,880 stock options exercised, net of 166,780 shares tendered in payment of option price and income tax withholding amounts	4,914	—	—	4,914
Tax benefit of stock-based compensation	1,541	—	—	1,541
Stock-based compensation expense	2,906	—	—	2,906
Common cash dividend declared (\$0.48 per share)	—	(21,350)	—	(21,350)
Balance at September 30, 2014	\$321,132	\$572,362	\$(7,630)	\$885,864
Balance at December 31, 2012	\$271,335	\$463,860	\$15,991	\$751,186
Net income	—	65,361	—	65,361
Other comprehensive loss, net of tax benefit	—	—	(23,939)	(23,939)
Common stock transactions:				
25,667 common shares purchased and retired	(448)	—	—	(448)
26,096 common shares issued	543	—	—	543
120,873 non-vested common shares issued	—	—	—	—
10,517 non-vested common shares forfeited	—	—	—	—
688,864 stock options exercised, net of 336,442 shares tendered in payment of option price and income tax withholding amounts	8,137	—	—	8,137
Tax benefit of stock-based compensation	1,578	—	—	1,578
Stock-based compensation expense	2,207	—	—	2,207
Cash dividends declared:				
Common (\$0.27 per share)	—	(11,765)	—	(11,765)
Balance at September 30, 2013	\$283,352	\$517,456	\$(7,948)	\$792,860

See accompanying notes to unaudited consolidated financial statements.

Table of ContentsFIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2014	2013
Cash flows from operating activities:		
Net income	\$61,625	\$65,361
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	(6,740)	(2,125)
Net gain on disposal of premises and equipment	(68)	(224)
Depreciation and amortization	12,168	12,293
Net premium amortization on investment securities	10,784	11,426
Net gain on investment securities transactions	(80)	(26)
Net gain on sale of mortgage loans held for sale	(12,947)	(20,376)
Net gain on sale of OREO	(551)	(3,195)
Write-downs of OREO and other assets pending disposal	87	3,180
Net reversal of impairment of mortgage servicing rights	(117)	(121)
Deferred income tax expense	8,537	6,302
Net (increase) decrease in cash surrender value of company-owned life insurance	(2,540)	28
Stock-based compensation expense	2,906	2,207
Tax benefits from stock-based compensation expense	1,541	1,578
Excess tax benefits from stock-based compensation expense	(1,503)	(1,488)
Originations of mortgage loans held for sale	(682,011)	(1,387,785)
Proceeds from sales of mortgage loans held for sale	676,061	1,419,539
Changes in operating assets and liabilities:		
Increase in interest receivable	(2,749)	(1,515)
Decrease (increase) in other assets	(1,585)	9,434
Increase (decrease) in accrued interest payable	22	(1,135)
Increase (decrease) in accounts payable and accrued expenses	1,321	(2,622)
Net cash provided by operating activities	64,161	110,736
Cash flows from investing activities:		
Purchases of investment securities:		
Held-to-maturity	(10,431)	(13,915)
Available-for-sale	(322,838)	(564,448)
Proceeds from maturities, pay-downs and sales of investment securities:		
Held-to-maturity	29,432	15,818
Available-for-sale	398,383	569,606
Purchases of company-owned life insurance	(15,000)	—
Proceeds from sales of mortgage servicing rights	266	470
Extensions of credit to customers, net of repayments	(148,854)	(147,826)
Recoveries of loans charged-off	7,323	9,434
Proceeds from sales of OREO	5,877	25,185
Acquisition of bank and bank holding company, net of cash and cash equivalents received	35,556	—
Capital expenditures, net of sales	(6,599)	(2,489)
Net cash used in investing activities	\$(26,885)	\$(108,165)

Table of ContentsFIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2014	2013
Cash flows from financing activities:		
Net increase (decrease) in deposits	\$310,370	\$(131,786)
Net decrease in repurchase agreements	(25,880)	(77,675)
Net decrease in other borrowed funds	(11,926)	(22)
Repayments of long-term debt	(35)	(32)
Redemption of preferred stock	—	(50,000)
Proceeds from issuance of common stock	4,914	8,680
Excess tax benefits from stock-based compensation expense	1,503	1,488
Purchase and retirement of common stock	(9,736)	(448)
Dividends paid to common stockholders	(21,350)	(11,765)
Net cash provided by (used in) financing activities	247,860	(261,560)
Net increase (decrease) in cash and cash equivalents	285,136	(258,989)
Cash and cash equivalents at beginning of period	534,827	801,332
Cash and cash equivalents at end of period	\$819,963	\$542,343
Supplemental disclosures of cash flow information:		
Cash paid during the period for income taxes	\$21,100	\$30,529
Cash paid during the period for interest expense	13,049	17,094
See accompanying notes to unaudited consolidated financial statements.		

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FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except share and per share data)

(1) Basis of Presentation

In the opinion of management, the accompanying unaudited consolidated financial statements of First Interstate BancSystem, Inc. and subsidiaries (the "Company") contain all adjustments (all of which are of a normal recurring nature) necessary to present fairly the financial position of the Company at September 30, 2014 and December 31, 2013, and the results of operations for each of the three and nine month periods ended and cash flows for each of the nine month periods ended September 30, 2014 and 2013 in conformity with U.S. generally accepted accounting principles. The balance sheet information at December 31, 2013 is derived from audited consolidated financial statements. Certain reclassifications, none of which were material, have been made to conform prior year financial statements to the September 30, 2014 presentation. These reclassifications did not change previously reported net income or stockholders' equity.

These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. Operating results for the three and nine months ended September 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.

(2) Acquisition

On February 10, 2014, the Company entered into an agreement and plan of merger to acquire all of the outstanding stock of Mountain West Financial Corp ("MWFC"), a Montana-based bank holding company that operates one wholly-owned subsidiary bank, Mountain West Bank, NA ("MWB"), with branches located in five of the Company's current market areas in Montana. The acquisition was completed on July 31, 2014, and the Company merged MWB with its existing bank subsidiary, First Interstate Bank ("FIB"), on October 17, 2014. The acquisition allowed the Company to gain market share in several of its current market areas. The Company also expects to benefit from future cost savings related to the merger of MWB with FIB.

Under the terms of the agreement and plan of merger, each outstanding share of Mountain West common stock was canceled and converted into the right to receive 0.2552 shares of the Company's Class A common stock plus \$7.125 in cash, or, at the stockholder's election, an amount in all cash or all stock intended to be substantially equal in value to the combination of stock and cash merger consideration described above. Consideration for the acquisition of \$74,451 consisted of cash of \$38,479 and the issuance of 1,378,230 shares of the Company's Class A common stock valued at \$26.10 per share, the closing price of the Company's Class A common stock as quoted on the NASDAQ stock market on the acquisition date. The acquisition was accounted for using the acquisition method with the cash portion of the purchase price funded from cash on hand.

The assets and liabilities of MWFC were recorded in the Company's consolidated financial statements at their estimated fair values as of the acquisition date. The excess value of the consideration paid over the fair value of assets acquired and liabilities assumed is recorded as goodwill. This acquisition was accounted for as a tax-free exchange; therefore, goodwill recorded in conjunction with this acquisition is not deductible for income tax purposes.

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FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
 (Dollars in thousands, except share and per share data)

The following table summarized the consideration paid, fair values of MWFC assets acquired and liabilities assumed and the resulting goodwill. All amounts reported are provisional pending completion of review of valuations obtained from third parties.

As of July 31, 2014	As Recorded by MWFC	Fair Value Adjustments	As Recorded by the Company
Assets acquired:			
Cash and cash equivalents	\$74,035	\$—	\$74,035
Investment securities	104,945	(34)	(1) 104,911
Loans	378,558	(18,286)	(2) 360,272
Allowance for loan losses	(11,598)	)11,598	(3) —
Premises and equipment	35,283	(5,685)	(4) 29,598
Company-owned life insurance	13,046	—	13,046
Deferred tax asset, net	6,491	1,461	(5) 7,952
Core deposit intangible	—	11,014	(6) 11,014
Other assets	16,559	(5,300)	(7) 11,259
Total assets acquired	617,319	(5,232)	) 612,087
Liabilities assumed:			
Deposits	515,538	(159)	(8) 515,379
Other liabilities	20,501	2,290	(9) 22,791
Subordinated debentures held by subsidiary trusts	20,439	—	(10) 20,439
Total liabilities assumed	556,478	2,131	558,609
Net assets acquired	\$60,841	\$(7,363)	) 53,478
Consideration paid:			
Cash			38,479
Class A common stock			35,972
Total consideration			74,451
Goodwill			\$20,973

Explanation of fair value adjustments:

- Write down of the book value of investment securities to their estimated fair values on the date of acquisition based upon quotes obtained from an independent third party pricing service.
Write down of the book value of loans to their estimated fair values. Except for collateral dependent loans acquired with deteriorated credit quality, the fair value of loans was estimated using cash flow projections based on the remaining maturity and repricing terms, adjusted for estimated future credit losses and prepayments and discounted to present value using a risk-adjusted market rate for similar loans. The fair value of collateral dependent loans acquired with deteriorated credit quality was estimated based on the Company's analysis of the fair value of the each loan's underlying collateral, discounted using market-derived rates of return with consideration given to the period of time and costs associated with foreclosure and disposition of the collateral.

- (3) Adjustment to remove the MWB allowance for loan losses at acquisition date as the credit risk is accounted for in the fair value adjustment for loans receivable described in (2) above.
- (4) Write down of the book value of premises and equipment to their estimated fair values based upon appraisals obtained from an independent third party appraiser.
- (5) Adjustment represents the net deferred tax assets resulting from fair value adjustments related to acquired assets, assumed liabilities, core deposit intangible assets and other purchase accounting adjustments.

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FIRST INTERSTATE BANCSYSTEM, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except share and per share data)

- (6) Adjustment represents the value of the core deposit base assumed in the acquisition based upon a valuation obtained from an independent third party valuation expert.
- (7) Adjustment consists of a reduction in the value of equity method investments and accrued interest receivable and the write-off of federal and state income taxes receivable, pre-existing goodwill and computer software costs.
- (8) Decrease in book value of time deposits to their estimated fair values based upon interest rates of similar time deposits with similar terms on the date of acquisition.
- (9) Adjustment represents decrease in the book value of Federal Home Loan Bank borrowings to their estimated fair market values based upon interest interest rates of similar advances with similar characteristics on the date of acquisition.
- (10) Recorded value of junior subordinated debentures held by subsidiary trusts approximates fair value as of the acquisition date due to the short-term nature of the instruments. The Company intends to redeem these debentures in December 2014.

The core deposit intangible asset of \$11,014 is being amortized using an accelerated method over the estimated useful lives of the related deposits of ten years.

The Company recorded third party acquisition-related costs of \$1,053