

GLACIER BANCORP INC
Form 10-Q
August 06, 2010

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**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 June 30, 2010**

**Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____**

**COMMISSION FILE 0-18911
GLACIER BANCORP, INC.**

(Exact name of registrant as specified in its charter)

MONTANA

81-0519541

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification No.)

49 Commons Loop, Kalispell, Montana

59901

(Address of principal executive offices)

(Zip Code)

(406) 756-4200

Registrant's telephone number, including area code

Not Applicable

(Former name, former address, and former fiscal year, if changed since last report)

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 (§232.405 of this chapter) 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 checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller reporting Company

(Do not check if a smaller reporting company)

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of Registrant's common stock outstanding on July 19, 2010 was 71,915,073. No preferred shares are issued or outstanding.

GLACIER BANCORP, INC.
Quarterly Report on Form 10-Q
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Glacier Bancorp, Inc.
Unaudited Condensed Consolidated Statements of Financial Condition

(Dollars in thousands, except per share data)	June 30, 2010	December 31, 2009	June 30, 2009
Assets			
Cash on hand and in banks	\$ 95,603	120,731	100,773
Federal funds sold	71,605	87,155	62,405
Interest bearing cash deposits	1,260	2,689	24,608
Cash and cash equivalents	168,468	210,575	187,786
Investment securities, available-for-sale	1,743,268	1,506,394	994,147
Loans held for sale	73,207	66,330	92,166
Loans receivable, gross	3,958,962	4,063,915	4,036,593
Allowance for loan and lease losses	(141,665)	(142,927)	(97,374)
Loans receivable, net	3,890,504	3,987,318	4,031,385
Premises and equipment, net	144,361	140,921	135,902
Other real estate owned	64,419	57,320	47,424
Accrued interest receivable	29,973	29,729	30,346
Deferred tax asset	35,361	41,082	14,890
Core deposit intangible, net	12,316	13,937	11,477
Goodwill	146,259	146,259	146,259
Other assets	59,907	58,260	38,808
Total assets	\$ 6,294,836	6,191,795	5,638,424
Liabilities			
Non-interest bearing deposits	\$ 852,121	810,550	754,844
Interest bearing deposits	3,657,995	3,289,602	2,631,599
Federal Home Loan Bank advances	529,982	790,367	613,478
Securities sold under agreements to repurchase	224,397	212,506	180,779
Federal Reserve Bank discount window		225,000	587,000
Other borrowed funds	10,063	13,745	17,192
Accrued interest payable	8,300	7,928	8,421
Subordinated debentures	125,060	124,988	120,157
Other liabilities	41,170	31,219	35,290
Total liabilities	5,449,088	5,505,905	4,948,760
Stockholders Equity			
Preferred shares, \$0.01 par value per share, 1,000,000 shares authorized, none issued or outstanding			

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Common stock, \$0.01 par value per share, 117,187,500 shares authorized	719	616	615
Paid-in capital	643,512	497,493	495,223
Retained earnings substantially restricted	192,724	188,129	196,208
Accumulated other comprehensive income (loss)	8,793	(348)	(2,382)
Total stockholders equity	845,748	685,890	689,664
Total liabilities and stockholders equity	\$ 6,294,836	6,191,795	5,638,424
Number of shares outstanding	71,915,073	61,619,803	61,519,808
Book value per share	\$ 11.76	11.13	11.21
See accompanying notes to unaudited condensed consolidated financial statements.			

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Glacier Bancorp, Inc.
Unaudited Condensed Consolidated Statements of Operations

(Dollars in thousands, except per share data)	Three Months ended June 30,		Six Months ended June 30,	
	2010	2009	2010	2009
Interest Income				
Residential real estate loans	\$ 11,421	13,871	23,254	28,212
Commercial loans	37,003	37,597	73,675	75,563
Consumer and other loans	10,720	11,142	21,360	22,481
Investment securities and other	14,674	11,810	28,927	23,696
Total interest income	73,818	74,420	147,216	149,952
Interest Expense				
Deposits	9,222	9,433	18,553	19,567
Federal Home Loan Bank advances	2,454	1,852	4,765	3,671
Securities sold under agreements to repurchase	399	409	815	1,003
Subordinated debentures	1,648	1,676	3,284	3,583
Other borrowed funds	26	569	216	1,269
Total interest expense	13,749	13,939	27,633	29,093
Net Interest Income	60,069	60,481	119,583	120,859
Provision for loan losses	17,246	25,140	38,156	40,855
Net interest income after provision for loan losses	42,823	35,341	81,427	80,004
Non-Interest Income				
Service charges and other fees	10,641	10,215	20,161	19,234
Miscellaneous loan fees and charges	1,259	1,162	2,385	2,322
Gain on sale of loans	6,133	9,071	10,024	15,221
Gain on sale of investments	242		556	
Other income	3,143	870	4,475	1,918
Total non-interest income	21,418	21,318	37,601	38,695
Non-Interest Expense				
Compensation, employee benefits and related expense	21,652	20,710	43,008	42,654
Occupancy and equipment expense	5,988	5,611	11,936	11,506
Advertising and promotions	1,644	1,722	3,236	3,446
Outsourced data processing expense	761	680	1,455	1,351
Core deposit intangibles amortization	801	762	1,621	1,536
Other real estate owned expense	7,373	2,321	9,691	2,841

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Federal Deposit Insurance Corporation premiums	2,165	3,832	4,365	5,000
Other expense	7,852	7,325	14,885	14,255
Total non-interest expense	48,236	42,963	90,197	82,589
Earnings Before Income Taxes	16,005	13,696	28,831	36,110
Federal and state income tax expense	2,783	3,044	5,539	9,679
Net Earnings	\$ 13,222	10,652	23,292	26,431
Basic earnings per share	\$ 0.19	0.17	0.35	0.43
Diluted earnings per share	\$ 0.19	0.17	0.35	0.43
Dividends declared per share	\$ 0.13	0.13	0.26	0.26
Return on average assets (annualized)	0.85%	0.77%	0.76%	0.96%
Return on average equity (annualized)	6.25%	6.18%	6.02%	7.72%
Average outstanding shares basic	71,913,102	61,515,946	67,363,476	61,489,422
Average outstanding shares diluted	71,914,894	61,518,289	67,364,377	61,493,266
See accompanying notes to unaudited condensed consolidated financial statements.				

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Glacier Bancorp, Inc.
Unaudited Condensed Consolidated Statements of Stockholders Equity
and Comprehensive Income
Year ended December 31, 2009 and Six Months ended June 30, 2010

	Common Stock		Paid-in	Retained Earnings	Accumulated Other	Total
	Shares	Amount	Capital	Substantially	Comprehensive	Stock-
(Dollars in thousands, except per share data)				Restricted	Income	holders
					(Loss)	Equity
Balance at December 31, 2008	61,331,273	\$ 613	491,794	185,776	(1,243)	676,940
Comprehensive income:						
Net earnings				34,374		34,374
Unrealized gain on securities, net of reclassification adjustment and taxes					895	895
Total comprehensive income						35,269
Cash dividends declared (\$0.52 per share)				(32,021)		(32,021)
Stock options exercised	188,535	2	2,552			2,554
Stock issued in connection with acquisition	99,995	1	1,419			1,420
Stock based compensation and tax benefit			1,728			1,728
Balance at December 31, 2009	61,619,803	\$ 616	497,493	188,129	(348)	685,890
Comprehensive income:						
Net earnings				23,292		23,292
Unrealized gain on securities, net of reclassification adjustment and taxes					9,141	9,141
Total comprehensive income						32,433
Cash dividends declared (\$0.26 per share)				(18,697)		(18,697)
Public offering of stock issued	10,291,465	103	145,493			145,596
Stock options exercised	3,805		58			58
Stock based compensation and tax benefit			468			468
Balance at June 30, 2010	71,915,073	\$ 719	643,512	192,724	8,793	845,748

See accompanying notes to unaudited condensed consolidated financial statements.

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Glacier Bancorp, Inc.
Unaudited Condensed Consolidated Statements of Cash Flows

(Dollars in thousands)	Six Months ended June 30	
	2010	2009
Operating Activities		
Net cash provided by operating activities	\$ 96,450	25,726
Investing Activities		
Proceeds from sales, maturities and prepayments of investments available-for-sale	244,484	97,332
Purchases of investments available-for-sale	(469,030)	(103,724)
Principal collected on commercial and consumer loans	335,866	483,879
Commercial and consumer loans originated or acquired	(349,027)	(529,042)
Principal collections on real estate loans	92,035	97,507
Real estate loans originated or acquired	(67,688)	(76,282)
Net purchase of FHLB and FRB stock	(1,729)	(61)
Proceeds from sale of other real estate owned	25,722	5,257
Net addition of premises and equipment and other real estate owned	(9,003)	(7,854)
Net cash used in investment activities	(198,370)	(32,988)
Financing Activities		
Net increase in deposits	409,964	123,881
Net (decrease) increase in FHLB advances	(260,385)	275,022
Net increase (decrease) in securities sold under repurchase agreements	11,891	(7,584)
Net decrease in Federal Reserve Bank discount window	(225,000)	(327,000)
Net (decrease) increase in other borrowed funds	(3,610)	8,844
Cash dividends paid	(18,697)	(15,999)
Excess (deficiencies) benefits related to the exercise of stock options	(4)	75
Proceeds from exercise of stock options and other stock issued	145,654	2,554
Net cash provided by financing activities	59,813	59,793
Net (decrease) increase in cash and cash equivalents	(42,107)	52,531
Cash and cash equivalents at beginning of period	210,575	135,255
Cash and cash equivalents at end of period	\$ 168,468	187,786
Supplemental Disclosure of Cash Flow Information		
Cash paid during the period for interest	\$ 27,262	30,423
Cash paid during the period for income taxes	8,061	23,407
Sale and refinancing of other real estate owned	6,320	2,243
Other real estate acquired in settlement of loans	45,888	44,584
See accompanying notes to unaudited condensed consolidated financial statements.		

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Notes to Unaudited Condensed Consolidated Financial Statements

1) Basis of Presentation

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of Glacier Bancorp Inc. s (the Company) financial condition as of June 30, 2010 and 2009, stockholders equity and comprehensive income for the six months ended June 30, 2010, the results of operations for the three and six month periods ended June 30, 2010 and 2009, and cash flows for the six months ended June 30, 2010 and 2009. The condensed consolidated statement of financial condition and statement of stockholders equity and comprehensive income of the Company as of December 31, 2009 have been derived from the audited consolidated statements of the Company as of that date.

The accompanying condensed consolidated financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company s Annual Report on Form 10-K/A for the year ended December 31, 2009. Operating results for the three and six months ended June 30, 2010 are not necessarily indicative of the results anticipated for the year ending December 31, 2010. Certain reclassifications have been made to the 2009 financial statements to conform to the 2010 presentation.

Material estimates that are particularly susceptible to significant change include the determination of the allowance for loan and lease losses (ALLL or allowance) and the valuations related to investments, business combinations and real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the ALLL and other real estate valuation estimates management obtains independent appraisals for significant items. Estimates relating to investments are obtained from independent parties. Estimates relating to business combinations are determined based on internal calculations using significant independent party inputs and independent party valuations.

2) Organizational Structure

The Company, headquartered in Kalispell, Montana, is a Montana corporation incorporated in 2004 as a successor corporation to the Delaware corporation incorporated in 1990. The Company is a regional multi-bank holding company that provides a full range of banking services to individual and corporate customers in Montana, Idaho, Wyoming, Colorado, Utah and Washington through its bank subsidiaries (collectively referred to hereafter as the Banks). The bank subsidiaries are subject to competition from other financial service providers. The bank subsidiaries are also subject to the regulations of certain government agencies and undergo periodic examinations by those regulatory authorities.

As of June 30, 2010, the Company is the parent holding company for eleven wholly-owned, independent community bank subsidiaries: Glacier Bank (Glacier), First Security Bank of Missoula (First Security), Western Security Bank (Western), Big Sky Western Bank (Big Sky), Valley Bank of Helena (Valley), and First Bank of Montana (First Bank-MT), all located in Montana, Mountain West Bank (Mountain West) and Citizens Community Bank (Citizens) located in Idaho, Bank (Bank) and First National Bank & Trust (First National) located in Wyoming, and Bank of the San Juans (San Juans) located in Colorado.

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In April 2010, the Company formed a wholly owned subsidiary, GBCI Other Real Estate (GORE) to isolate bank foreclosed properties for legal protection and administrative purposes. During the quarter, foreclosed properties were transferred to the new entity from bank subsidiaries at fair market value and such properties are currently held for sale.

In addition, the Company owns seven trust subsidiaries, Glacier Capital Trust II (Glacier Trust II), Glacier Capital Trust III (Glacier Trust III), Glacier Capital Trust IV (Glacier Trust IV), Citizens (ID) Statutory Trust I (Citizens Trust I), Bank of the San Juans Bancorporation Trust I (San Juans Trust I), First Company Statutory Trust 2001 (First Co Trust 01) and First Company Statutory Trust 2003 (First Co Trust 03) for the purpose of issuing trust preferred securities and, in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 810, *Consolidation*, the trust subsidiaries are not consolidated into the Company s financial statements. The Company does not have any other off-balance sheet entities.

On October 2, 2009, the Company completed the acquisition of First Company and its subsidiary First National. First National became a separate wholly-owned subsidiary of the Company and the financial condition and results of operations are included from the acquisition date.

FASB ASC Topic 810, *Consolidation*, provides guidance as to when a company should consolidate the assets, liabilities, and activities of a variable interest entity (VIE) in its financial statements, and when a company should disclose information about its relationship with a VIE. A VIE is a legal structure used to conduct activities or hold assets, and a VIE must be consolidated by a company if it is the primary beneficiary that absorbs the majority of the entity s expected losses, receives a majority of the entity s expected residual returns, or both.

The Company has equity investments in Certified Development Entities (CDE) which have received allocations of new markets tax credits (NMTC). The Company also has equity investments in low-income housing tax credit (LIHTC) partnerships. The CDE s and the LIHTC partnerships are VIE s. The underlying activities of the VIE s are community development projects designed primarily to promote community welfare, such as economic rehabilitation and development of low-income areas by providing housing, services, or jobs for residents. The maximum exposure to loss in the VIE s is the amount of equity invested or credit extended by the Company; however, the Company has credit protection in the form of indemnification agreements, guarantees, and collateral arrangements. The Company has evaluated the variable interests held by the Company and others and where the Company is the primary beneficiary of a VIE, the VIE has been consolidated into the bank subsidiary which holds the direct investment in the VIE. Currently, only CDE (NMTC) investments are consolidated into the Company s financial statements. For the CDE (NMTC) investments, the creditors and other beneficial interest holders have no recourse to the general credit of the bank subsidiaries. As of June 30, 2010, the Company had investments in VIE s of \$39,876,000 and \$2,362,000 for the CDE (NMTC) and LIHTC partnerships, respectively. The consolidated VIE s as well as the unconsolidated VIE s are regularly monitored by the Company to determine if any reconsideration events have occurred that could cause its primary beneficiary status to change.

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See Note 12 *Operating Segment Information* for selected financial data including net earnings and total assets for the parent company and each of the subsidiaries. Although the consolidated total assets of the Company were \$6.3 billion at June 30, 2010, nine of the eleven community banks had total assets of less than \$1 billion. The smallest community bank subsidiary had \$194 million in total assets, while the largest community bank subsidiary had \$1.3 billion in total assets at June 30, 2010.

The following abbreviated organizational chart illustrates the various relationships as of June 30, 2010:

Glacier Bancorp. Inc.
(Parent Holding Company)

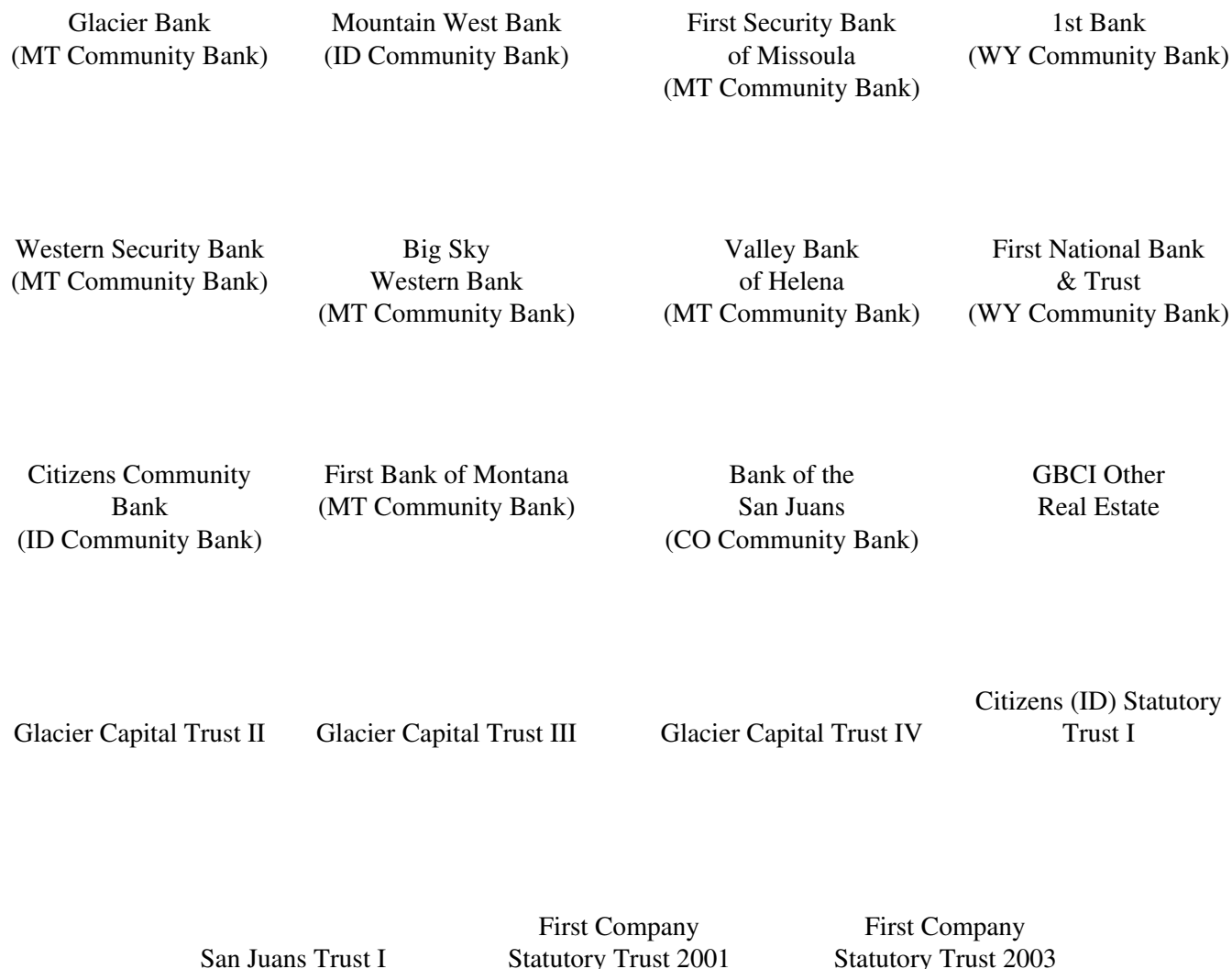


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3) Investment Securities

A comparison of the amortized cost and estimated fair value of the Company's investment securities, available-for-sale and other investments is as follows:

(Dollars in thousands)	As of June 30, 2010				Estimated Fair Value
	Weighted Yield	Amortized Cost	Gross Gains	Unrealized Losses	
U.S. Government and federal agency Maturing after one year through five years	1.62%	\$ 210	4		214
Government sponsored enterprises Maturing after one year through five years	2.43%	41,963	627		42,590
Maturing after five years through ten years	1.75%	82			82
Maturing after ten years	1.15%	11			11
	2.43%	42,056	627		42,683
State and local governments and other issues					
Maturing within one year	3.95%	920	7		927
Maturing after one year through five years	3.92%	8,970	202	(6)	9,166
Maturing after five years through ten years	4.15%	27,339	674	(67)	27,946
Maturing after ten years	4.80%	481,374	10,697	(1,944)	490,127
	4.75%	518,603	11,580	(2,017)	528,166
Collateralized debt obligations Maturing after ten years	8.40%	14,360		(5,532)	8,828
Residential mortgage-backed securities	2.58%	1,088,635	17,531	(7,734)	1,098,432
Total marketable securities	3.31%	1,663,864	29,742	(15,283)	1,678,323
Other investments					
FHLB and FRB stock, at cost	1.42%	64,319			64,319
Other stock	0.05%	624	7	(5)	626
Total investment securities	3.23%	\$ 1,728,807	29,749	(15,288)	1,743,268

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(Dollars in thousands)	As of December 31, 2009				Estimated Fair Value
	Weighted Yield	Amortized Cost	Gross Unrealized Gains	Losses	
U.S. Government and federal agency Maturing after one year through five years	1.62%	\$ 210		(1)	209
Government sponsored enterprises Maturing after one year through five years	3.21%	74			74
Maturing after five years through ten years	1.64%	40			40
Maturing after ten years	2.05%	63			63
	2.43%	177			177
State and local governments and other issues					
Maturing within one year	2.48%	2,040	6		2,046
Maturing after one year through five years	3.30%	9,326	208	(12)	9,522
Maturing after five years through ten years	3.84%	27,125	786	(168)	27,743
Maturing after ten years	4.80%	434,165	10,140	(2,640)	441,665
	4.71%	472,656	11,140	(2,820)	480,976
Collateralized debt obligations Maturing after ten years	8.40%	14,688		(7,899)	6,789
Residential mortgage-backed securities	3.42%	956,033	15,167	(16,158)	955,042
Total marketable securities	3.89%	1,443,764	26,307	(26,878)	1,443,193
Other investments					
FHLB and FRB stock, at cost	1.30%	62,577			62,577
Other stock	0.05%	624			624
Total investment securities	3.78%	\$ 1,506,965	26,307	(26,878)	1,506,394

Maturities of securities do not reflect repricing opportunities present in adjustable rate securities, nor do they reflect expected shorter maturities based upon early prepayment of principal. Weighted yields on tax-exempt investment securities exclude the tax effect.

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Interest income includes tax-exempt interest for the six months ended June 30, 2010 and 2009 of \$11,438,000 and \$11,070,000, respectively, and for the three months ended June 30, 2010 and 2009 of \$5,870,000 and \$5,739,000 respectively.

Gross proceeds from sale of marketable securities for the six months ended June 30, 2010 and 2009 were \$32,323,000 and \$0, respectively, resulting in gross gains of \$1,349,000 and \$0, respectively, and gross losses of \$793,000 and \$0, respectively. The cost of any investment sold is determined by specific identification.

At June 30, 2010, the Company had investment securities with carrying values of approximately \$904,230,000, pledged as collateral for Federal Home Loan Bank (FHLB) advances, Federal Reserve Bank (FRB) discount window borrowings, securities sold under agreements to repurchase, U.S. Treasury Tax and Loan borrowings and deposits of several local government units.

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The investments in the FHLB stock are required investments related to the Company's borrowings from FHLB. FHLB obtains its funding primarily through issuance of consolidated obligations of the FHLB system. The U.S. Government does not guarantee these obligations, and each of the 12 FHLBs are jointly and severally liable for repayment of each other's debt.

Investments with an unrealized loss position at June 30, 2010:

(Dollars in thousands)	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
State and local governments and other issues	\$ 69,320	985	22,342	1,032	91,662	2,017
Collateralized debt obligations	1,940	60	6,888	5,472	8,828	5,532
Residential mortgage-backed securities	431,208	1,783	36,090	5,951	467,298	7,734
Other investments other stock	7	5			7	5
Total temporarily impaired securities	\$ 502,475	2,833	65,320	12,455	567,795	15,288

Investments with an unrealized loss position at December 31, 2009:

(Dollars in thousands)	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Government and federal agency	\$ 208	1			208	1
State and local governments and other issues	74,045	1,835	18,094	985	92,139	2,820
Collateralized debt obligations	6,789	7,899			6,789	7,899
Residential mortgage-backed securities	466,196	3,861	39,780	12,297	505,976	16,158
Total temporarily impaired securities	\$ 547,238	13,596	57,874	13,282	605,112	26,878

The Company assesses individual securities in its investment securities portfolio for impairment at least on a quarterly basis, and more frequently when economic or market conditions warrant. An investment is impaired if the fair value of the security is less than its carrying value at the financial statement date. If impairment is determined to be other-than-temporary, an impairment loss is recognized by reducing the amortized cost for the credit loss portion of the impairment with a corresponding charge to earnings.

For fair value estimates provided by third party vendors, management also considered the models and methodology, for appropriate consideration of both observable and unobservable inputs, including appropriately adjusted discount rates and credit spreads for securities with limited or inactive markets, and whether the quoted prices reflect orderly transactions. For certain securities, the Company obtained independent estimates of inputs, including cash flows, in supplement to third party vendor provided information. The Company also reviewed financial statements of select issuers, with follow up discussions with issuers' management for clarification and verification of information relevant

to the Company's impairment analysis.

In evaluating debt securities for other-than-temporary impairment losses, management assesses whether the Company intends to sell or if it is more likely-than-not that it will be required to sell impaired debt securities. In so doing, management considers contractual constraints, liquidity, capital, asset / liability management and securities portfolio objectives. With respect to its impaired debt securities at June 30, 2010, management determined that it does not intend to sell and that there is no expected requirement to sell any of its impaired debt securities.

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Based on an analysis of its impaired securities as of June 30, 2010, the Company determined that none of such securities had other-than-temporary impairment.

4) Loans Receivable, Net and Loans Held for Sale

The following table summarizes the Company's loan and lease portfolio:

(Dollars in thousands)	June 30, 2010		December 31, 2009		June 30, 2009	
	Amount	Percent	Amount	Percent	Amount	Percent
Real estate loans						
Residential	\$ 693,768	17.8%	\$ 746,050	18.7%	\$ 747,931	18.6%
Held for sale	73,207	1.9%	66,330	1.7%	92,166	2.3%
Total	766,975	19.7%	812,380	20.4%	840,097	20.9%
Commercial loans						
Real estate	1,882,285	48.4%	1,900,438	47.7%	1,944,784	48.2%
Other commercial	692,031	17.8%	724,966	18.2%	649,634	16.1%
Total	2,574,316	66.2%	2,625,404	65.9%	2,594,418	64.3%
Consumer and other loans						
Consumer	188,654	4.8%	201,001	5.0%	198,454	4.9%
Home equity	510,030	13.1%	501,920	12.6%	502,288	12.5%
Total	698,684	17.9%	702,921	17.6%	700,742	17.4%
Net deferred loan fees premiums and discounts	(7,806)	-0.2%	(10,460)	-0.3%	(6,498)	-0.2%
Loans receivable, gross	4,032,169	103.6%	4,130,245	103.6%	4,128,759	102.4%
Allowance for loan and lease losses	(141,665)	-3.6%	(142,927)	-3.6%	(97,374)	-2.4%
Loans receivable, net	\$ 3,890,504	100.0%	\$ 3,987,318	100.0%	\$ 4,031,385	100.0%

In June 2009, FASB issued an amendment to FASB ASC Topic 860, *Accounting for Transfers and Servicing of Financial Assets*, and is effective for transfers occurring after the beginning of the first annual reporting period that begins after November 15, 2009. The Company adopted this amendment for all new transfers, primarily consisting of transfers of loans, occurring on or subsequent to January 1, 2010. The Company generally sells its long-term mortgage loans originated, retaining servicing only when required by certain lenders. The sale of loans in the secondary mortgage market reduces the Company's risk of holding long-term fixed rate loans in the loan portfolio. Mortgage loans sold with no servicing rights retained for the six months ended June 30, 2010 and 2009 were \$402,116,000 and \$706,310,000, respectively. The amount of loans sold and serviced for others at June 30, 2010 and 2009 was approximately \$181,348,000 and \$170,594,000, respectively.

In accordance with this amendment, transfers of SBA loans are recognized as sales when the warranty period expires, which is typically 90 days. The Company has been active in originating commercial SBA loans, some of which are sold to investors. As of June 30, 2010, the Company had \$8,094,000 of SBA loans sold for which there was a deferred gain of \$753,000 due to unexpired warranty periods.

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The Company occasionally purchases and sells other loan participations, the majority of which are large commercial loans. For participation transactions after the adoption of the amendment, the bank subsidiaries typically originate and sell the loan participations, at fair value, on a proportionate ownership basis, with no recourse conditions.

The following table sets forth information regarding the Company's non-performing assets at the dates indicated:

(Dollars in thousands)	June 30, 2010	December 31, 2009	June 30, 2009
Real estate and other assets owned	\$ 64,419	57,320	47,424
Accruing loans 90 days or more overdue	3,030	5,537	10,086
Non-accrual loans	190,338	198,281	116,362
Total non-performing assets	\$ 257,787	261,138	173,872
Non-performing assets as a percentage of total subsidiary assets	4.01%	4.13%	3.06%

The following table summarizes impaired loans at the dates indicated:

(Dollars in thousands)	June 30, 2010	December 31, 2009	June 30, 2009
Impaired loans, without valuation allowance	\$ 144,109	141,613	92,338
Impaired loans, with valuation allowance	72,830	77,129	47,749
Impaired loans, gross	216,939	218,742	140,087
Valuation allowance included in ALLL	(15,221)	(19,760)	(9,034)
Impaired loans, net	\$ 201,718	198,982	131,053

The following table illustrates the loan and lease loss experience:

(Dollars in thousands)	June 30, 2010	December 31, 2009	June 30, 2009
Balance at the beginning of the year	\$ 142,927	76,739	76,739
Charge-offs	(41,584)	(60,896)	(21,246)
Recoveries	2,166	2,466	1,026
Provision	38,156	124,618	40,855
Balance at the end of the period	\$ 141,665	142,927	97,374
Net charge-offs as a percentage of total loans	0.98%	1.42%	0.49%

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5) Intangible Assets

The following table sets forth information regarding the Company's core deposit intangible and mortgage servicing rights as of June 30, 2010:

(Dollars in thousands)	Core Deposit Intangible	Mortgage Servicing Rights ¹	Total
Gross carrying value	\$ 31,847		
Accumulated amortization	(19,531)		
Net carrying value	\$ 12,316	978	13,294
Weighted-average amortization period (Period in years)	9.1	9.3	9.1
Aggregate amortization expense			
For the three months ended June 30, 2010	\$ 801	46	847
For the six months ended June 30, 2010	1,621	81	1,702
Estimated amortization expense			
For the year ended December 31, 2010	\$ 2,603	116	2,719
For the year ended December 31, 2011	1,895	69	1,964
For the year ended December 31, 2012	1,534	67	1,601
For the year ended December 31, 2013	1,283	65	1,348
For the year ended December 31, 2014	1,034	63	1,097

¹ The mortgage servicing rights are included in other assets and gross carrying value and accumulated amortization are not readily available.

Acquisitions are accounted for as prescribed by FASB ASC Topic 805, *Business Combinations*. Acquisition accounting requires the total purchase price to be allocated to the estimated fair values of assets acquired and liabilities assumed, including certain intangible assets. Goodwill is recorded if the purchase price exceeds the net fair value of assets acquired and a bargain purchase gain is recorded in other income if the net fair value of assets acquired exceeds the purchase price.

Adjustment of the allocated purchase price may be related to fair value estimates for which all information has not been obtained of the acquired entity known or discovered during the allocation period, the period of time required to identify and measure the fair values of the assets and liabilities acquired in the business combination. The allocation period is generally limited to one year following consummation of a business combination.

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6) Deposits

The following table illustrates the amounts outstanding for deposits \$100,000 and greater at June 30, 2010 according to the time remaining to maturity. Included in the Certificates of Deposit are brokered deposits of \$504,399,000, of which \$395,685,000 are issued through the Certificate of Deposit Account Registry System. Included in the Demand Deposits are brokered deposits of \$142,253,000.

(Dollars in thousands)	Certificates of Deposit	Demand Deposits	Totals
Within three months	\$ 433,687	1,699,321	2,133,008
Three months to six months	280,875		280,875
Seven months to twelve months	185,349		185,349
Over twelve months	119,816		119,816
Totals	\$ 1,019,727	1,699,321	2,719,048

7) Advances and Other Borrowings

The following chart illustrates the average balances and the maximum outstanding month-end balances for FHLB advances, repurchase agreements and borrowings through the FRB:

(Dollars in thousands)	As of and for the Six Months ended June 30, 2010	As of and for the Year ended December 31, 2009	As of and for the Six Months ended June 30, 2009
FHLB advances			
Amount outstanding at end of period	\$ 529,982	790,367	613,478
Average balance	\$ 717,628	473,038	352,183
Maximum outstanding at any month-end	\$ 807,644	790,367	613,478
Weighted average interest rate	1.34%	1.68%	2.10%
Repurchase agreements			
Amount outstanding at end of period	\$ 224,397	212,506	180,779
Average balance	\$ 222,371	204,503	191,388
Maximum outstanding at any month-end	\$ 242,110	234,914	199,669
Weighted average interest rate	0.74%	0.98%	1.06%
Federal Reserve Bank discount window			
Amount outstanding at end of period	\$	225,000	587,000
Average balance	\$ 71,851	658,262	891,558
Maximum outstanding at any month-end	\$ 235,000	1,005,000	1,005,000
Weighted average interest rate	0.25%	0.26%	0.27%
Total FHLB advances, repurchase agreements, and Federal Reserve Bank discount window			
Amount outstanding at end of period	\$ 754,379	1,227,873	1,381,257
Average balance	\$ 1,011,850	1,335,803	1,435,129
Maximum outstanding at any month-end	\$ 1,284,754	2,030,281	1,818,147
Weighted average interest rate	1.13%	0.87%	0.82%

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8) Stockholders Equity

The Federal Reserve Board has adopted capital adequacy guidelines that are used to assess the adequacy of capital in supervising a bank holding company. The following table illustrates the Federal Reserve Board's capital adequacy guidelines and the Company's compliance with those guidelines as of June 30, 2010.

(Dollars in thousands)	Tier 1 (Core) Capital	Tier 2 (Total) Capital	Leverage Capital
Total stockholders equity	\$ 845,748	845,748	845,748
Less:			
Goodwill and intangibles	(152,133)	(152,133)	(152,133)
Accumulated other comprehensive unrealized gain on AFS securities	(8,793)	(8,793)	(8,793)
Plus:			
Allowance for loan and lease losses		58,296	
Unrealized gain on AFS securities		1	
Subordinated debentures	124,500	124,500	124,500
Regulatory capital	\$ 809,322	867,619	809,322
Risk weighted assets	\$ 4,580,391	4,580,391	
Total adjusted average assets			\$ 6,118,846
Capital as % of risk weighted assets	17.67%	18.94%	13.23%
Regulatory well capitalized requirement	6.00%	10.00%	5.00%
Excess over well capitalized requirement	11.67%	8.94%	8.23%

9) Earnings Per Share

Basic earnings per common share is computed by dividing net earnings by the weighted average number of shares of common stock outstanding during the period presented. Diluted earnings per share is computed by including the net increase in shares as if dilutive outstanding stock options were exercised, using the treasury stock method.

The following schedule contains the data used in the calculation of basic and diluted earnings per share:

	For the Three Months ended June 30,		For the Six Months ended June 30,	
	2010	2009	2010	2009
Net earnings available to common stockholders, basic and diluted	\$ 13,222,000	10,652,000	23,292,000	26,431,000
Average outstanding shares basic	71,913,102	61,515,946	67,363,476	61,489,422
Add: dilutive stock options	1,792	2,343	901	3,844
Average outstanding shares diluted	71,914,894	61,518,289	67,364,377	61,493,266

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Basic earnings per share	\$	0.19	0.17	0.35	0.43
Diluted earnings per share	\$	0.19	0.17	0.35	0.43

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There were approximately 1,861,188 and 2,399,487 average shares excluded from the diluted average outstanding share calculation for the three months ended June 30, 2010 and 2009, respectively, due to the option exercise price exceeding the market price.

10) Comprehensive Income

The Company's only component of comprehensive income other than net earnings is the unrealized gains and losses on available-for-sale securities.

(Dollars in thousands)	For the Three Months ended June 30,		For the Six Months ended June 30,	
	2010	2009	2010	2009
Net earnings	\$ 13,222	10,652	23,292	26,431
Unrealized holding gain (loss) arising during the period	5,635	7,687	15,588	(1,866)
Tax (expense) benefit	(2,209)	(3,012)	(6,109)	727
Net after tax	3,426	4,675	9,479	(1,139)
Reclassification adjustment for gains included in net earnings	(242)		(556)	
Tax expense	95		218	
Net after tax	(147)		(338)	
Net unrealized gain (loss) on securities	3,279	4,675	9,141	(1,139)
Total comprehensive income	\$ 16,501	15,327	32,433	25,292

11) Federal and State Income Taxes

The Company and its bank subsidiaries join together in the filing of consolidated income tax returns in the following jurisdictions: federal, Montana, Idaho, Colorado and Utah. Although 1st Bank and First National have operations in Wyoming and Mountain has operations in Washington, neither Wyoming nor Washington imposes a corporate-level income tax. All required income tax returns have been timely filed. The following schedule summarizes the years that remain subject to examination as of June 30, 2010:

	Years ended December 31,
Federal	2006, 2007 and 2008
Montana	2003, 2004, 2005, 2006, 2007 and 2008
Idaho	2003, 2004, 2005, 2006, 2007 and 2008
Colorado	2005, 2006, 2007 and 2008
Utah	2006, 2007 and 2008

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During 2010 and 2009, the Company made investments in CDE s which received NMTC allocations. Administered by the Community Development Financial Institutions Fund of the U.S. Department of the Treasury, the NMTC program is aimed at stimulating economic and community development and job creation in low-income communities. The federal income tax credits received are claimed over a seven-year credit allowance period. The Company also has made investments in LIHTC s which are indirect Federal subsidies used to finance the development of affordable rental housing for low-income households. The federal income tax credits received are claimed over a ten-year credit allowance period. The Company invests in Qualified Zone Academy and Qualified School Construction bonds whereby the Company receives quarterly federal income tax credits until the bonds mature. The federal income tax credits on the bonds are subject to federal and state income tax. Following is a list of expected federal income tax credits to be received in the years indicated.

Years ended	New Markets Tax Credits	Low-Income Housing Tax Credits	Investment Securities Tax Credits	Total
(Dollars in thousands)				
2010	\$ 2,000	337	916	3,253
2011	2,000	785	970	3,755
2012	2,306	785	970	4,061
2013	2,400	785	970	4,155
2014	2,400	785	970	4,155
Thereafter	2,964	3,324	8,349	14,637
	\$ 14,070	6,801	13,145	34,016

The Company determined its unrecognized tax benefit to be \$0 and \$113,000 as of June 30, 2010 and 2009, respectively. The Company recognizes interest related to unrecognized income tax benefits in interest expense and penalties are recognized in other expense. During the six months ended June 30, 2010 and 2009, the Company did not recognize interest expense or penalties with respect to income tax liabilities. The Company had approximately \$0 and \$20,000 accrued for the payment of interest at June 30, 2010 and 2009, respectively. The Company had no accrued liabilities for the payment of penalties at June 30, 2010 and 2009.

12) Operating Segment Information

FASB ASC Topic 280, *Segment Reporting*, requires that a public business enterprise report financial and descriptive information about its reportable operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision makers in deciding how to allocate resources and in assessing performance. The Company defines operating segments and evaluates segment performance internally based on individual bank charters. If required, VIEs are consolidated into the operating segment which invested into such entities.

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The accounting policies of the individual operating segments are the same as those of the Company. Transactions between operating segments are conducted at fair value, resulting in profits that are eliminated for reporting consolidated results of operations. Intersegment revenues primarily represents interest income on intercompany borrowings, management fees, and data processing fees received by individual banks or the parent company. Intersegment revenues, expenses and assets are eliminated in order to report results in accordance with accounting principles generally accepted in the United States of America. Expenses for centrally provided services are allocated based on the estimated usage of those services.

The following schedules provide selected financial data for the Company's operating segments:

Three months ended and as of June 30, 2010								
(Dollars in thousands)	Glacier	Mountain West	First Security	1st Bank	Western	Big Sky	Valley	First National
External revenues	\$ 18,969	22,183	13,097	7,753	8,811	5,099	5,798	3,659
Intersegment revenues	48	19	20	30	123	1	40	14
Expenses	(16,407)	(21,759)	(10,057)	(6,919)	(6,686)	(4,397)	(3,921)	(3,180)
Net Earnings (Loss)	\$ 2,610	443	3,060	864	2,248	703	1,917	493
Total Assets	\$ 1,320,555	1,200,382	932,179	644,877	610,208	366,439	368,321	295,164

	Citizens	First Bank of MT	San Juans	GORE	Parent	Eliminations	Total Consolidated
External revenues	\$ 4,608	2,472	2,688	43	56		95,236
Intersegment revenues	28	32	24		17,885	(18,264)	
Expenses	(3,842)	(1,705)	(2,135)	(268)	(4,719)	3,981	(82,014)
Net Earnings (Loss)	\$ 794	799	577	(225)	13,222	(14,283)	13,222
Total Assets	\$ 271,190	193,806	204,815	19,856	985,895	(1,118,851)	6,294,836

Three months ended and as of June 30, 2009							
(Dollars in thousands)	Glacier	Mountain West	First Security	1st Bank	Western	Big Sky	Valley
External revenues	\$ 20,283	23,859	13,332	8,470	9,055	5,522	5,777
Intersegment revenues	46	1	248	55	208		66
Expenses	(17,555)	(22,853)	(10,279)	(9,637)	(7,762)	(4,746)	(4,231)
Net Earnings (Loss)	\$ 2,774	1,007	3,301	(1,112)	1,501	776	1,612
Total Assets	\$ 1,217,302	1,266,555	831,352	588,480	541,763	332,505	291,021

	Citizens	First Bank of MT	San Juans	Parent	Eliminations	Total Consolidated
External revenues	\$ 4,186	2,521	2,643	58	32	95,738
Intersegment revenues	2			14,990	(15,616)	

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Expenses	(3,591)	(1,844)	(2,193)	(4,396)	4,001	(85,086)
Net Earnings (Loss)	\$ 597	677	450	10,652	(11,583)	10,652
Total Assets	\$ 243,830	176,222	177,850	825,575	(854,031)	5,638,424

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Six Months ended and as of June 30, 2010								
(Dollars in thousands)	Glacier	Mountain West	First Security	1st Bank	Western	Big Sky	Valley	First National
External revenues	\$ 37,704	41,133	25,653	15,729	16,939	9,935	10,890	7,699
Intersegment revenues	96	38	38	121	255	1	76	22
Expenses	(34,142)	(40,243)	(20,217)	(13,420)	(13,003)	(8,901)	(7,552)	(6,856)
Net Earnings (Loss)	\$ 3,658	928	5,474	2,430	4,191	1,035	3,414	865
Total Assets	\$ 1,320,555	1,200,382	932,179	644,877	610,208	366,439	368,321	295,164

(Dollars in thousands)	Citizens	First Bank of MT	San Juans	GORE	Parent	Eliminations	Total Consolidated
External revenues	\$ 8,756	4,892	5,325	43	119		184,817
Intersegment revenues	28	82	24		32,521	(33,302)	
Expenses	(7,412)	(3,396)	(4,596)	(268)	(9,348)	7,829	(161,525)
Net Earnings (Loss)	\$ 1,372	1,578	753	(225)	23,292	(25,473)	23,292
Total Assets	\$ 271,190	193,806	204,815	19,856	985,895	(1,118,851)	6,294,836

Six Months ended and as of June 30, 2009							
(Dollars in thousands)	Glacier	Mountain West	First Security	1st Bank	Western	Big Sky	Valley
External revenues	\$ 41,022	45,239	26,644	16,781	17,994	11,168	11,474
Intersegment revenues	93	1	555	126	371		85
Expenses	(33,766)	(43,043)	(20,391)	(16,940)	(14,811)	(9,284)	(8,277)
Net Earnings (Loss)	\$ 7,349	2,197	6,808	(33)	3,554	1,884	3,282
Total Assets	\$ 1,217,302	1,266,555	831,352	588,480	541,763	332,505	291,021

(Dollars in thousands)	Citizens	First Bank of MT	San Juans	Parent	Eliminations	Total Consolidated
External revenues	\$ 8,105	4,933	5,171	116		188,647
Intersegment revenues	2			35,242	(36,475)	
Expenses	(6,910)	(3,611)	(4,306)	(8,927)	8,050	(162,216)
Net Earnings (Loss)	\$ 1,197	1,322	865	26,431	(28,425)	26,431
Total Assets	\$ 243,830	176,222	177,850	825,575	(854,031)	5,638,424

13) Fair Value Measurement

FASB ASC Topic 820, *Fair Value Measurements and Disclosures*, requires the Company to disclose information relating to fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Topic establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1 Quoted prices in active markets for identical assets or liabilities
- Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

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The following is a description of the inputs and valuation methodologies used for financial assets measured at fair value on a recurring basis. There have been no significant changes in the valuation techniques during the period ended June 30, 2010.

Investment securities fair value for available-for-sale securities is estimated by obtaining quoted market prices for identical assets, where available. If such prices are not available, fair value is based on independent asset pricing services and models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections, and cash flows. For those securities where greater reliance on unobservable inputs occurs, such securities are classified as Level 3 within the hierarchy.

The following schedule discloses the major class of assets measured at fair value on a recurring basis for the period ended June 30, 2010:

(Dollars in thousands)	Assets/ Liabilities Measured at Fair Value 6/30/10	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets				
U.S. Government and federal agency	\$ 214		214	
Government sponsored enterprises	42,683		42,683	
State and local governments and other issues	528,166		528,166	
Collateralized debt obligations	8,828			8,828
Residential mortgage-backed securities	1,098,432		1,096,540	1,892
Total financial assets	\$ 1,678,323		1,667,603	10,720

The following schedule discloses the major class of assets measured at fair value on a recurring basis for the period ended June 30, 2009:

(Dollars in thousands)	Assets/ Liabilities Measured at Fair Value 6/30/09	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial assets				
U.S. Government and federal agency	\$ 207		207	
Government sponsored enterprises	291		291	
State and local governments and other issues	466,382		466,107	275
Collateralized debt obligations	9,972			9,972
Residential mortgage-backed securities	455,820		450,567	5,253
Total financial assets	\$ 932,672		917,172	15,500

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The following schedules reconcile the beginning and ending balances for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the six month periods ended June 30, 2010 and 2009.

(Dollars in thousands)	Total	Significant Unobservable Inputs (Level 3)		
		State and Local Government and Other Issues	Collateralized Debt Obligations	Residential Mortgage-backed Securities
Balance as of December 31, 2009	\$ 9,988	2,088	6,789	1,111
Total unrealized gains included in other comprehensive income	3,147		2,366	781
Amortization, accretion and principal payments	(327)		(327)	
Transfers out of Level 3	(2,088)	(2,088)		
Balance as of June 30, 2010	\$ 10,720		8,828	1,892

(Dollars in thousands)	Total	Significant Unobservable Inputs (Level 3)		
		State and Local Government and Other Issues	Collateralized Debt Obligations	Residential Mortgage-backed Securities
Balance as of December 31, 2008	\$ 23,421	284	15,540	7,597
Total unrealized gains included in other comprehensive income	(7,295)		(5,408)	(1,887)
Amortization, accretion and principal payments	(887)	(9)	(160)	(718)
Purchases	261			261
Balance as of June 30, 2009	\$ 15,500	275	9,972	5,253

The change in unrealized gains related to available-for-sale securities is reported in the accumulated other comprehensive income (loss). A state and local government security was transferred out of Level 3 and into Level 2 during the first quarter 2010 as a result of third party pricing being obtained and expected to be obtained in future quarters, whereas third party pricing was unavailable prior to first quarter 2010 for such security and there was a greater reliance on unobservable inputs for fair value.

The following is a description of the inputs and valuation methodologies used for assets recorded at fair value on a non-recurring basis. There have been no significant changes in the valuation techniques during the period ended June 30, 2010.

Other real estate owned – real estate and other assets owned are carried at the lower of fair value at acquisition date or current estimated fair value, less estimated cost to sell. Estimated fair value of real estate and other assets owned is based on appraisals. Real estate and other assets owned are classified within Level 3 of the fair value hierarchy.

Collateral-dependent impaired loans, net of ALLL – loans included in the Company's financials for which it is probable that the Company will not collect all principal and interest due according to contractual terms are considered impaired in accordance with FASB ASC Topic 310, *Receivables*. Estimated fair value of collateral-dependent impaired loans is based on the fair value of the collateral, less estimated cost to sell. Collateral-dependent impaired loans are classified within Level 3 of the fair value hierarchy.

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The following schedule discloses the major class of assets with a recorded change in the financial statements resulting from re-measuring the assets at fair value on a non-recurring basis for the periods ended June 30, 2010 and 2009:

	Assets/ Liabilities Measured at Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(Dollars in thousands)	6/30/10			
Financial assets				
Other real estate owned	\$ 3,694			3,694
Collateral-dependent impaired loans, net of allowance for loan and lease losses	49,162			49,162
Total financial assets	\$ 52,856			52,856

	Assets/ Liabilities Measured at Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(Dollars in thousands)	6/30/09			
Financial assets				
Other real estate owned	\$ 6,883			6,883
Collateral-dependent impaired loans, net of allowance for loan and lease losses	42,015			42,015
Total financial assets	\$ 48,898			48,898

The following is a description of the methods used to estimate the fair value of all other financial instruments recognized at amounts other than fair value.

Financial Assets

The estimated fair value of cash, federal funds sold, interest bearing cash deposits, and accrued interest receivable is the book value of such financial assets.

The estimated fair value of FHLB and FRB stock is book value due to the restrictions that such stock may only be sold to another member institution or the FHLB or FRB at par value.

Loans receivable, net of ALLL fair value for unimpaired loans, net of ALLL, is estimated by discounting the future cash flows using the rates at which similar notes would be written for the same remaining maturities. Impaired loans are primarily collateral-dependent and the estimated fair value is based on the fair value of the collateral.

Financial Liabilities

The estimated fair value of accrued interest payable is the book value of such financial liabilities.

Deposits fair value of term deposits is estimated by discounting the future cash flows using rates of similar deposits with similar maturities. The estimated fair value of demand, NOW, savings, and money market deposits is the book value since rates are regularly adjusted to market rates.

Advances from FHLB fair value of advances is estimated based on borrowing rates currently available to the Company for advances with similar terms and maturities.

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Repurchase agreements and other borrowed funds fair value of term repurchase agreements and other term borrowings is estimated based on current repurchase rates and borrowing rates currently available to the Company for repurchases and borrowings with similar terms and maturities. The estimated fair value for overnight repurchase agreements and other borrowings is book value.

Subordinated debentures fair value of the subordinated debt is estimated by discounting the estimated future cash flows using current estimated market rates for subordinated debt issuances with similar characteristics.

Off-balance sheet financial instruments commitments to extend credit and letters of credit represent the principal categories of off-balance sheet financial instruments. Rates for these commitments are set at time of loan closing, such that no adjustment is necessary to reflect these commitments at market value. The Company has immaterial off-balance sheet financial instruments.

The following presents the carrying amounts and estimated fair values in accordance with FASB ASC Topic 825, *Financial Instruments*, as of June 30, 2010:

(Dollars in thousands)	June 30, 2010		June 30, 2009	
	Amount	Fair Value	Amount	Fair Value
Financial assets				
Cash and cash equivalents	\$ 168,468	168,468	187,786	187,786
Investment securities	1,678,949	1,678,949	933,136	933,136
FHLB and FRB stock	64,319	64,319	61,011	61,011
Loans receivable, net of allowance for loan and lease losses	3,890,504	3,880,395	4,031,385	4,036,828
Accrued interest receivable	29,973	29,973	30,346	30,346
Total financial assets	\$ 5,832,213	5,822,104	5,243,664	5,249,107
Financial liabilities				
Deposits	\$ 4,510,116	4,521,182	3,386,443	3,397,205
Federal Home Loan Bank advances	529,982	542,390	613,478	618,812
Federal Reserve Bank discount window			587,000	587,000
Repurchase agreements and other borrowed funds	234,460	234,472	197,971	197,993
Subordinated debentures	125,060	74,488	120,157	65,987
Accrued interest payable	8,300	8,300	8,421	8,421
Total financial liabilities	\$ 5,407,918	5,380,832	4,913,470	4,875,418

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14) Rate/Volume Analysis

Net interest income can be evaluated from the perspective of relative dollars of change in each period. Interest income and interest expense, which are the components of net interest income, are shown in the following table on the basis of the amount of any increases (or decreases) attributable to changes in the dollar levels of the Company's interest-earning assets and interest-bearing liabilities (Volume) and the yields earned and rates paid on such assets and liabilities (Rate). The change in interest income and interest expense attributable to changes in both volume and rates has been allocated proportionately to the change due to volume and the change due to rate.

(Dollars in thousands)	Six Months ended June 30, 2010 vs. 2009		
	Increase (Decrease) Due to:		
	Volume	Rate	Net
Interest income			
Residential real estate loans	\$ (2,513)	(2,445)	(4,958)
Commercial loans	(412)	(1,476)	(1,888)
Consumer and other loans	(343)	(778)	(1,121)
Investment securities	15,900	(10,669)	5,231
Total interest income	12,632	(15,368)	(2,736)
Interest expense			
NOW accounts	377	5	382
Savings accounts	79	(208)	(129)
Money market demand accounts	430	(991)	(561)
Certificate accounts	2,113	(4,394)	(2,281)
Wholesale deposits	5,261	(3,686)	1,575
FHLB advances	3,810	(2,716)	1,094
Repurchase agreements and other borrowed funds	(3,776)	2,236	(1,540)
Total interest expense	8,294	(9,754)	(1,460)
Net interest income	\$ 4,338	(5,614)	(1,276)

15) Average Balance Sheet

The following schedule provides (i) the total dollar amount of interest and dividend income of the Company for earning assets and the resultant average yield; (ii) the total dollar amount of interest expense on interest-bearing liabilities and the resultant average rate; (iii) net interest and dividend income and interest rate spread; and (iv) net interest margin and net interest margin (tax-equivalent). Non-accrual loans are included in the average balance of the loans.

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(Dollars in thousands)	Three Months ended 6/30/10			Six Months ended 6/30/10		
	Average Balance	Interest & Dividends	Average Yield/Rate	Average Balance	Interest & Dividends	Average Yield/Rate
Assets						
Residential real estate loans	\$ 768,174	11,421	5.95%	\$ 775,634	23,254	6.00%
Commercial loans	2,588,734	37,003	5.73%	2,590,621	73,675	5.73%
Consumer and other loans	695,835	10,720	6.18%	693,525	21,360	6.21%
Total loans	4,052,743	59,144	5.85%	4,059,780	118,289	5.88%
Tax-exempt investment securities ¹	473,222	5,870	4.96%	466,530	11,438	4.90%
Taxable investment securities ²	1,294,892	8,804	2.72%	1,238,682	17,489	2.82%
Total earning assets	5,820,857	73,818	5.09%	5,764,992	147,216	5.15%
Goodwill and intangibles	159,039			159,443		
Non-earning assets	291,083			279,947		
Total assets	\$ 6,270,979			\$ 6,204,382		
Liabilities						
NOW accounts	\$ 714,714	673	0.38%	\$ 715,472	1,406	0.40%
Savings accounts	341,882	189	0.22%	336,807	393	0.24%
Money market demand accounts	847,712	1,962	0.93%	829,746	3,925	0.95%
Certificate accounts	1,080,561	5,183	1.92%	1,076,479	10,594	1.98%
Wholesale deposits ³	602,342	1,215	0.81%	488,388	2,235	0.92%
FHLB advances	634,182	2,454	1.55%	717,628	4,765	1.34%
Securities sold under agreements to repurchase and other borrowed funds	352,840	2,073	2.36%	429,973	4,315	2.02%
Total interest bearing liabilities	4,574,233	13,749	1.21%	4,594,493	27,633	1.21%
Non-interest bearing deposits	808,371			794,263		
Other liabilities	39,645			35,545		
Total liabilities	5,422,249			5,424,301		
Stockholders Equity						
Common stock	719			674		

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Paid-in capital	643,395	578,959
Retained earnings	196,250	194,954
Accumulated other comprehensive income	8,366	5,494
Total stockholders equity	848,730	780,081
Total liabilities and stockholders equity	\$ 6,270,979	\$ 6,204,382

Net Interest Income \$ 60,069 \$ 119,583

Net Interest Spread	3.88%	3.94%
Net Interest Margin	4.14%	4.18%
Net Interest Margin (tax-equivalent)	4.35%	4.39%

¹ Excludes tax effect of \$5,064,000 and \$2,599,000 on tax-exempt investment security income for the year-to-date and quarter ended June 30, 2010, respectively.

² Excludes tax effect of \$709,000 and \$397,000 on investment security tax credits for the year-to-date and quarter ended June 30, 2010, respectively.

³ Wholesale deposits include brokered deposits classified as NOW, money market demand, and CDs.

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ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
Results of Operations – The three months ended June 30, 2010
Compared to March 31, 2010 and June 30, 2009

Performance Summary

The Company reported net earnings of \$13.2 million for the second quarter of 2010, an increase of \$2.6 million, or 24 percent, from the \$10.7 million net earnings reported for the second quarter of 2009. Included in this increase was a pre-tax gain of \$1.8 million from the sale of Mountain West's merchant card servicing portfolio. The diluted earnings per share of \$0.19 for the quarter represented a 12 percent increase from the diluted earnings per share of \$0.17 for the same quarter of 2009. Annualized return on average assets and return on average equity for the second quarter were 0.85 percent and 6.25 percent, respectively, which compares with prior year returns for the second quarter of 0.77 percent and 6.18 percent, respectively.

Revenue Summary

(Unaudited - Dollars in thousands)	June 30, 2010	Three Months ended March 31, 2010	June 30, 2009
Net interest income			
Interest income	\$ 73,818	73,398	74,420
Interest expense	13,749	13,884	13,939
Total net interest income	60,069	59,514	60,481
Non-interest income			
Service charges, loan fees, and other fees	11,900	10,646	11,377
Gain on sale of loans	6,133	3,891	9,071
Gain on sale of investments	242	314	
Other income	3,143	1,332	870
Total non-interest income	21,418	16,183	21,318
	\$ 81,487	75,697	81,799
Net interest margin (tax-equivalent)	4.35%	4.43%	4.87%

(Unaudited - Dollars in thousands)	\$ Change from March 31, 2010	\$ Change from June 30, 2009	% Change from March 31, 2010	% Change from June 30, 2009
Net interest income				
Interest income	\$ 420	(602)	1%	-1%
Interest expense	(135)	(190)	-1%	-1%
Total net interest income	555	(412)	1%	-1%
Non-interest income				
Service charges, loan fees, and other fees	1,254	523	12%	5%

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Gain on sale of loans	2,242	(2,938)	58%	-32%
Gain on sale of investments	(72)	242	-23%	n/m
Other income	1,811	2,273	136%	261%
Total non-interest income	5,235	100	32%	0%
	\$ 5,790	(312)	8%	0%

n/m not measurable

Table of Contents**Net Interest Income**

Net interest income for the current quarter increased \$555 thousand and decreased \$412 thousand over prior year's quarter. The current quarter net interest margin as a percentage of earning assets, on a tax-equivalent basis, was 4.35 percent which is 8 basis points lower than the 4.43 percent for the prior quarter and included a 4 basis points reduction from the reversal of interest on non-accrual loans. The net interest margin for the current quarter is 52 basis points lower than the 4.87 percent result for the second quarter of 2009.

Non-interest Income

Non-interest income for the quarter totaled \$21.4 million, an increase of \$5.2 million over the prior quarter and \$100 thousand over the same quarter as last year. Fee income of \$11.9 million increased \$1.3 million, or 12 percent, during the quarter primarily from an increase in debit card income. This compares to an increase of \$523 thousand, or 5 percent, over the same period last year. Gain on sale of loans increased \$2.2 million, or 58 percent, over the prior quarter as a reduction in mortgage interest rates during the second quarter led to an increase in loan origination volume. Gain on sale of loans decreased \$2.9 million, or 32 percent, over the same period last year, primarily the result of a significant reduction in re-finance activity and a slowing of residential loans originated and sold in the secondary market. Net gain on sale of investments was \$242 thousand for the current quarter 2010 compared to \$314 thousand for the previous quarter. Other income of \$3.1 million for the current quarter is an increase of \$1.8 million and \$2.3 million from prior quarter and prior year second quarter, respectively, of which \$1.8 million relates to the current quarter sale of Mountain West's merchant card servicing portfolio.

Non-interest Expense

(Unaudited - Dollars in thousands)	Three Months ended		
	June 30, 2010	March 31, 2010	June 30, 2009
Compensation and employee benefits	\$ 21,652	21,356	20,710
Occupancy and equipment expense	5,988	5,948	5,611
Advertising and promotions	1,644	1,592	1,722
Outsourced data processing	761	694	680
Core deposit intangibles amortization	801	820	762
Other real estate owned expense	7,373	2,318	2,321
Federal Deposit Insurance Corporation premiums	2,165	2,200	3,832
Other expenses	7,852	7,033	7,325
Total non-interest expense	\$ 48,236	41,961	42,963

(Unaudited - Dollars in thousands)	\$ Change from March 31, 2010	\$ Change from June 30, 2009	% Change from March 31, 2010	% Change from June 30, 2009
	Compensation and employee benefits	\$ 296	942	1%	5%
Occupancy and equipment expense	40	377	1%	7%
Advertising and promotions	52	(78)	3%	-5%
Outsourced data processing	67	81	10%	12%
Core deposit intangibles amortization	(19)	39	-2%	5%
Other real estate owned expense	5,055	5,052	218%	218%
Federal Deposit Insurance Corporation premiums	(35)	(1,667)	-2%	-44%
Other expenses	819	527	12%	7%
Total non-interest expense	\$ 6,275	5,273	15%	12%

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Non-interest expense of \$48.2 million for the quarter increased by \$6.3 million, or 15 percent, from the prior quarter and increased \$5.3 million, or 12 percent, from the prior year second quarter. Compensation and employee benefits of \$21.7 million increased only \$296 thousand, or 1 percent, from the previous quarter and \$942 thousand, or 5 percent, from the prior year second quarter which is due to the addition of First National employees. The number of full-time equivalent employees increased from 1,651 to 1,654 during the quarter, and increased from 1,597 since the end of the 2009 second quarter.

Occupancy and equipment expense increased \$40 thousand, or 1 percent, from the prior quarter and increased \$377 thousand, or 7 percent, from the prior year second quarter. Advertising and promotion expense increased \$52 thousand, or 3 percent, from prior quarter and decreased \$78 thousand, or 5 percent, from the second quarter of 2009. Other real estate owned expenses increased \$5.1 million, or 218 percent, from prior quarter and increased \$5.1 million, or 218 percent, from the prior year. The current quarter other real estate owned expense of \$7.4 million included \$1.5 million of operating expenses, \$2.9 million of fair value write-downs, and \$3.0 million of loss on sale of other real estate owned. The other real estate owned expenses have increased as the Company moves to aggressively dispose of problem assets and other real estate owned. Federal Deposit Insurance Corporation (FDIC) premiums decreased \$1.7 million, or 44 percent, from the prior year second quarter which included a FDIC special assessment. Other expenses increased \$819 thousand, or 12 percent, from the prior quarter and increased \$527 thousand, or 7 percent, from the prior year second quarter.

The efficiency ratio (non-interest expense / net interest income plus non-interest income) was 59 percent for the quarter, compared to 53 percent for the 2009 second quarter. The increase in the efficiency ratio from the prior year is the result of the increase in other expenses primarily from other real estate owned expenses, losses and write-downs.

Provision for Loan Losses

The current quarter provision for loan loss expense was \$17.2 million, a decrease of \$3.7 million from prior quarter and a decrease of \$7.9 million from the same quarter in 2009. Net charged-off loans for the current quarter were \$19.2 million compared to \$20.2 million for the prior quarter and \$11.5 million for the same quarter in 2009.

The determination of the allowance for loan and lease losses (ALLL or Allowance) and the related provision for loan losses is a critical accounting estimate that involves management's judgments about current environmental factors which affect loan losses, such factors including economic conditions, changes in collateral values, net charge-offs, and other factors discussed in Additional Management's Discussion and Analysis Allowance for Loan and Lease Losses.

Table of Contents**Results of Operations The six months ended June 30, 2010**
Compared to the six months ended June 30, 2009**Performance Summary**

Net earnings for the six months ended June 30, 2010 were \$23.3 million, which is a decrease of \$3.1 million or 12 percent, over the prior year. Diluted earnings per share of \$0.35 is a decrease of 19 percent over \$0.43 earned in the first half of 2009.

Revenue Summary

(Unaudited - Dollars in thousands)	Six Months ended		\$ Change	% Change
	June 30, 2010	June 30, 2009		
Net interest income				
Interest income	\$ 147,216	\$ 149,952	\$ (2,736)	-2%
Interest expense	27,633	29,093	(1,460)	-5%
Total net interest income	119,583	120,859	(1,276)	-1%
Non-interest income				
Service charges, loan fees, and other fees	22,546	21,556	990	5%
Gain on sale of loans	10,024	15,221	(5,197)	-34%
Gain on sale of investments	556		556	n/m
Other income	4,475	1,918	2,557	133%
Total non-interest income	37,601	38,695	(1,094)	-3%
	\$ 157,184	\$ 159,554	\$ (2,370)	-1%
Net interest margin (tax-equivalent)	4.39%	4.90%		

Net Interest Income

Net interest income for the six month period decreased \$1.3 million, or 1 percent, over the same period in 2009. Total interest income decreased \$2.7 million, or 2 percent, while total interest expense decreased \$1.5 million, or 5 percent. The decrease in interest income is due to a lower yield and volume of loans coupled with an increase in lower yielding investment securities. The decrease in interest expense is primarily attributable to the rate decreases on interest bearing deposits and lower cost borrowings. The net interest margin as a percentage of earning assets, on a tax equivalent basis, decreased 51 basis points from 4.90 percent for 2009 to 4.39 percent for 2010.

Non-interest Income

Non-interest income decreased \$1.1 million over the same period in 2009. Fee income for the first half of 2010 has increased \$990 thousand, or 5 percent, compared to prior year primarily from an increase in debit card income. Gain on sale of loans decreased \$5.2 million, or 34 percent, over the first six months of last year, primarily the result of a significant reduction in re-finance activity and a slowing of residential loans originated and sold in the secondary market. Other income increased \$2.6 million over the same period in 2009, of which \$1.8 million relates to the current quarter sale of Mountain West's merchant card servicing portfolio.

Table of Contents**Non-interest Expense**

(Unaudited - Dollars in thousands)	Six Months ended		\$	%
	June 30,	June 30,		
	2010	2009	Change	Change
Compensation and employee benefits	\$ 43,008	\$ 42,654	\$ 354	1%
Occupancy and equipment expense	11,936	11,506	430	4%
Advertising and promotions	3,236	3,446	(210)	-6%
Outsourced data processing	1,455	1,351	104	8%
Core deposit intangibles amortization	1,621	1,536	85	6%
Other real estate owned expense	9,691	2,841	6,850	241%
Federal Deposit Insurance Corporation premiums	4,365	5,000	(635)	-13%
Other expenses	14,885	14,255	630	4%
Total non-interest expense	\$ 90,197	\$ 82,589	\$ 7,608	9%

Non-interest expense for the first six month of 2010 increased by \$7.6 million, or 9 percent, from the same period prior year. Compensation and employee benefits increased \$354 thousand, or 1 percent, from 2009. Occupancy and equipment expense increased \$430 thousand, or 4 percent, reflecting the cost of additional locations and facility upgrades. Advertising and promotion expense decreased by \$210 thousand, or 6 percent, from 2009. Other real estate owned expense increased \$6.9 million, or 241 percent, from the prior first six months. The other real estate owned expenses for the first six months of 2010 of \$9.7 million included \$2.2 million of operating expenses, \$3.3 million of fair value write-downs, and \$4.2 of loss on sale of other real estate owned. FDIC premiums decreased \$635 thousand, or 13 percent, from the prior year first six months which included a special assessment of \$2.5 million. Other expense increased \$630 thousand, or 4 percent, from the prior year.

The efficiency ratio (non-interest expense / net interest income plus non-interest income) was 57 percent for the first six months of 2010, compared to 52 percent for the same period in 2009. The increase in the efficiency ratio from the prior year is the result of the increase in other expenses primarily from other real estate owned expenses, losses and write-downs.

Provision for Loan Losses

The provision for loan loss expense was \$38.2 million for the first six months of 2010, a decrease of \$2.7 million, or 7 percent, from the same period in 2009. Net charged-off loans during the six months ended June 30, 2010 was \$39.4 million, an increase of \$19.2 million from the same period in 2009.

Table of Contents**Financial Condition Analysis****Assets**

		December		\$ Change from December	\$ Change from
(Unaudited - Dollars in thousands)	June 30, 2010	31, 2009	June 30, 2009	31, 2009	June 30, 2009
Cash on hand and in banks	\$ 95,603	120,731	100,773	(25,128)	(5,170)
Investments, interest bearing deposits, FHLB stock, FRB stock, and fed funds	1,816,133	1,596,238	1,081,160	219,895	734,973
Loans					
Residential real estate	764,286	797,626	836,917	(33,340)	(72,631)
Commercial	2,570,140	2,613,218	2,591,149	(43,078)	(21,009)
Consumer and other	697,743	719,401	700,693	(21,658)	(2,950)
Loans receivable, gross	4,032,169	4,130,245	4,128,759	(98,076)	(96,590)
Allowance for loan and lease losses	(141,665)	(142,927)	(97,374)	1,262	(44,291)
Loans receivable, net	3,890,504	3,987,318	4,031,385	(96,814)	(140,881)
Other assets	492,596	487,508	425,106	5,088	67,490
Total assets	\$ 6,294,836	6,191,795	5,638,424	103,041	656,412

Total assets at June 30 2010 were \$6.295 billion, which is \$103 million, or 2 percent, greater than total assets of \$6.192 billion at December 31, 2009. Total assets increased \$656 million, or 12 percent, from June 30, 2009, of which \$272 million, including \$161 million in loans, related to the acquisition of First National in October 2009.

Investment securities, including interest bearing deposits, FHLB and FRB stock, and federal funds sold, have increased \$220 million, or 14 percent, from December 31, 2009 and increased \$735 million, or 68 percent, from June 30, 2009. The Company continues to purchase investment securities as loan originations slow, such purchases are predominately mortgage-backed securities issued by Freddie Mac and Fannie Mae with short weighted average lives. The Company continues to be very selective in its purchases of tax-exempt investment securities. Investment securities represent 29 percent of total assets at June 30, 2010 versus 19 percent of total assets at June 30, 2009.

At June 30, 2010, gross loans were \$4.032 billion, a decrease of \$98 million over gross loans of \$4.130 billion at December 31, 2009. Excluding net charge-offs of \$39 million and loans transferred to other real estate of \$46 million, loans decreased \$13 million, or 1 percent annualized, from December 31, 2009.

Liabilities

		December		\$ Change from December	\$ Change from
(Unaudited - Dollars in thousands)	June 30, 2010	31, 2009	June 30, 2009	31, 2009	June 30, 2009
Non-interest bearing deposits	\$ 852,121	810,550	754,844	41,571	97,277
Interest bearing deposits	3,657,995	3,289,602	2,631,599	368,393	1,026,396
Federal Home Loan Bank advances	529,982	790,367	613,478	(260,385)	(83,496)
Federal Reserve Bank discount window		225,000	587,000	(225,000)	(587,000)

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Securities sold under agreements to repurchase and other borrowed funds	234,460	226,251	197,971	8,209	36,489
Other liabilities	49,470	39,147	43,711	10,323	5,759
Subordinated debentures	125,060	124,988	120,157	72	4,903
Total liabilities	\$ 5,449,088	5,505,905	4,948,760	(56,817)	500,328

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As of June 30, 2010, non-interest bearing deposits increased \$42 million, or 10 percent annualized, since December 31, 2009 and increased \$97 million, or 13 percent, since June 30, 2009. Interest bearing deposits of \$3.658 billion at June 30, 2010 includes \$414 million issued through the Certificate of Deposit Account Registry System. Interest bearing deposits increased \$368 million, or 22 percent annualized, from December 31, 2009 and \$1.026 billion, or 39 percent from June 30, 2009. The increase in interest bearing deposits from December 31, 2009 and June 30, 2009 includes \$308 million and \$507 million, respectively, from wholesale deposits. The increase in non-interest bearing deposits and interest bearing deposits from June 30, 2009 includes \$39 million and \$197 million, respectively, from the First National acquisition.

As a result of the deposit growth, borrowings overall have been reduced. FHLB advances decreased \$260 million, or 33 percent, from December 31, 2009 and decreased \$83 million, or 14 percent, from June 30, 2009. There were no Federal Reserve Bank borrowings through the Term Auction Facility program (TAF) at June 30, 2010 due to cessation of the TAF program by the Federal Reserve. TAF borrowings totaled \$225 million at December 31, 2009 and \$587 million at June 30, 2009. Repurchase agreements and other borrowed funds were \$234 million at June 30, 2010, an increase of \$8 million from December 31, 2009 and an increase of \$36 million from June 30, 2009.

Stockholders Equity

Unaudited - Dollars in thousands, except per share data)	June 30, 2010	December 31, 2009	Change	
			from December 2009	from June 30, 2009
Common equity	\$ 836,955	686,238	692,046)
Deferred income taxes	(26,114	)(1,064,583))
Changes in assets and liabilities:				
Accounts receivable	(1,682,020	)464,005	(1,329,407)
Inventories	2,231,901	285,886	(428,128)
Other current assets	(136,735	)669,937	(622,691)
Accounts payable	(388,421	)(1,116,679	1,253,493)
Warranty reserves	11,749	(63,765	(600,140)
Accrued group health insurance claims	40,870	(152,313	(122,998)
Accrued bonuses	71,715	911,520		
Other accrued expenses	239,250	(595,960	728,258)
Customer deposits	(376,543	)297,216	160,873)
Current income taxes	100,377	143,398	1,026,055)
Other assets	4,500	1,025	(12,524)
Net cash provided by operating activities of continuing operations	5,547,776	5,905,440	2,044,818)
Cash flows from investing activities:				
Capital expenditures	(827,302	)(1,131,792	(406,717)
Proceeds from sale of assets	19,801	313,249	290,000)
Net cash used in investing activities of continuing operations	(807,501	)(818,543	(116,717)
Cash flows from financing activities:				
Payments on long-term debt	(25,935	)(24,254	(18,740)
Proceeds from employee stock purchase plan	49,117	21,329	13,262)
Proceeds from exercise of stock options	832,907	186,444	89,703)
Net cash provided by financing activities of continuing operations	856,089	183,519	84,225)
Net cash contributed to continuing operations from discontinued operations			473,231)
Net increase in cash and cash equivalents	5,596,364	5,270,416	2,485,557)
Cash and cash equivalents at beginning of year	14,031,984	8,761,568	6,276,011)
Cash and cash equivalents at end of year	\$ 19,628,348	\$ 14,031,984	\$ 8,761,568)

See accompanying notes to consolidated financial statements.

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

Years Ended December 31, 2005, 2004 and 2003

1. Company

Ballantyne of Omaha, Inc., a Delaware corporation (Ballantyne or the Company), and its wholly-owned subsidiaries Strong Westrex, Inc., and Design & Manufacturing, Inc., design, develop, manufacture and distribute commercial motion picture equipment and lighting systems and distributes restaurant products. The Company's products are distributed to movie exhibition companies, sports arenas, auditoriums, amusement parks, special venues, and the food service industry. Refer to the Business Segment Section (note 13) for further information.

2. Summary of Significant Accounting Policies

The principal accounting policies upon which the accompanying consolidated financial statements are based are summarized as follows:

a. Basis of Presentation and Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

b. Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results and changes in facts and circumstances may alter such estimates and affect results of operations and financial position in future periods.

c. Allowance for Doubtful Accounts

Accounts receivable are presented net of allowance for doubtful accounts of \$420,223 and \$485,829 at December 31, 2005 and 2004, respectively. This allowance is developed based on several factors including overall customer credit quality, historical write-off experience and a specific analysis that projects the ultimate collectibility of the account. As such, these factors may change over time causing the reserve level to adjust accordingly.

d. Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market and include appropriate elements of material, labor and manufacturing overhead. Inventory balances are net of reserves of slow moving or obsolete inventory estimated based on management's review of inventories on hand compared to estimated future usage and sales.

e. Goodwill and Intangible Assets

The Company capitalizes and includes in intangible assets the excess of cost over the fair value of net identifiable assets of operations acquired through purchase transactions (goodwill) in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 142 requires goodwill no longer be amortized to earnings, but instead be reviewed at least annually for impairment. An impairment loss is recognized to the extent that the carrying

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

amount exceeds the asset's estimated fair value. The majority of the goodwill is attributed to the Company's theatre segment.

Other intangible assets are stated at cost and amortized on a straight-line basis over the expected periods to be benefited (25 to 36 months). These assets became fully amortized during 2005.

f. Property, Plant and Equipment

Significant expenditures for the replacement or expansion of property, plant and equipment are capitalized. Depreciation of property, plant and equipment is provided over the estimated useful lives of the respective assets using the straight-line method. For financial reporting purposes, assets are depreciated over the estimated useful lives of 20 years for buildings and improvements, 3 to 10 years for machinery and equipment, 7 years for furniture and fixtures and 3 years for computers and accessories. The Company generally uses accelerated methods of depreciation for income tax purposes.

g. Income Taxes

Income taxes are accounted for under the asset and liability method. The Company uses an estimate of its annual effective rate at each interim period based on the facts and circumstances at the time while the actual effective rate is calculated at year-end. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized.

h. Revenue Recognition

The Company recognizes revenue from product sales upon shipment to the customer when collectibility is reasonably assured. Revenues related to services are recognized as earned over the terms of the contracts or delivery of the service to the customer.

The Company enters into transactions that represent multiple element arrangements, which may include a combination of services and asset sales. Under EITF 00-21, *Revenue Arrangements with Multiple Deliverables*, multiple element arrangements are assessed to determine whether they can be separated into more than one unit of accounting. A multiple element arrangement is separated into more than one unit of accounting if all of the following criteria are met.

- The delivered item(s) has value on a standalone basis;
- There is objective and reliable evidence of the fair value of the undelivered item(s);
- If the arrangement includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the Company.

If these criteria are not met, then revenue is deferred until such criteria are met or until the period(s) over which the last undelivered element is delivered. If there is objective and reliable evidence of fair value for all units of accounting in an arrangement, the arrangement consideration is allocated to the

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

separate units of accounting based on each unit's relative fair value. There may be cases, however, in which there is objective and reliable evidence of fair value of the undelivered item(s) but no such evidence for the delivered item(s). In those cases, the residual method is used to allocate the arrangement consideration. Under the residual method, the amount of consideration allocated to the delivered items(s) equals the total arrangement consideration less the aggregate fair value of the undelivered item.

i. Research and Development

Research and development costs are charged to operations in the period incurred. Such costs amounted to approximately \$455,000, \$328,000 and \$590,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

j. Advertising Costs

Advertising and promotional costs are expensed as incurred and amounted to approximately \$729,000, \$725,000 and \$989,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

k. Fair Value of Financial Instruments

The fair value of a financial instrument is the amount at which the instruments could be exchanged in a current transaction between willing parties. Cash and cash equivalents, accounts receivable, debt, accounts payable and accrued expenses reported in the consolidated balance sheets equal or approximate their fair values.

l. Cash and Cash Equivalents

All highly liquid financial instruments with maturities of three months or less from date of purchase are classified as cash equivalents in the consolidated balance sheets and statements of cash flows.

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

m. Earnings Per Common Share

The Company computes and presents earnings per share in accordance with SFAS No. 128, *Earnings Per Share*. Basic earnings per share has been computed on the basis of the weighted average number of shares of common stock outstanding. Diluted earnings per share has been computed on the basis of the weighted average number of shares of common stock outstanding after giving effect to potential common shares from dilutive stock options. The following table provides a reconciliation between basic and diluted income per share:

	Years Ended December 31,		
	2005	2004	2003
Basic earnings per share:			
Earnings applicable to common stock	\$ 4,308,897	\$ 5,073,329	\$ 578,510
Weighted average common shares outstanding	13,255,349	12,828,096	12,637,880
Basic earnings per share	\$ 0.33	\$ 0.40	\$ 0.05
Diluted earnings per share:			
Earnings applicable to common stock	\$ 4,308,897	\$ 5,073,329	\$ 578,510
Weighted average common shares outstanding	13,255,349	12,828,096	12,637,880
Assuming conversion of options outstanding	597,550	780,780	549,088
Weighted average common shares outstanding, as adjusted	13,852,899	13,608,876	13,186,968
Diluted earnings per share	\$ 0.31	\$ 0.37	\$ 0.04

At December 31, 2005, options to purchase 268,800 shares of common stock at a weighted average price of \$8.43 per share were outstanding, but were not included in the computation of diluted earnings per share for the year ended December 31, 2005 as the options' exercise price was greater than the average market price of the common shares. These options expire between January 2007 and May 2010. At December 31, 2004, options to purchase 237,925 shares of common stock at a weighted average price of \$8.61 per share were outstanding, but were not included in the computation of diluted earnings per share for the year ended December 31, 2004 as the options' exercise price was greater than the average market price of the common shares.

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

n. Stock Based Compensation

As permitted under SFAS No. 123, *Accounting for Stock-Based Compensation*, and amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, the Company elected to account for its stock based compensation plans under the provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Consequently, when both the number of shares and the exercise price is known at the grant date, no compensation expense is recognized for stock options issued to employees and directors unless the exercise price of the option is less than the quoted value of the Company's common stock at the date of grant. Had compensation cost for the Company's stock compensation plans been determined consistent with SFAS No. 123 as amended by SFAS No. 148, the Company's net income, basic earnings per share and diluted earnings per share would have decreased to the pro forma amounts indicated below:

	Years Ended December 31,		
	2005	2004	2003
Net income:			
As reported	\$ 4,308,897	\$ 5,073,329	\$ 578,510
Stock-based compensation expense, determined under fair value based method, net of tax	(91,431)	(180,322)	(79,009)
Proforma net income	\$ 4,217,466	\$ 4,893,007	\$ 499,501
Basic earnings per share:			
As reported	\$ 0.33	\$ 0.40	\$ 0.05
Proforma earnings per share	\$ 0.32	\$ 0.38	\$ 0.04
Diluted earnings per share:			
As reported	\$ 0.31	\$ 0.37	\$ 0.04
Proforma earnings per share	\$ 0.30	\$ 0.36	\$ 0.04

The average fair value of each option granted in 2005, 2004 and 2003 amounted to \$2.55, \$2.18 and \$0.75, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model made with the following weighted average assumptions:

	Years Ended December 31,		
	2005	2004	2003
Risk-free interest rate	3.82 %	4.15 %	4.01 %
Dividend yield	0 %	0 %	0 %
Expected volatility	66.9 %	58.8 %	56.8 %
Expected life in years	3.6	10.0	8.7

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

o. Impairment of Long-Lived Assets

The Company reviews long-lived assets, exclusive of goodwill, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair value. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

The Company's most significant long-lived assets subject to these periodic assessments of recoverability are property, plant and equipment, which have a net book value of \$5.4 million at December 31, 2005. Because the recoverability of property, plant and equipment is based on estimates of future undiscounted cash flows, these estimates may vary due to a number of factors, some of which may be outside of management's control. To the extent that the Company is unable to achieve management's forecasts of future income, it may become necessary to record impairment losses for any excess of the net book value of property, plant and equipment over its fair value.

p. Warranty Reserves

The Company generally grants a warranty to its customers for a one-year period following the sale of all new equipment, and on selected repaired equipment for a one-year period following the repair. The warranty period is extended under certain circumstances and for certain products. The Company accrues for these costs at the time of sale or repair, when events dictate that additional accruals are necessary.

The following table summarizes warranty activity for the three years ended December 31, 2005.

Warranty accrual at December 31, 2002	\$ 1,332,173
Charged to expense	288,433
Amounts written off, net of recoveries	(888,573)
Warranty accrual at December 31, 2003	\$ 732,033
Charged to expense	561,335
Amounts written off, net of recoveries	(625,100)
Warranty accrual at December 31, 2004	\$ 668,268
Charged to expense	342,514
Amounts written off, net of recoveries	(330,765)
Warranty accrual at December 31, 2005	\$ 680,017

q. Comprehensive Income

The Company's comprehensive income consists solely of net income. All other items were not material to the consolidated financial statements.

r. Reclassifications

Certain amounts in the accompanying consolidated financial statements and notes thereto have been reclassified to conform to the 2005 presentation.

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

s. Recently Issued Accounting Pronouncements

The Financial Accounting Standards Board (FASB) has adopted SFAS No. 151, *Inventory Costs* an Amendment of ARB No. 43, Chapter 4. The provisions of SFAS 151 are intended to eliminate narrow differences between the existing accounting standards of the FASB and the International Accounting Standards Board (IASB) related to inventory costs, in particular, the treatment of abnormal idle facility expense, freight, handling costs and spoilage. SFAS 151 requires that these costs be recognized as current period charges regardless of the extent to which they are considered abnormal. The provisions of SFAS 151 are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of SFAS 151 is not expected to have a significant impact on the Company's results of operations or financial position.

The FASB has issued Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R) which replaced SFAS 123 and superseded APB 25. Under the provisions of SFAS 123R, companies are required to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with limited exception). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award, usually the vesting period. On April 14, 2005, the Securities and Exchange Commission (SEC) approved a delay to the effective date of SFAS 123R. Under the new SEC rule, SFAS 123R is effective for annual periods that begin after June 15, 2005. SFAS 123R applies to all awards granted, modified, repurchased or cancelled after December 31, 2005 and to unvested awards at the date of adoption. The Company expects to use the Black-Scholes option-pricing model using similar assumptions as those currently used to determine pro-forma compensation expense disclosed in the footnotes to these financial statements. The Company will adopt SFAS 123R in the first quarter of 2006.

The FASB issued FSP FAS 123R-2, *Practical Accommodation to the Application of Grant Date as Defined in FAS 123R* (FSP 123R-2) in October 2005. FSP 123R-2 provides guidance on the application of grant date as defined in SFAS No. 123R. In accordance with this standard, a grant date of an award exists if a) the award is a unilateral grant and b) the key terms and conditions of the award are expected to be communicated to an individual recipient within a relatively short time period from the date of approval. The Company will adopt this standard when it adopts SFAS 123R, and it is not expected to have a material impact on its consolidated financial position, results of operations or cash flows.

During 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* (SFAS 154). SFAS 154 is a replacement of Accounting Principles Board No. 20, *Accounting Changes* and FASB Statement No. 3 *Reporting Accounting Changes in Interim Financial Statement*. SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application as the required method for reporting a change in accounting principle. SFAS 154 provides guidance for determining whether retrospective application of a change in accounting principle is impracticable and for reporting a change when retrospective application is impracticable. The reporting of a correction of an error by restating previously issued financial statements is also addressed by SFAS 154. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 31, 2005. The Company will adopt this pronouncement beginning in fiscal year 2006.

During 2005, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets* which eliminates the exception to the fair-value principle for exchanges of similar productive assets, which had been accounted for based on the book value of the asset surrendered with no gain recognition. Nonmonetary exchanges have to be accounted for at fair-value, recognizing any gain or loss, if the transactions meet the

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

commercial-substance criterion and fair-value determinable. The Statement reduces the differences between U.S. and international accounting standards. This Statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company will adopt this Statement in the first quarter of fiscal 2006 and does not expect this pronouncement to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-1 (FSP FAS 109-1), Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities provided by the American Jobs Creation Act of 2004. FSP FAS 109-1 clarifies that the deduction will be treated as a special deduction as described in SFAS 109, Accounting for Income Taxes. As such, the special deduction has no effect on deferred tax assets and liabilities existing at the date of enactment. The impact of the deduction will be reported in the period in which the deduction is claimed. The incentive for U.S. qualified production activities included in the Act is effective as of December 21, 2004.

3. Sale of Rental Assets and Operations

On July 31, 2002, the Company sold certain rental assets and operations of Xenotech Rental Corp. in North Hollywood, California to the subsidiary's former general manager for proceeds of \$500,000. The Company recorded a gain of approximately \$175,000 on the sale. The Company retained all cash, accounts receivable, inventory and payable amounts recorded at the time of sale. In January 2003, the Company sold its entertainment lighting rental operations located in Orlando, Florida and Atlanta, Georgia. In connection with the transaction, certain assets were segregated and sold in two separate transactions to the general manager of each location for an aggregate of \$290,000. The Company retained all cash, accounts receivable, inventory and payable balances recorded at the time of sale. The Company recorded an aggregate gain of approximately \$136,000 from these sales transactions during 2003. The assets and operating results of the operations sold were not material to the consolidated financial statements.

4. Intangible Assets

Intangible assets consist of the following:

	At December 31, 2005		
	Cost	Accumulated Amortization	Net Book Value
Nonamortizable intangible assets:			
Goodwill	\$ 3,720,743	(1,253,524)	2,467,219
Amortizable intangible assets:			
Customer relationships	113,913	(113,913)	
Trademarks	1,000	(1,000)	
Non-competition agreement	6,882	(6,882)	
	\$ 3,842,538	(1,375,319)	2,467,219

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

	At December 31, 2004		
	Cost	Accumulated Amortization	Net Book Value
Nonamortizable intangible assets:			
Goodwill	\$ 3,720,743	(1,253,524)	2,467,219
Amortizable intangible assets:			
Customer relationships	113,913	(91,763)	22,150
Trademarks	1,000	(1,000)	
Non-competition agreement	6,882	(5,544)	1,338
	\$ 3,842,538	(1,351,831)	2,490,707

SFAS No. 142, effective January 1, 2002, requires goodwill no longer be amortized to earnings, but instead be reviewed at least annually for impairment. Consequently, the Company stopped amortizing goodwill on January 1, 2002. In applying SFAS No. 142, the Company performed the annual reassessment and impairment test in the fourth quarters of 2005 and 2004 and determined that goodwill was not impaired.

During 2002, the Company purchased certain intangible assets pertaining to an asset purchase agreement between the Company and Forest Industrial Tool, Inc. The assets were recorded based on the present value of future cash payments under the agreement. The Company was amortizing these intangibles on a straight-line basis over the expected periods to be benefited (25 to 36 months) until they became fully depreciated during 2005.

The Company recorded amortization expense relating to other identifiable intangible assets of \$23,488, \$40,585 and \$40,743 for the years ending December 31, 2005, 2004 and 2003, respectively.

5. Inventories

Inventories consist of the following:

	December 31,	
	2005	2004
Raw materials and components	\$ 7,008,791	\$ 8,995,922
Work in process	1,339,323	1,276,297
Finished goods	1,593,951	1,901,747
	\$9,942,065	\$ 12,173,966

The inventory balances are net of reserves for slow moving or obsolete inventory of approximately \$1,138,000 and \$1,086,000 as of December 31, 2005 and 2004, respectively.

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

6. Property, Plant and Equipment

Property, plant and equipment include the following:

	December 31,	
	2005	2004
Land	\$ 343,500	\$ 343,500
Buildings and improvements	4,699,981	4,687,859
Machinery and equipment	9,511,671	9,125,868
Office furniture and fixtures	2,212,273	1,932,367
Construction in process	39,155	28,922
	16,806,580	16,118,516
Less accumulated depreciation	11,426,647	10,441,921
Net property, plant and equipment	\$ 5,379,933	\$ 5,676,595

Depreciation expense amounted to approximately \$1,113,000, \$1,042,000 and \$1,163,000 for the years ending December 31, 2005, 2004 and 2003, respectively.

7. Debt

The Company is a party to a revolving credit facility with First National Bank of Omaha expiring August 28, 2006. The Company expects to renew the credit facility in the ordinary course of business. The credit facility provides for borrowings up to the lesser of \$4.0 million or amounts determined by an asset based lending formula, as defined. Borrowings available under the credit facility amounted to \$4.0 million at December 31, 2005. No amounts are currently outstanding. The Company would pay interest on outstanding amounts equal to the Prime Rate plus 0.25% (7.50% at December 31, 2005) and pays a fee of 0.125% on the unused portion. The credit facility contains certain restrictive covenants primarily related to maintaining certain earnings, as defined, and restrictions on acquisitions and dividends. All of the Company's personal property and stock in its subsidiaries secure this credit facility.

Long-term debt at December 31, 2005 consisted entirely of installment payments relating to the purchase of certain intangible assets. Future maturities of long-term debt as of December 31, 2005 are \$27,761 in 2006 and \$14,609 in 2007.

8. Income Taxes

Income before income taxes consists of:

	Years Ended December 31,		
	2005	2004	2003
United States	\$ 6,558,558	\$ 5,685,666	\$ 874,269
Foreign	226,207	205,847	199,712
	\$ 6,784,765	\$ 5,891,513	\$ 1,073,981

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

Income tax expense (benefit) attributable to income from continuing operations consists of:

	Years Ended December 31,		
	2005	2004	2003
Current:			
Federal expense	\$ 2,284,114	\$ 1,727,908	\$ 438,493
State expense	178,000	119,000	24,700
Foreign expense	39,868	35,859	32,278
Deferred benefit	(26,114)	(1,064,583)	
	\$ 2,475,868	\$ 818,184	\$ 495,471

Income tax expense attributable to income from continuing operations differed from the amounts computed by applying the U.S. Federal income tax rate of 34 percent to pretax income from continuing operations as follows:

	Years Ended December 31,		
	2005	2004	2003
Expected tax expense	\$ 2,306,820	\$ 2,003,113	\$ 365,154
State income taxes, net of federal effect	117,480	78,540	16,302
Valuation allowances		(1,493,867)	65,793
Other	51,568	230,398	48,222
	\$ 2,475,868	\$ 818,184	\$ 495,471

Deferred tax assets and liabilities were comprised of the following:

	December 31,	
	2005	2004
Deferred tax assets:		
Non-deductible accruals	\$ 307,836	\$ 352,664
Inventory reserves	517,185	514,352
Warranty reserves	250,926	247,259
State NOL	40,000	56,000
Uncollectible receivable reserves	155,062	179,757
Accrued group health insurance claims	101,648	86,801
Other	115,517	115,455
Net deferred tax assets	1,488,174	1,552,288
Deferred tax liability depreciation and amortization	(397,477)	(487,705)
Net deferred tax assets	\$ 1,090,697	\$ 1,064,583

During the third quarter of 2004, the Company reversed all valuation allowances against its deferred tax assets as management believed that it was more likely than not that all deferred tax assets would be realized taking into consideration all available evidence including historical pre-tax and taxable income, projected future pre-tax and taxable income and the expected timing of the reversals of existing temporary differences. The reversal was recorded as an offset against income tax expense in the amount of \$1.5 million of which \$1.1 million relates to projected future pre-tax income. As of December 31, 2005, the

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

Company had state NOL carryforwards available to offset future state taxable income which are set to expire beginning in 2006 and thereafter.

The American Job Creative Act of 2004 was signed into law in October 2004 and replaces an export incentive with a deduction from domestic manufacturing incomes. The change did not have a material impact on the Company's results of operations, financial position or cash flows.

9. Supplemental Cash Flow Information

Supplemental disclosures to the consolidated statements of cash flows are as follows:

	Years Ended December 31,		
	2005	2004	2003
Interest paid	\$ 9,561	\$ 12,087	\$ 39,296
Income taxes paid	\$ 2,401,605	\$ 1,739,369	\$ 523,033
Income tax benefit related to stock option plans	\$ 283,146	\$ 153,247	\$ 16,685

10. Stockholder Rights Plan

On May 26, 2000, the Board of Directors of the Company adopted a Stockholder Rights Plan (the Rights Plan). Under terms of the Rights Plan, which expires June 9, 2010, the Company declared a distribution of one right for each outstanding share of common stock. The rights become exercisable only if a person or group (other than certain exempt persons, as defined) acquires 15 percent or more of Ballantyne common stock or announces a tender offer for 15 percent or more of Ballantyne's common stock. Under certain circumstances, the Rights Plan allows stockholders, other than the acquiring person or group, to purchase the Company's common stock at an exercise price of half the market price.

11. Common Stock

a. Option Plans

The Company has adopted a 1995 Incentive and Non-Incentive Stock Option Plan for employees, (1995 Employee Stock Option Plan), a 1995 Non-Employee Directors Non-Incentive Stock Option Plan (1995 Outside Directors Plan), a 2001 Non-Employee Directors Stock Option Plan (2001 Directors Plan), a 2005 Restricted Stock Plan and a 2005 Outside Directors Stock Option Plan. A total of 1,402,940 shares of Ballantyne common stock have been reserved for issuance pursuant to these plans at December 31, 2005. The 1995 Employee Stock Option Plan and the 1995 Directors Stock Option Plan expired in September 2005 except, in each case, with respect to grants and awards outstanding. The 1995 Employee Stock Option Plan provided for the granting of incentive and non-incentive stock options while the 1995, 2001 and 2005 Outside Directors Stock Option Plans provide for the granting of non-incentive stock options only. The purpose of the 2001 Directors Plan was to enable the Company to grant options to purchase Company stock to its non-employee directors in lieu of all or part of the cash retainer otherwise paid to them for service on the Board. The per share exercise price of incentive stock options may not be less than 100% of the fair market value of a share of Ballantyne common stock on the date of grant (110% of fair market value in the case of an incentive stock option granted to any person who, at the time the incentive stock option is granted, owns (or is considered as owning within the meaning of Section 424 (d) of the Internal Revenue Code of 1986, as amended) stock possessing more than 10% of the total combined voting powers of all classes of stock of the Company or any parent or subsidiary). With respect

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

to non-incentive stock options, the per share exercise price may not be less than 85% of the fair market value of a share of Ballantyne common stock on the date of grant.

The following table summarizes stock option activity for the three years ended December 31, 2005.

	Number of Options	Weighted Average Exercise Price
Options outstanding at December 31, 2002	1,445,084	\$ 2.99
Granted	211,250	1.09
Exercised	(77,856)	1.15
Forfeited	(115,874)	4.33
Options outstanding at December 31, 2003	1,462,604	\$ 2.69
Granted	40,000	3.04
Exercised	(213,051)	0.63
Forfeited	(87,200)	7.54
Options outstanding at December 31, 2004	1,202,353	\$ 2.72
Granted	70,875	4.75
Exercised	(386,150)	2.16
Forfeited		
Options outstanding at December 31, 2005	887,078	\$ 3.13
Options exercisable at December 31, 2005	839,828	\$ 3.04

The following table summarizes information about stock options outstanding and exercisable at December 31, 2005:

Range of option exercise price	Options outstanding at December 31, 2005			Exercisable at December 31, 2005		
	Number of options	Weighted average remaining contractual life	Weighted average exercise price per option	Number of options	Weighted average remaining contractual life	Weighted average exercise price per option
\$0.36 to 1.19	598,278	5.85	\$ 0.75	598,278	5.85	\$ 0.75
3.04 to 4.75	90,875	5.22	4.37	43,625	6.10	3.97
7.30 to 11.43	197,925	1.76	9.74	197,925	1.76	9.74
\$0.36 to 11.43	887,078	4.87	\$ 3.13	839,828	4.90	\$ 3.04

In addition to those options granted above, the Company granted 100,000 contractual stock options during 2001 to its Chairman of the Board that were not granted pursuant to any plan. These options are 100% vested and can be exercised at a price of \$0.49. The options expire in September 2006.

b. Employee Stock Purchase Plan

The Company's Employee Stock Purchase Plan (the "Plan") provides for the purchase of shares of Ballantyne common stock by eligible employees at a per share purchase price equal to 85% of the fair market value of a share of Ballantyne common stock at either the beginning or end of the offering period, as defined, whichever is lower. Purchases are made through payroll deductions of up to 10% of each

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

participating employee's salary. The number of shares that can be purchased by participants in any offering period is 2,000 shares. Additionally, the Plan has set certain limits, as defined, in regard to the number of shares that may be purchased by all eligible employees during an offering period. At December 31, 2005, 150,000 shares of common stock remained available for issuance under the Plan. The Plan expires in September 2010.

12. Commitments, Contingencies and Concentrations

a. Bonus Plans

During 2004, the Board of Directors approved two cash incentive plans, the Executive Officers Performance Bonus Compensation Plan and the Employee Performance Bonus Compensation Plan to replace the Company's previous Profit Sharing Plan. The plans are annual cash incentive programs that provide certain officers and key employees cash bonuses if the Company achieves certain financial goals. Each payout is further subject to the achievement of certain individual goals, as defined. Charges to expense for the plans amounted to approximately \$1,213,000 and \$995,000 for the years ending December 31, 2005 and 2004, respectively. No amounts were expensed or paid under the previous Profit Sharing Plan during the year ending December 31, 2003.

b. Retirement Plan

The Company sponsors a defined contribution 401-K plan (the Plan) for all eligible employees. Pursuant to the provisions of the Plan, employees may defer up to 100% of their compensation. The Company will match 50% of the amount deferred up to 6% of their compensation. The contributions made to the Plan by the Company for the years ended December 31, 2005, 2004 and 2003 amounted to approximately \$186,000, \$194,000 and \$177,000, respectively.

c. Postretirement Health Care

The Company sponsors a postretirement health care plan (the Plan) for certain current and former executives and their spouses. The Company's policy is to fund the cost of the Plan as expenses are incurred. The costs of the postretirement benefits are accrued over the employees' service lives.

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

In accordance with SFAS No. 132, *Disclosures About Pensions and Other Postretirement Benefits*, the following table sets forth the funded status of the Plan, reconciled to the accrued postretirement benefit cost recognized in the Company's consolidated balance sheets at December 31, 2005 and 2004.

	2005	2004
Reconciliation of benefit obligation		
Benefit obligation at beginning of year	\$ 384,967	\$ 331,753
Service cost	10,798	10,572
Interest cost	21,378	21,776
Benefits paid, net of contributions	(3,185)	(20,437)
Actuarial (gain) loss	(5,290)	41,303
Benefit obligation at end of year	\$ 408,668	\$ 384,967
Reconciliation of funded status		
Funded status	\$ (408,668)	\$ (384,967)
Unrecognized actuarial loss	55,519	60,809
Unrecognized prior service cost	22,390	49,260
Net amount recognized at year-end	\$ (330,759)	\$ (274,898)
Amounts recognized in the consolidated balance sheet consists of:		
Accrued benefit liability included in other accrued expenses and other accrued expenses, net of current portion	\$ (330,759)	\$ (274,898)

The following table provides the components of net periodic benefit cost for the Plan for the three years ended December 31, 2005, 2004 and 2003:

	2005	2004	2003
Service cost	\$ 10,798	\$ 10,572	\$ 8,584
Interest cost	21,378	21,776	19,632
Amortization of prior-service cost	26,870	26,870	26,870
Amortization of loss		3,735	
Prior year service cost			193,485
Net periodic benefit cost	\$ 59,046	\$ 62,953	\$ 248,571

The prior year service costs are amortized on a straight-line basis over the average remaining service period of active participants. Gains and losses in excess of 10% of the benefit obligation are amortized over the average remaining service period of active participants.

The Plan is unfunded and thus has no assets. The discount rate assumptions used to determine benefit obligations at December 31, 2005, 2004 and 2003 were 5.50%, 6.0% and 6.25%, respectively. The discount rate assumptions used to determine net periodic benefit cost for the years ended December 31, 2005, 2004 and 2003 were 6.0%, 6.25% and 6.75%, respectively. For measurement purposes, the annual rate of increase in the per capita cost of covered health care benefits was assumed to be 8.5%, 9.0% and 9.5% for the years ending December 31, 2005, 2004 and 2003, respectively. The rate of increase for all years was assumed to decrease gradually each year to a rate of 6% for 2011 and remain at that level thereafter. The Company expects to pay \$6,045 under the Plan in 2006.

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

The following table summarizes future expected benefit payments related to the Plan at December 31, 2005:

2005	\$ 6,045
2006	26,104
2007	28,040
2008	29,928
2009	24,259
2010 - 2015	\$140,963

Assumed health care trend rates have a significant effect on the amounts reported for health care plans. A 1% change in assumed health care cost trend rates would have the following effects:

	1% Increase	1% Decrease
Effect on total service and interest cost components of periodic postretirement health care benefit cost	\$ 4,620	\$ (4,038)
Effect on the health care component of the accumulated postretirement benefit obligation	\$ 56,692	\$ (49,620)

In December 2003, the United States enacted into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act). The Act established a prescription drug benefit under Medicare, known as Medicare Part D and a federal subsidy to sponsors of retired healthcare benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. On May 19, 2004, the FASB issued Staff Position No. FAS-106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (FSP-106-2), which requires measures of the accumulated postretirement benefit obligation and net periodic postretirement benefit costs to reflect the effects of the Act in the first interim or annual period beginning after June 15, 2004. On January 21, 2005, final regulations under the Act were issued. The effects of the Act did not have a material impact on the Consolidated Financial Statements of the Company.

d. Concentrations

The Company's top ten customers accounted for approximately 48% of 2005 consolidated net revenues. The top ten customers were primarily from the theatre segment. Trade accounts receivable from these customers represented approximately 60% of net consolidated receivables at December 31, 2005. Sales to AMC Theatres, Inc. represented approximately 10% of consolidated sales. Additionally, receivables from Vari International represented 16% of net consolidated receivables at December 31, 2005. While the Company believes its relationships with such customers are stable, most arrangements are made by purchase order and are terminable at will by either party. A significant decrease or interruption in business from the Company's significant customers could have a material adverse effect on the Company's business, financial condition and results of operations. The Company could also be adversely affected by such factors as changes in foreign currency rates and weak economic and political conditions in each of the countries in which the Company sells its products.

Financial instruments that potentially expose the Company to a concentration of credit risk principally consist of accounts receivable. The Company sells product to a large number of customers in many

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

different geographic regions. To minimize credit concentration risk, the Company performs ongoing credit evaluations of its customers' financial condition.

The principal raw materials and components used in the Company's manufacturing processes include aluminum, reflectors, electronic subassemblies and sheet metal. The Company uses a single manufacturer for each of its intermittent movement components, reflectors, aluminum castings, lenses and xenon lamps. Although the Company has not to-date experienced a significant difficulty in obtaining these components, no assurance can be given that shortages will not arise in the future. The loss of any one or more of such contract manufacturers could have a short-term adverse effect on the Company until alternative manufacturing arrangements are secured.

Sales to foreign customers amounted to approximately \$15,800,000, \$15,000,000 and \$14,400,000 for the years ending December 31, 2005, 2004 and 2003, respectively. Export sales are sensitive to worldwide economic and political conditions that can lead to volatility. Additionally, certain areas of the world are more cost conscious than the U.S. market and there are instances where Ballantyne's products are priced higher than local manufacturers. Additionally, foreign exchange rates and excise taxes sometimes make marketing the Company's products at reasonable selling prices difficult.

e. Leases

The Company and its subsidiaries lease office facilities, furniture, autos and equipment under operating leases expiring through 2008. These leases generally contain renewal options and the Company expects to renew or replace the leases in the ordinary course of business. Rent expense under operating lease agreements amounted to approximately \$74,000, \$98,000 and \$108,000 for the years ending December 31, 2005, 2004 and 2003, respectively.

The Company leases a facility in Florida used by the audiovisual segment that was sold on December 31, 2002. In connection with the sale, the Company entered into a sublease agreement with the purchaser (Strong Audiovisual Incorporated). The term of this sublease is for a period of 42 months ending on June 30, 2006. There are no options to extend the term of the sublease.

The following is a schedule of future minimum lease payments for operating leases having initial or remaining non-cancelable lease terms in excess of one year as of December 31, 2005:

	2006	2007	2008
Operating leases	\$ 87,327	\$ 36,446	\$ 26,477
Sublease rentals	(36,377)	()	
Net	\$ 50,950	\$ 36,446	\$ 26,477

f. Self-Insurance

The Company is self-insured up to certain stop loss limits for group health insurance. Accruals for claims incurred but not paid as of December 31, 2005 and 2004 are included in accrued group health insurance claims in the accompanying consolidated balance sheets. The Company's policy is to accrue the employee health benefit accruals based on historical information along with certain assumptions about future events.

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

g. Litigation

On March 18, 2005 the plaintiff dismissed without prejudice an asbestos-related lawsuit in a Madison County, Illinois entitled *Julia Crow, Individually and as Special Administrator of the Estate of Thomas Smith V. A. W. Chesterton, et al.*, including Ballantyne.

Ballantyne is currently a defendant in an asbestos case entitled *Bercu v. BICC Cables Corporation, et al.*, filed June 27, 2003 in the Supreme Court of the State of New York. There are numerous defendants including Ballantyne. The case is set for trial to commence on May 1, 2006. Ballantyne believes that it has strong defenses and intends to seek a pre-trial summary judgment in its favor. Even so, it is not possible to predict the outcome of either the summary judgment request or the trial. Likewise, it is difficult to predict the amount of damages, if any, that a jury might award and the plaintiffs have made no monetary demand upon Ballantyne. It is possible that an adverse resolution of this case could have a material adverse effect on Ballantyne's results of operations, financial position or cash flows.

Ballantyne is a party to various other legal actions which are ordinary routine litigation matters incidental to the Company's business, such as products liability. Based on currently available information, management believes that the ultimate outcome of these matters individually and in the aggregate, will not have a material adverse effect on the Company's results of operations, financial position or cash flows.

h. Environmental

The Company is subject to various federal, state and local laws and regulations pertaining to environmental protection and the discharge of material into the environment. During 2001, Ballantyne was informed by a neighboring company of likely contaminated soil on certain parcels of land adjacent to Ballantyne's main manufacturing facility in Omaha, Nebraska. The Environmental Protection Agency and the Nebraska Health and Human Services System subsequently determined that certain parcels of Ballantyne property had various levels of contaminated soil relating to a former pesticide company which previously owned the property and that burned down in the 1960's. During October 2004, Ballantyne agreed to enter into an Administrative Order on Consent (AOC) to resolve the matter. The AOC holds Ballantyne and two other parties jointly and severally responsible for the cleanup. In this regard, the three parties have also entered into a Site Allocation Agreement by which they will divide past, current and future costs of the EPA, the costs of remediation and the cost of long term maintenance. In connection with the AOC, the Company has paid its share of the costs. At December 31, 2005, the Company has provided for management's estimate of any future payments relating to this matter which is not material to the consolidated financial statements.

i. Contingencies

In October 2003, management identified that an administrative-level employee misappropriated funds from the Company. The actions took place from 1998 through October 2003, when the employee was terminated. As a result of the investigation by the Company's management and audit committee, the total loss was determined to be approximately \$768,000 over the five-year-period. The additional expenses incurred due to the misappropriation of funds were primarily recorded and expensed by the Company as selling expenses in the years when the fraudulent expense claims were submitted by the former employee. The Company has subsequently recovered \$460,000 of the misappropriated funds from insurance and other sources of which \$160,000 was received and recorded in 2004 as a reduction of selling expenses. The

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

remaining \$300,000 was received and recorded prior to 2004. No other recovery or restitution possibilities exist.

13. Business Segment Information

The presentation of segment information reflects the manner in which management organizes segments for making operating decisions and assessing performance.

As of December 31, 2005, the Company's operations are conducted principally through three business segments: Theatre, Lighting and Restaurant. Theatre operations include the design, manufacture, assembly and sale of motion picture projectors, xenon lamphouses and power supplies, sound systems, film handling equipment and the sale of xenon lamps and lenses. The lighting segment operations include the design, manufacture, assembly and sale of follow spotlights, stationary searchlights and computer operated lighting systems for the motion picture production, television, live entertainment, theme parks and architectural industries. During January 2003, the Company disposed of its remaining lighting rental operations. The restaurant segment includes the manufacture and sale of replacement parts and the sale of seasonings, marinades and barbeque sauces. During 2003, the Company began phasing out its restaurant equipment product line, which accounted for 47% of total segment sales in 2003. Going forward, the Company continues to supply parts to its installed equipment customer base and distributes its

Flavor-Crisp® marinade and breading products as well as support its Chicken-On-The-Run and BBQ-On-The-Run programs. The Company allocates resources to business segments and evaluates the performance of these segments based upon reported segment gross profit. However, certain key operations of a particular segment are tracked on the basis of operating profit. There are no significant intersegment sales. All intersegment transfers are recorded at historical cost.

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

Summary by Business Segments

	2005	2004	2003
Net revenue			
Theatre	\$ 49,651,050	\$ 45,144,254	\$ 32,562,367
Lighting	3,374,820	2,847,014	3,162,171
Restaurant	831,127	1,153,242	1,708,748
Total revenue	\$ 53,856,997	\$ 49,144,510	\$ 37,433,286
Gross profit			
Theatre	\$ 13,453,120	\$ 12,464,254	\$ 7,515,711
Lighting	1,074,015	765,290	785,551
Restaurant	378,236	285,128	314,389
Total gross profit	14,905,371	13,514,672	8,615,651
Selling and administrative expenses	(8,464,349)	(7,731,394)	(7,639,458)
Gain on disposal of assets	9,171	104,892	136,056
Operating income	6,450,193	5,888,170	1,112,249
Net interest income	381,469	94,672	47,872
Other expense, net	(46,897)	(91,329)	(86,140)
Income from continuing operations before income taxes	\$ 6,784,765	\$ 5,891,513	\$ 1,073,981
Identifiable assets			
Theatre	\$ 42,866,118	\$ 39,129,877	\$ 32,924,370
Lighting	3,382,738	2,764,847	2,943,804
Restaurant	687,071	276,316	1,366,593
Total	\$ 46,935,927	\$ 42,171,040	\$ 37,234,767
Expenditures on capital equipment			
Theatre	\$ 787,230	\$ 1,049,740	\$ 349,305
Lighting	40,072	82,052	49,038
Restaurant			8,374
Total	\$ 827,302	\$ 1,131,792	\$ 406,717
Depreciation and amortization			
Theatre	\$ 1,087,371	\$ 1,021,142	\$ 1,097,008
Lighting	49,451	61,218	75,248
Restaurant			31,683
Total	\$ 1,136,822	\$ 1,082,360	\$ 1,203,939
Gain on disposal of long-lived assets			
Theatre	\$ 8,621	\$ 96,154	\$
Lighting	550	8,738	136,056
Restaurant			
Total	\$ 9,171	\$ 104,892	\$ 136,056

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

Summary by Geographical Area

	2005	2004	2003
Net revenue			
United States	\$ 38,038,322	\$ 34,122,116	\$ 22,988,646
Canada	786,455	759,067	860,712
Asia	7,445,010	7,781,716	6,332,108
Mexico and South America	5,697,097	4,254,069	4,971,733
Europe	1,768,934	2,079,968	1,988,913
Other	121,179	147,574	291,174
Total	\$ 53,856,997	\$ 49,144,510	\$ 37,433,286
Identifiable assets			
United States	\$ 44,910,526	\$ 40,513,053	\$ 35,690,521
Asia	2,025,401	1,657,987	1,544,246
Total	\$ 46,935,927	\$ 42,171,040	\$ 37,234,767

Net revenues by business segment are to unaffiliated customers. Net sales by geographical area are based on destination of sales. Identifiable assets by geographical area are based on location of facilities.

Ballantyne of Omaha, Inc. and Subsidiaries
Notes to Consolidated Financial Statements (Continued)

14. Quarterly Financial Data (Unaudited)

The following is a summary of the unaudited quarterly results of operations for 2005 and 2004:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2005:				
Net revenue	\$ 12,511,869	13,041,594	14,260,237	14,043,297
Gross profit	3,394,591	3,686,992	4,056,243	3,767,545
Net income	941,914	1,061,261	1,229,045	1,076,677
Basic and diluted earnings per share:				
Basic	0.07	0.08	0.09	0.08
Diluted	0.07	0.08	0.09	0.08
Stock price:				
High	5.93	4.85	4.94	5.16
Low	4.06	3.70	3.69	4.42
2004:				
Net revenue	\$ 11,297,412	11,657,967	11,675,514	14,513,617
Gross profit	3,157,734	3,237,163	3,304,311	3,815,464
Net income	854,995	845,315	2,144,139	1,228,880
Basic and diluted earnings per share:				
Basic	0.07	0.07	0.17	0.09
Diluted	0.06	0.06	0.16	0.09
Stock price:				
High	3.12	3.40	3.78	4.83
Low	2.46	2.48	2.98	2.90

Earnings per share is computed independently for each of the quarters. Therefore, the sum of the quarterly earnings per share may not equal the total for the year.

Schedule II

**Ballantyne Of Omaha, Inc.
and Subsidiaries
Valuation and Qualifying Accounts**

	Balance at beginnings of year	Charged to costs and expense (income)	Amounts Written in (off) (1)	Balance at end of year
Allowance for doubtful accounts and notes				
Year ended December 31, 2005				
Allowance for doubtful accounts	\$ 485,829	20,699	(86,305)	420,223
Year ended December 31, 2004				
Allowance for doubtful accounts(3)	\$ 512,962	74,956	(102,089)	485,829
Year ended December 31, 2003				
Allowance for doubtful accounts(2)	\$ 553,297	(47,543)	7,208	512,962
Inventory reserves				
Year ended December 31, 2005				
Inventory reserves	\$ 1,085,540	449,577	(397,545)	1,137,572
Year ended December 31, 2004				
Inventory reserves	\$ 1,157,100	601,157	(672,717)	1,085,540
Year ended December 31, 2003				
Inventory reserves	\$ 1,553,520	638,317	(1,034,737)	1,157,100

- (1) The deductions from reserves are net of recoveries.
- (2) Excludes charge of \$393,177 relating to potential preferential payment relating to a past customer bankruptcy which is included as bad debt expense and in accrued liabilities in the consolidated financial statements.
- (3) Excludes recovery of \$291,927 relating to preferential payment claim relating to the past customer bankruptcy discussed in (2).

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

None

Item 9A. Controls and Procedures

The Company carried out an evaluation under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Securities Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective at ensuring that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 (as amended) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. There have been no changes in the Company's internal control over financial reporting during the fourth fiscal quarter for the period covered by this report that have materially affected, or are reasonably likely to materially affect, such internal control over financial reporting.

Item 9B. Other Information

None

PART III

Item 10. Directors and Executive Officers of the Registrant

Incorporated by reference to the Ballantyne of Omaha, Inc. Proxy Statement for the Annual Meeting of Stockholders to be held May 24, 2006.

Item 11. Executive Compensation

Incorporated by reference to the Ballantyne of Omaha, Inc. Proxy Statement for the Annual Meeting of Stockholders to be held May 24, 2006.

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

Incorporated by reference to the Ballantyne of Omaha, Inc. Proxy Statement for the Annual Meeting of Stockholders to be held May 24, 2006.

Item 13. Certain Relationships and Related Transactions

Incorporated by reference to the Ballantyne of Omaha, Inc. Proxy Statement for the Annual Meeting of Stockholders to be held May 24, 2006.

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Item 14. Principal Accounting Fees and Services

Incorporated by reference to the Ballantyne of Omaha, Inc. Proxy Statement For the Annual Meeting of Stockholders to be held May 24, 2006.

PART IV

Item 15. Exhibits, Financial Statement Schedules

a. The following documents are filed as part of this report:

1. Consolidated Financial Statements:

An Index to the Consolidated Financial Statements is filed as a part of Item 8.

2. Financial Statement Schedules:

Schedule II Valuation and Qualifying Accounts is included on page 60.

Financial Statements of the Registrant's subsidiaries are omitted because the Registrant is primarily an operating company and the subsidiaries are wholly-owned.

3. Exhibits See Exhibit Index on page 64.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BALLANTYNE OF OMAHA, INC.

By: /s/ JOHN WILMERS
John Wilmers, President,
Chief Executive Officer, and Director

By: /S/ BRAD FRENCH
Brad French, Secretary/Treasurer and
Chief Financial Officer

Date: March 28, 2006

Date: March 28, 2006

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By: /s/ WILLIAM F. WELSH, II
William F. Welsh, II, Chairman

Date: March 28, 2006

By: /s/ ALVIN ABRAMSON
Alvin Abramson, Director

Date: March 28, 2006

By: /s/ MARC E. LEBARON
Marc E. LeBaron, Director

Date: March 28, 2006

By: /s/ MARK D. HASEBROOCK
Mark D. Hasebroock, Director

Date: March 28, 2006

EXHIBIT INDEX

- 3.1 Certificate of Incorporation as amended through July 20, 1995 (incorporated by reference to Exhibits 3.1 and 3.3 to the Registration Statement on Form S-1, File No. 33-93244) (the 1995 Form S-1).
 - 3.1.1 Amendment to the Certificate of Incorporation (incorporated by reference to Exhibit 3.1.1 to the Form 10-Q for the quarter ended June 30, 1997).
 - 3.2 Bylaws of the Company as amended through August 24, 1995 (incorporated by reference to Exhibit 3.2 to the 1995 Form S-1).
 - 3.2.1 First Amendment to Bylaws of the Company dated December 12, 2001 (incorporated by reference to Exhibit 3.2.1 to the Form 10-K for the year ended December 31, 2001).
 - 3.3 Stockholder Rights Agreement dated May 25, 2000 between the Company and Mellon Investor Services L.L.C. (formerly ChaseMellon Shareholder Services, L.L.C.) (incorporated by reference to Exhibit 1 to the Form 8-A12B as filed on May 26, 2000).
 - 3.3.1 First Amendment dated April 30, 2001 to Rights Agreement dated as of May 25, 2000 between the Company and Mellon Investor Services, L.L.C. as Rights Agent (incorporated by reference to the Form 8-K as filed on May 7, 2001).
 - 3.3.2 Second Amendment dated July 25, 2001 to Rights Agreement dated as of May 25, 2000 between the Company and Mellon Investor Services, L.L.C., as Rights Agent (incorporated by reference to Exhibit 3.3.2 to the Form 10-Q for the quarter ended September 30, 2001).
 - 3.3.3 Third Amendment dated October 2, 2001 to Rights Agreement dated as of May 25, 2001 between the Company and Mellon Investor Services, L.L.C. as Rights Agent (incorporated by reference to Exhibit 3.3.3 to the Form 10-Q for the quarter ended September 30, 2001).
 - 4.2 Revolving Credit Agreement dated March 10, 2003 between the Company and First National Bank of Omaha (incorporated by reference to Exhibit 4.2 to the Form 10-K for the year ended December 31, 2002).
 - 4.2.1 First Amendment to Revolving Credit Agreement dated August 31, 2003 between the Company and First National Bank of Omaha, Inc. (incorporated by reference to Exhibit 4.2.1 to the Form 10-Q for the quarter ended September 30, 2003).
 - 4.2.2 Second Amendment to Revolving Credit Agreement dated February 27, 2004 between the Company and First National Bank of Omaha, Inc (incorporated by reference to Exhibit 4.2.2 to the Form 10-K for the year ended December 31, 2003).
 - 4.2.3 Third Amendment to Revolving Credit Agreement dated August 30, 2004 between the Company and First National Bank of Omaha, Inc. (incorporated by reference to Exhibit 4.2.2 to the Form 10-Q for the quarter ended September 30, 2004).
 - 4.2.4 Fourth Amendment to Revolving Credit Agreement between the Company and First National Bank of Omaha (incorporated by reference to Exhibit 4.2.4 to the Form 10-Q for the quarter ended September 30, 2005).
 - 4.3 Authorized Digital Cinema Reseller Master Agreement dated May 23, 2005 between the Company and NEC Solutions (America), Inc. (incorporated by reference to Exhibit 4.3 to the Form 10-Q for the quarter ended June 30, 2005).
 - 10.1 Ballantyne of Omaha, Inc. Restricted Stock Plan (incorporated by reference to Appendix D to the Schedule 14A Definitive Proxy Statement for the Company s 2005 Annual Meeting).*
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- 10.2 Ballantyne of Omaha, Inc. 2005 Outside Directors Stock Option Plan (incorporated by reference to Appendix C to the Schedule 14A Definitive Proxy Statement for the Company's 2005 Annual Meeting).*
- 10.3 Form of 2001 Non-Employee Directors' Stock Option Plan (incorporated by reference to Exhibit 10.8.2 to the Form 10-Q for the quarter ended June 30, 2001).*
- 10.3.1 First Amendment to the 2001 Non-Employee Directors' Stock Option Plan (incorporated by reference to Exhibit 10.8.6 to the Form 10-K for the year ended December 31, 2001). *
- 10.4 Ballantyne of Omaha, Inc. 2005 Employee Stock Purchase Plan (incorporated by reference to Appendix B to the Schedule 14A Definitive Proxy Statement for the Company's 2005 Annual Meeting).*
- 10.6 Ballantyne of Omaha, Inc. Executive Officers Performance Bonus Compensation Plan (incorporated by reference to Exhibit 10.6 to the Form 10-Q for the quarter ended June 30, 2004).*
- 10.7 Distributorship Agreement, dated November 1, 2004 between the Company and ISCO Precision Optics GmbH. (incorporated by reference to Exhibit 10.7 to the Form 10-K for the year ending December 31, 2004).
- 21 Registrant owns 100% of the outstanding capital stock of the following subsidiaries:

Name	Jurisdiction of Incorporation
a. Strong Westrex, Inc.	Nebraska
b. Xenotech Rental Corp.	Nebraska
c. Design & Manufacturing, Inc.	Nebraska
d. Xenotech Strong, Inc.	Nebraska

- 23 Consent of KPMG LLP.
- 31.1 Rule 13a-14(a) Certification of Chief Executive Officer.
- 31.2 Rule 13a-14(a) Certification of Chief Financial Officer.
- 32.1 18 U.S.C. Section 1350 Certification of Chief Executive Officer.
- 32.2 18 U.S.C. Section 1350 Certification of Chief Financial Officer.

* Management contract or compensatory plan.

- Filed herewith.