Zacks Small-Cap Research

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# First Business Financial Services, Inc. (FBIZ-NASDAQ)

## FBIZ: Large Loan Loss Provision Mars an Otherwise Strong Quarter

| | |
|---|---|
| **Current Recommendation** | **Outperform** |
| Prior Recommendation | Neutral |
| Date of Last Change | 11/01/2011 |
| Current Price (07/31/12) | $22.26 |
| **Twelve- Month Target Price** | **$26.00** |

## OUTLOOK

FBIZ posted second quarter diluted EPS of $0.60, down 12% from the $0.68 EPS (before a one-time tax benefit) posted last year, and $0.21 below our $0.81 estimate. Relative to our estimate, this largely reflected a $1.4 million higher-than-expected loan loss provision primarily related to the write-off of loans related to a single commercial and industrial client. On the positive side, growth in net interest income was much better than we had anticipated as FBIZ posted a record 3.49% net interest margin and added a $31 million chunk of loans toward the end of the second quarter, its first quarterly loan growth since 2010's third quarter. Compared to the year-ago quarter, second quarter results were boosted by a 7% gain in net interest income from 4% growth in average interest-earning assets plus a 10 basis-point jump in the net interest margin and solid 9% growth in noninterest income. This was partly offset by a 7% increase in total noninterest expense, largely due to higher compensation costs, a 39% surge in the loss provision, and an effective tax rate that was almost 2 points higher than that posted in the prior-year quarter. The Company continued to reduce problem assets. Nonaccrual loans fell $4.7 million, or 24%, sequentially to $15.5 million, while foreclosed assets declined $0.7 million, or 25%, to $1.9 million. As a percent of total loans and OREO, NPAs fell 72 basis points sequentially to 2.01% from 2.73% at the end of the first quarter and 218 basis points year over year from the 4.18% at the end of 2011's June quarter. We are cutting our 2012 and 2013 diluted EPS estimates by a dime to $3.25 from $3.35 and to $3.60 from $3.70, respectively, due to the second quarter shortfall. Each represents an 11% gain over the prior year.

## SUMMARY DATA

| | |
|---|---|
| **52-Week High** | **$23.49** |
| **52-Week Low** | **$14.04** |
| **One-Year Return (%)** | **50.15** |
| **Beta** | **0.03** |
| **Average Daily Volume (sh)** | **2,648** |
| **Shares Outstanding (mil)** | **2.6** |
| **Market Capitalization ($mil)** | **$58** |
| **Short Interest Ratio (days)** | **1.37** |
| **Institutional Ownership (%)** | **12** |
| **Insider Ownership (%)** | **19** |
| **Annual Cash Dividend** | **$0.28** |
| **Dividend Yield (%)** | **1.26** |
| **5-Yr. Historical Growth Rates** | |
| **Net Revenue (%)** | **13.4** |
| **Earnings Per Share (%)** | **14.1** |
| **Dividend (%)** | **3.1** |
| **P/E using TTM EPS** | **7.0** |
| **P/E using 2012 Estimate** | **6.8** |
| **P/E using 2013 Estimate** | **6.2** |
| **Zacks Rank** | **3** |

| | |
|---|---|
| **Risk Level** | **Average** |
| **Type of Stock** | **Small-Value** |
| **Industry** | **Banks-Midwest** |
| **Zacks Rank in Industry** | **32 of 38** |

## ZACKS ESTIMATES

### Net Revenue
(in millions of $)

| | Q1 (Mar) | Q2 (Jun) | Q3 (Sep) | Q4 (Dec) | Year (Dec) |
|---|---|---|---|---|---|
| 2010 | 9.5 A | 9.4 A | 9.8 A | 10.0 A | 38.7 A |
| 2011 | 10.2 A | 10.7 A | 10.8 A | 10.8 A | 42.5 A |
| 2012 | 10.8 A | 11.5 A | 11.5 E | 11.5 E | 45.3 E |
| 2013 | | | | | 46.7 E |

### Earnings per Share
(EPS is operating earnings before nonrecurring items)

| | Q1 (Mar) | Q2 (Jun) | Q3 (Sep) | Q4 (Dec) | Year (Dec) |
|---|---|---|---|---|---|
| 2010 | 0.35 A | 0.46 A | 0.38 A | 0.24 A | 1.42 A |
| 2011 | 0.52 A | 0.68 A | 0.83 A | 0.90 A | 2.94 A |
| 2012 | 0.84 A | 0.60 A | 0.88 E | 0.93 E | 3.25 E |
| 2013 | | | | | 3.60 E |

Quarterly EPS may not add to total due to changes in shares outstanding.

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## SECOND QUARTER RESULTS

FBIZ posted second quarter diluted EPS of $0.60, down 12% from the $0.68 EPS (before a $0.29 per diluted share one-time tax benefit related to a change in regulation for net operating loss carryforwards by the state of Wisconsin) posted last year, and $0.21 below our $0.81 estimate.

Relative to our estimate, this largely reflected a $1.4 million higher-than-expected loan loss provision primarily related to the write-off of loans related to a single commercial and industrial client. On the positive side, growth in net interest income was much better than we had anticipated as FBIZ posted a record 3.49% net interest margin and added a $31 million chunk of loans toward the end of the second quarter, marking the first quarterly increase in loans outstanding since 2010's third quarter.

Compared to the year-ago quarter, second quarter results were boosted by a gain in net interest income from 4% growth in average interest-earning assets and a 10 basis-point jump in the net interest margin and solid 9% growth in noninterest income. This was partly offset by a 7% increase in total noninterest expense, largely due to higher compensation costs, a 39% surge in the loan loss provision, and an effective tax rate that was almost 2 points higher than that posted in the prior-year quarter.

The Company continued to reduce problem assets. Nonaccrual loans fell $4.7 million, or 24%, sequentially to $15.5 million, while foreclosed assets declined $0.7 million, or 25%, to $1.9 million. As a percentage of total loans and OREO, nonperforming assets fell 72 basis points sequentially to 2.01% from 2.73% at the end of the first quarter and 218 basis points year over year from the 4.18% at the end of 2011's June quarter.

We are cutting our 2012 diluted EPS estimate by a dime to $3.25 from $3.35, principally to reflect the second quarter shortfall from our estimate stemming from the large loan loss provision, partly offset by an increase in our net interest income estimate due to an 11 basis-point rise in the net interest margin, and a 150 basis-point reduction in the effective tax rate to 34.0% from 35.5% related to a higher proportion of tax-favored municipal income. Our $3.25 estimate in 2012 represents an 11% gain over 2011's $2.94, which excludes a $0.7 million, or $0.29 per diluted share, one-time tax benefit related to a change in regulation for net operating loss carryforwards by the state of Wisconsin.

We have also revised our 2013 down by $0.10 to $3.60 from $3.70, an 11% gain over our 2012 estimate.

We note that the ABA Banking Journal recently ranked FBIZ 15th among all publicly traded banks with $1-10 billion in total assets (of which there are about 250 companies in the US), based upon ROE in 2011, which was 12.8% for FBIZ. It is the first time FBIZ has made this list, and speaks to the tremendous improvement in operating performance the Company has made over the last few years.

Below, we discuss second quarter results in more detail.

Net Interest Income

Net interest income increased 7% year over year to $9.6 million, reflecting 4% growth in average interest-earning assets and a 10 basis-point jump in the net interest margin to a record 3.49%. The net interest margin benefitted from a lower level of nonaccruing loans as well as a reduction in interest expense from lower deposit costs, with the yield falling 48 basis points to 1.50% as the Company reduced its exposure to higher cost brokered certificates of deposit by not replacing them as they matured and, to a lesser extent, by a lower rate paid on money market accounts.

This was partly offset by a 29 basis-point slide in the yield on interest-earning assets to 5.07%, as well as a shift in the asset mix to securities and short-term investments, away from higher yield loans and leases. The yield on the loan and lease receivables portfolio rose 13 basis points year over year to 6.19%, as higher yield commercial and industrial loans assumed greater importance in the loan mix. In addition, the

mortgage securities portfolio yield fell 83 basis points to 1.89%, as FBIZ invested cash flows from these obligations at current reduced market interest rates.

Net interest income of $9.6 was almost $0.6 million better than our estimate, mainly reflecting the fact that the 3.49% net interest margin was 29 basis points above our 3.20% estimate, aided by the lower cost of funds and the shift in the mix of the loan portfolio.

That said, we believe the second quarter was the high point for the year, and expect the net interest margin to gradually recede from 3.49% posted in the second quarter to 3.35% by the end of the 2012 and to 3.30% in 2013, and are using a 3.34% estimate for all of 2012 and a 3.30% estimate for 2013 (the same as before). This compares to our previous estimate of 3.23% for 2012 and the 3.29% that was actually posted in 2011.

Noninterest Income

Noninterest income rose 9% year over year to $1.9 million (matching our estimate), as all line items, except loan fees and other noninterest income, were higher than those of a year ago. The main contributors were a 15% rise in trust and investment services income to $0.8 million and an 18% increase in services charges on deposits to $0.5 million, reflecting an increase in C&I deposit accounts that tend to have higher transaction volumes.

Trust and investment services fee income benefitted from a 33% jump in assets under management to $608.8 million, reflecting the addition of new clients, and a 4% rise in assets under administration to $138.4 million. We expect accelerating quarterly growth in this segment, as two recently hired business development officers, hired in the first and second quarter, become more productive over time.

Loan Loss Provision

The loan loss provision surged 39% year over year to $2.0 million, reflecting the write-off of loans related to a single commercial and industrial client. Relative to our estimate, it was $1.4 million higher than the $0.6 million we had projected.

Going forward, we have raised our estimate for the loan loss provision for 2012 by $1.5 million from $2.3 million to $3.8 million, which is down 9% from 2011's $4.3 million, primarily reflecting the blip in the second quarter. For 2013, we are estimating a 32% reduction in the loss provision to $2.6 million due to two factors: (1) the absence of the large loss provision stemming from the one-time write-off as occurred in 2012's second quarter and (2) 5% year-over-year growth in the loan portfolio.

Noninterest Expense

Noninterest expense rose 7% year over year to $7.1 million and compares to our $7.0 million estimate, with the difference attributable to other noninterest expense, which was $0.1 million higher than our estimate.

Compensation expense climbed 10% to $4.2 million and other noninterest expense rose 4% to $2.9 million, primarily reflecting a 30% jump in professional fees to $0.4 million, reflecting higher audit and tax fees due to the Company's increasingly complex financial and tax situation.

Generally, the Company maintained tight control over operating expenses. Because net revenues rose 7.5% while noninterest expense increased 7.4%, the Company's efficiency ratio improved, falling 10 basis points to 61.9% compared to 62.0% in 2011's second quarter.

We expect operating efficiency to deteriorate for the remainder of 2012 before improving in 2013, reflecting the addition of seven new BDOs and four support staff in the first and second quarters. It takes about 12 months for a BDO to become fully productive, which will hurt 2012 results, but benefit 2013 as new staff becomes fully functional.

Income Taxes

The Company's effective tax rate was 33.0%, compared to 31.1% in the year-ago quarter and our 35.5% estimate. We have decreased our estimated effective tax rate to 33.5% for the balance of 2012 and all of 2013 as we expect a higher level of tax-favored municipal income. This compares to a full-year effective tax rate of 35.1% in 2011, excluding a $0.7 million one-time tax benefit related to a change in regulation for net operating loss carryforwards by the state of Wisconsin.

Net Income

FBIZ posted net earnings of $1.6 million ($0.60 diluted EPS), down 13% from $1.8 million ($0.68 diluted EPS) reported in the year-ago quarter. This compares to our $2.1 million net income estimate ($0.84 diluted EPS).

Profitability

FBIZ posted a 9.2% ROE and 0.54% ROA for the second quarter of 2012, compared to a 12.3% ROE and 0.65% ROA for the second quarter of 2011, as the Company reported lower net earnings.

Loans and Asset Quality

Loans rose $31 million, or 4%, sequentially to $863 million during the second quarter, marking the first quarterly increase in loans outstanding since 2010's third quarter. Sequentially, total mortgage loans increased $26 million, or 4%, to $589 million, while total commercial loans rose $6 million, or 2%, to $257 million, and consumer and other loans fell slightly to $17 million.

The Company is beginning to see improved loan demand in sufficient quantity to offset amortization of the existing loan portfolio. That said, increased rate competition from larger banks, such as JP Morgan Chase and Associated Bank, for the more creditworthy customers means that FBIZ is not winning as much business as it would like. At some point in the future, FBIZ may have to meet competitors' pricing to achieve satisfactory loan growth, but this has not occurred yet. Importantly, the Company has stated that it will not loosen credit standards to win new business, as some competitors are now doing.

Because of competition and the continuing lackluster economy, we are maintaining our estimate of 3% loan growth in 2012, but showing higher loan growth of 5% in 2013. This compares to a year-over-year decline of 3% in 2011.

Nonaccrual loans fell $4.7 million, or 24%, sequentially to $15.5 million, while foreclosed assets declined $0.7 million, or 25%, to $1.9 million. As a percentage of total loans and OREO, nonperforming assets fell 72 basis points sequentially to 2.01% from 2.73% at the end of the first quarter and 218 basis points year over year from the 4.18% at the end of 2011's June quarter.

This improvement was broadly based and affected all major loan categories. We have estimated further, though less spectacular, improvement ahead, with nonperforming assets dropping by $1.2 million through the end of 2013.

On a more detailed basis, quarterly improvement in nonaccrual loans reflected the paydown of $2.6 million in nonaccruing loans that were either refinanced by other financial institutions or paid off by customers, $1.7 million in loans that were charged off, $0.1 million of loans that were transferred to foreclosed properties, and $0.6 million of loans that were returned to accrual status, partly offset by the transfer of $0.2 million of loans to nonaccrual status.

The loan loss allowance as a percent of nonperforming assets rose to 85% at the end of the quarter from 63% at the end of 2012's first quarter. This was the result of a lower level of nonaccrual loans and foreclosed assets, aided by a modestly higher loan loss allowance that increased to $14.8 million, or 1.72% of gross loans, from $14.5 million, or 1.74% of gross loans.

In a development related to a recent standard issued by the Financial Accounting Standards Board, the Company has improved disclosure regarding the performance of its loan portfolio. There are now four

loan categories: Category I – loans performing satisfactorily; Category II – loans beginning to show signs of deterioration; Category III – loans requiring special attention; and Category IV – loans are impaired. At June 30, 2012 (figures for December 31, 2011 are in parentheses), FBIZ 's loan portfolio divided 78.4% (77.6%) Category I, 11.2% (12.4%) Category II, 7.7% (8.6%) Category III, and 1.9% (2.6%) Category IV. Importantly, both Category I, which represents the highest credit quality loan category, increased 140 basis points during the year to 76.61%, while Category IV, the weakest loan category giving rise to the majority of loan losses, improved by 72 basis points and fell to 1.85%.

Liquidity and Funding

FBIZ decreased cash and short-investments by $57.0 million aduring the second quarter as the Company reduced liquidity. In order to reduce excess liquidity going forward, FBIZ will not replace maturing brokered certificates of deposit, though this may take some time to work through. Positively, this should improve the Company's funding profile as the proportion of in-market core deposits to total deposits is increased and the proportion of brokered deposits is reduced.

The available-for-sale securities portfolio rose $25 million during the quarter to $195 million as mortgage securities increased by about $9 million to $175 million, municipal securities by $3 million to $8 million, and US Agency obligations by $13 million to $13 million, reflecting FBIZ's new investment strategy. FBIZ will gradually be increasing its exposure to municipal and FNMA and FHLMC securities, with these obligations growing to about 10% and 5-10%, respectively, of the investment securities portfolio. This compares to FBIZ's former strategy, under which the entire investment securities portfolio was invested exclusively in GNMA securities. We note that this new strategy should have a positive impact on net interest margins, but a negative effect on risk-adjusted capital ratios since municipal and FNMA and FHLMC securities have higher risk ratings than GNMA securities, which have a 0% risk weighting.

The Company remains heavily reliant on brokered deposits to fund its fixed-rate loan portfolio though these have been reduced by $50 million year to date. Brokered deposits were $397 million and represented 39% of total deposits at June quarterend (down from 40% at the end of March 2012). This is well below FBIZ's goal, which is to maintain brokered deposits at 50% or less of total deposits.

FBIZ's funding profile continues strong, and 27 months of brokered CD maturities (down slightly from 30 months at the end of March) could be financed with borrowing from the FHLB or Fed, in the event of a market meltdown.

Capital Adequacy and Dividends

The Company's capital adequacy ratios deteriorated during the quarter. The Tier 1 capital ratio fell 17 basis points to 8.04% at the end of 2012's second quarter from 8.21% at March 31, 2011, and the Total capital ratio slumped 25 basis points to 13.31% from 13.56%, largely due to growth in risk-weighted assets from expansion of the loan and securities portfolio, partly offset by growth in retained earnings.

Tangible common equity to tangible assets rose 12 basis point to 5.84% at June 30, 2012 from the March quarterend, due to a combination of growth in retained earnings and a decrease in total tangible assets.

Total shareholders' equity increased $1.3 million during the second quarter, due to a combination of $1.4 million growth in retained earnings, a $0.2 million decrease in accumulated comprehensive income, and a $0.1 million increase from other capital changes. Reflecting these factors, tangible book value per share also increased during the second quarter, by $0.46 per share to $25.77 from $25.31.

On June 19, 2012, FBIZ declared its regular quarterly $0.07 cash dividend, paid on July 15, 2012 to shareholders of record at the close of business on July 1, 2012. We do not expect any increase in the common dividend for the foreseeable future as the Company expects to retain earnings to meet future capital requirements under Basel III.

Basel III

The Company is evaluating its common equity needs following the recent release of Basel III proposals. FBIZ expects that a long period of implementation combined with growth in retained earnings may be sufficient to meet proposed Basel III requirements, and does not intend to shrink its balance sheet or issue dilutive common stock. However, FBIZ would consider a common share offering under the right circumstances.

## OVERVIEW

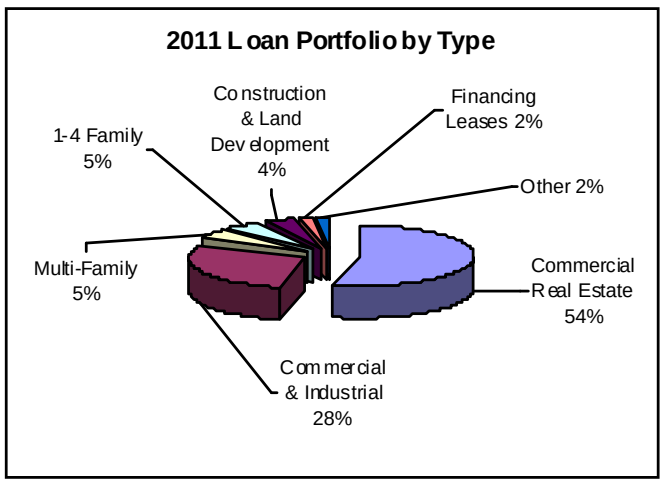
First Business Financial Services, Inc. (FBIZ or the Company) is a bank holding company headquartered in Madison, Wisconsin, with $1.2 billion in total assets at June 30, 2012. FBIZ specializes in business lending for small-medium-sized companies with sales ranging from $2-50 million. As an adjunct to these services, FBIZ also offers banking services to business owners, executives, professionals, and high net worth individuals, though this is a less significant part of its business.

Banking operations are carried on through two banks, First Business Bank (FBB) located in Madison and First Business Bank-Milwaukee (FBB-Milwaukee), as well as First Business Trust & Investments (FBTI), a division of FBB that offers trust and investment services. FBB also has three loan production offices located in northeast Wisconsin in Appleton, Oshkosh, and Green Bay.

FBB owns two non-bank subsidiaries that engage in lending that is different than that typical for banks through six single-person business development offices, which are located in Minneapolis, Minnesota; Chicago, Illinois; St. Louis, Missouri; Detroit, Michigan; Cleveland, Ohio; and Denver, Colorado. These subsidiaries include: First Business Capital Corp. (FBCC, with net income of $3.3 million in 2011), which is an asset-based commercial lender that provides secured lines of credit and term loans on equipment and real estate assets, primarily to manufacturers and wholesale distribution companies located throughout the United States; and First Business Equipment Finance, LLC (FBEF, with net income of $569,000 in 2011), which is a commercial finance company that finances equipment for small and middle market companies.

In addition, the Company has three non-bank subsidiaries that help manage other aspects of its business. These include: First Business Real Estate LLC (FBBRE, owned by FBB and having a $94,000 net loss in 2011), and First Business Bank-Milwaukee Real Estate LCC (FBBMRE, owned by FBB-Milwaukee and posting a net loss of $297,000 in 2011), which are limited liability companies that dispose of real estate and other assets acquired through foreclosure; and First Madison Investment Corp. (FMIC, owned by FBB, earning net income of $4.1 million in 2011), which is located in the state of Nevada and manages a portion of the Bank's investment portfolio, though it no longer invests in commercial real estate loans as of October 1, 2011. First Madison Capital Corp Nevada Corp was dissolved on October 1, 2011 and its assets were transferred to FBCC.

Unlike other banks, FBIZ does not have a retail branch network. Instead, the Company typically provides custom-tailored banking services to its approximately 2,000 clients at client offices. This has a couple of important implications. First, FBIZ does not have the overhead and expense connected with owning a branch network. Second, FBIZ lacks the in-market deposit base typically associated with a retail bank and must fund a significant part of its operations through the wholesale-brokered deposit market.




The loan portfolio has a concentration in commercial real estate (about one-third of which is owner occupied), accounting for 54% of total loans at

December 31, 2011. The rest of the lending book consists of commercial and industrial (accounting for 28% of total gross loans), 1-4 family (5%), multi-family (5%), construction and land development (4%), direct financing leases (2%), and consumer and other (2%). Almost all loans are secured, usually by real estate, inventory, accounts receivable, equipment, machinery, or corporate assets.

The liquidity portfolio, consisting of cash, short-term investments, and US agency mortgage obligations, represents 25% of total assets, while gross loans and leases accounts for 72%. Transaction and money market accounts accounted for 50% of total deposits at December 31, 2011, with certificates of deposit (CDs) at 8%, and brokered CDs at 42%.

In 2011, net interest income contributed 83% of net revenue. Other significant revenue sources include trust and investment services fee income (6% of net revenues), services charges on deposits (4%), loan fees (3 ½%), and increase in cash surrender value of bank-owned life insurance (1 ½%).

FBIZ's 2012 business plan includes: (1) improving asset quality of its loan portfolio, (2) generating organic growth in the loan portfolio, (3) increasing its market share of in-market core deposits, and (4) increasing fee income.

## VALUATION

FBIZ stock has outperformed the industry in 2012, with a year-to-date price increase of 34.9% versus 30.8% for banks in the Zacks Small-Cap Index, as well as the S&P 500's gain of 9.7%. This follows a good year in 2011 when FBIZ's stock price rose 23.6%, compared to advances of 0.0% for the S&P 500 and of 0.0% for banks in the Zacks Small-Cap Index.

At its current price, FBIZ is trading at a discount to the industry median P/E of 43% in 2013, based upon our 2013 EPS estimate. This is far in excess of the average 27% P/E discount for FBIZ, based upon 5-year historical P/E averages.

Turning to Price/Tangible Book Value, FBIZ is valued at 0.87X versus the industry median of 0.90X. This represents a 4% discount, or about 17 points better than the FBIZ's average historical discount of 21% since the end of 2005.

We believe a higher valuation is justified for a few reasons: (1) the Company's earnings and profitability prospects are much improved, with its ROE significantly higher than the median for other banks in the Zacks small-cap index; (2) FBIZ has a superior dividend yield relative to the median for its small-cap peers; and (3) liquidity in the shares has increased following the addition of FBIZ shares to the Russell Microcap Index on June 24, 2011.

Applying the 0.90X ratio to our estimated book value for FBIZ one year out results in a price target of approximately $26.00. This compares to FBIZ's current stock price of $22.26. When combined with the Company's current dividend yield, our new target price for FBIZ represents a total return of over 18%, above our expectations for broader U.S. equity market gains during this period. Therefore, we are maintaining our recommendation on FBIZ shares at Outperform.

## Industry Comparables- Small-cap Banks

| | | Price / Earnings Ratios | | | | | Return on Equity | | Return on Assets | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Pr Chg YTD | TTM* EPS | 2012E | 2013E | 5-Yr Avg | Price/ Tang Book | TTM* | 5-Yr Avg | TTM* | 5-Yr Avg | Div Yld |
| **FIRST BUS FINL** | **34.9** | **7.0** | **6.8** | **6.2** | **11.1** | **0.87** | **13.0** | **6.9** | **0.72** | **0.36** | **1.3** |
| S&P 500 | 9.7 | 14.3 | 13.4 | 12.5 | 17.0 | 9.8 | 49.1 | ----- | 10.4 | ----- | 2.2 |
| **Median** | **30.8** | **11.6** | **11.3** | **10.8** | **15.3** | **0.90** | **9.0** | **4.9** | **0.74** | **0.34** | **0.6** |
| Average | 30.2 | 15.2 | 12.0 | 10.8 | 20.4 | 0.8 | (87.5) | (3.0) | 0.6 | 0.3 | 1.4 |
| High | 170.0 | 63.3 | 19.0 | 15.3 | 45.2 | 1.5 | 16.2 | 11.6 | 1.8 | 2.2 | 6.8 |
| Low | (63.6) | 6.7 | 6.7 | 6.1 | 11.1 | 0.0 | (3,208.6) | (188.4) | (3.7) | (2.4) | ----- |

*Trailing twelve months

# First Business Financial Services, Inc.

**Income Statement and Balance Sheet**

*(Dollars in millions, except per share data)*

| Summary Financial Data | 12/07 | 12/08 | 12/09 | 12/10 | 12/11 | 12/12 E | 12/13 E |
|---|---|---|---|---|---|---|---|
| Net interest income | 23.2 | 26.3 | 28.1 | 32.0 | 35.5 | 37.5 | 38.5 |
| Non-interest income | 4.4 | 5.1 | 6.4 | 6.7 | 7.1 | 7.8 | 8.2 |
| Total net revenue | 27.6 | 31.4 | 34.5 | 38.7 | 42.6 | 45.3 | 46.7 |
| Loan loss provision | 2.9 | 4.3 | 8.2 | 7.0 | 4.3 | 3.8 | 2.6 |
| Non-interest expense | 19.7 | 21.9 | 24.5 | 25.7 | 26.4 | 28.4 | 29.7 |
| Income taxes & other | 1.7 | 2.1 | 0.8 | 2.4 | 4.2 | 4.5 | 4.8 |
| Zacks adjusted income before NRI | 3.3 | 3.1 | 1.0 | 3.6 | 7.7 | 8.6 | 9.6 |
| GAAP net income | 3.3 | 3.1 | 1.0 | 0.9 | 8.4 | 8.6 | 9.6 |
| Diluted EPS before NRI | 1.32 | 1.28 | 0.41 | 1.42 | 2.94 | 3.25 | 3.60 |
| Reported EPS | 1.32 | 1.28 | 0.41 | 0.37 | 3.23 | 3.25 | 3.60 |
| Dividends per share | 0.26 | 0.28 | 0.28 | 0.28 | 0.28 | 0.28 | 0.28 |
| | | | | | | | |
| Liquid assets | 114.9 | 132.8 | 235.0 | 204.2 | 297.6 | 260.2 | 262.9 |
| Loans & leases, gross | 781.6 | 852.8 | 854.5 | 878.0 | 851.5 | 880.5 | 926.3 |
| Total assets | 918.4 | 1,010.8 | 1,117.4 | 1,107.1 | 1,177.2 | 1,172.8 | 1,229.6 |
| Core deposits | 703.6 | 746.4 | 942.2 | 949.1 | 997.3 | 990.4 | 1,040.8 |
| Purchased funds | 105.0 | 129.5 | 58.2 | 41.2 | 54.8 | 55.0 | 55.0 |
| Long-term debt | 49.5 | 67.8 | 51.8 | 49.8 | 49.8 | 49.0 | 49.0 |
| Shareholders' equity | 48.6 | 53.0 | 54.4 | 55.3 | 64.2 | 72.2 | 81.1 |
| | | | | | | | |
| **Profitability** | | | | | | | |
| Return on avg assets | 0.39% | 0.32% | 0.10% | 0.33% | 0.68% | 0.74% | 0.80% |
| Return on avg equity | 6.86% | 6.11% | 1.90% | 6.46% | 12.83% | 12.55% | 12.59% |
| Net interest margin | 2.87% | 2.81% | 2.77% | 3.04% | 3.29% | 3.34% | 3.30% |
| Loan loss provision % avg assets | 0.35% | 0.44% | 0.78% | 0.64% | 0.38% | 0.33% | 0.22% |
| Noninterest income % avg assets | 0.53% | 0.53% | 0.61% | 0.61% | 0.63% | 0.66% | 0.69% |
| Noninterest expense % avg assets | 2.34% | 2.26% | 2.33% | 2.33% | 2.34% | 2.43% | 2.47% |
| Preprovision pretax income % avg assets | 0.95% | 0.98% | 0.95% | 1.18% | 1.43% | 1.44% | 1.42% |
| Tangible efficiency ratio | 71% | 70% | 72% | 66% | 62% | 63% | 63% |
| Payout ratio | 20% | 22% | 66% | 75% | 9% | 9% | 8% |
| | | | | | | | |
| **Asset Quality** | | | | | | | |
| Net charge-offs % avg loans | 0.19% | 0.28% | 0.69% | 0.57% | 0.74% | 0.45% | 0.31% |
| Allowance % loans | 1.26% | 1.39% | 1.65% | 1.85% | 1.66% | 1.60% | 1.50% |
| NPAs % loans & related assets | 1.22% | 2.25% | 3.45% | 4.56% | 2.81% | 1.95% | 1.75% |
| Allowance % NPAs | 103% | 61% | 48% | 41% | 59% | 82% | 86% |
| | | | | | | | |
| **Liquidity & Funding** | | | | | | | |
| Liquid assets % purchased funds | 109% | 103% | 404% | 496% | 543% | 473% | 478% |
| Core deposits % loans | 90% | 88% | 110% | 108% | 117% | 112% | 112% |
| Liquid assets % assets | 13% | 13% | 21% | 18% | 25% | 22% | 21% |
| Loans % assets | 85% | 84% | 76% | 79% | 72% | 75% | 75% |
| | | | | | | | |
| **Capital Adequacy** | | | | | | | |
| Total equity % assets | 5.29% | 5.24% | 4.87% | 5.00% | 5.45% | 6.16% | 6.59% |
| Tangible equity % assets | 5.00% | 4.98% | 4.63% | 5.00% | 5.45% | 6.16% | 6.59% |
| Tier 1 capital ratio | 5.42% | 6.48% | 6.61% | 6.65% | 7.91% | | |
| Total capital ratio | 10.22% | 12.00% | 12.15% | 11.23% | 13.11% | | |
| | | | | | | | |
| **Parent Company Statistics** | | | | | | | |
| Interest coverage | (1.1)X | (0.9)X | 0.3X | 0.2X | (0.0)X | 0.3X | 0.3X |
| Interest & dividend coverage | (0.9)X | (0.7)X | 0.2X | 0.2X | (0.0)X | 0.3X | 0.3X |
| Short-term debt coverage | 16.9X | Lge | Lge | Lge | N/A | N/A | N/A |
| Total debt coverage | 1.1X | 0.9X | 1.0X | 1.0X | N/A | N/A | N/A |
| Double leverage | 169.1% | 185.6% | 187.0% | 189.5% | 179.7% | 171.7% | 164.8% |

# First Business Financial Services, Inc.

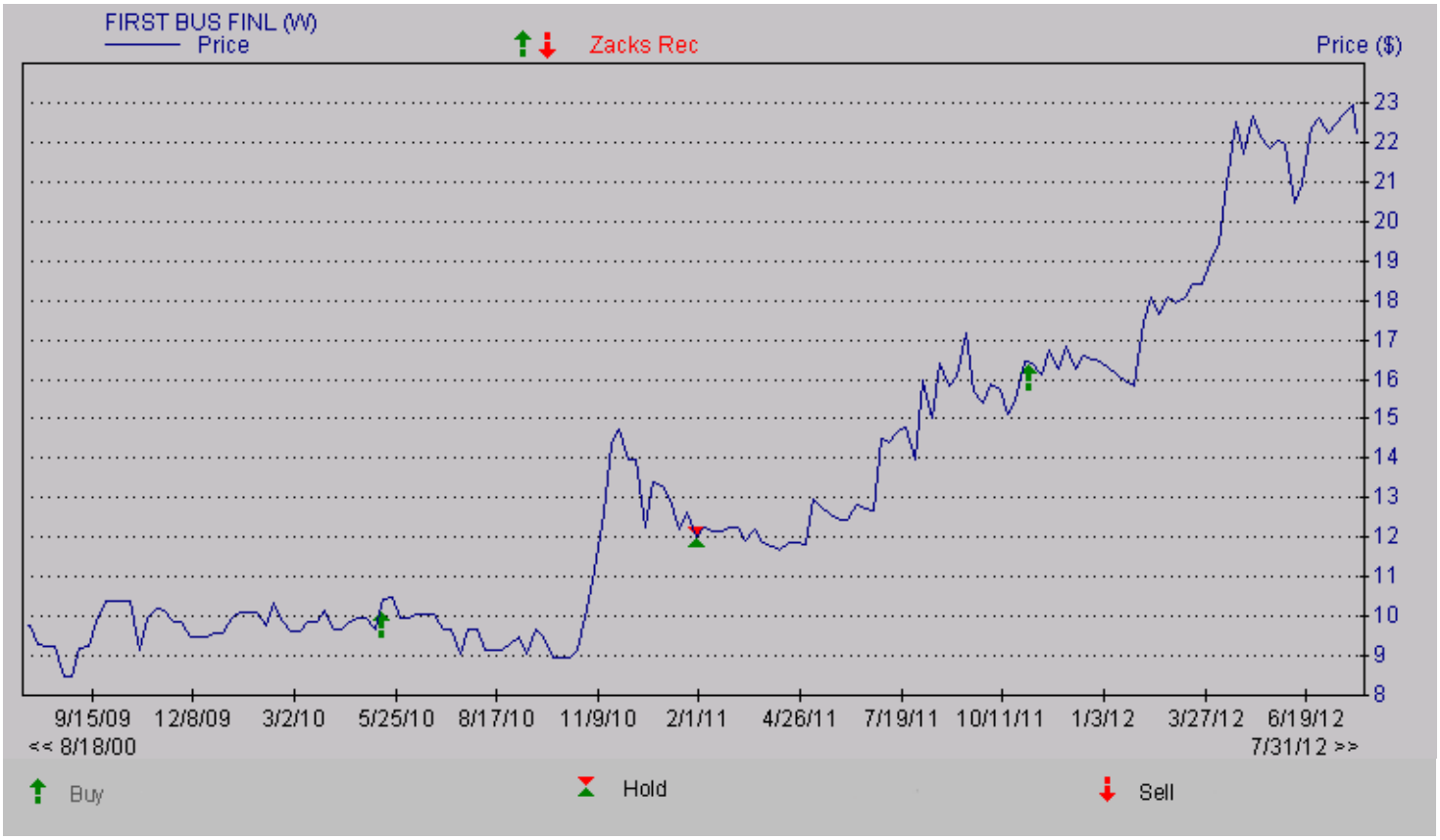
**Income Statement and Balance Sheet**

*(Dollars in millions, except per share data)*

| | 2011 | | | | 2012 | | | |
|---|---|---|---|---|---|---|---|---|
| **Summary Financial Data** | **Q1 A** | **Q2 A** | **Q3 A** | **Q4 A** | **Q1 A** | **Q2 A** | **Q3 E** | **Q4 E** |
| Net interest income | 8.5 | 9.0 | 9.1 | 8.9 | 8.9 | 9.6 | 9.5 | 9.5 |
| Non-interest income | 1.7 | 1.7 | 1.7 | 1.9 | 1.9 | 1.9 | 2.0 | 2.0 |
| Total net revenue | 10.2 | 10.7 | 10.8 | 10.8 | 10.8 | 11.5 | 11.5 | 11.5 |
| Loan loss provision | 1.4 | 1.5 | 0.4 | 0.9 | 0.5 | 2.0 | 0.7 | 0.6 |
| Non-interest expense | 6.8 | 6.6 | 6.8 | 6.2 | 6.8 | 7.1 | 7.2 | 7.2 |
| Income taxes & other | 0.7 | 0.8 | 1.4 | 1.3 | 1.3 | 0.8 | 1.3 | 1.2 |
| Zacks adjusted income before NRI | 1.3 | 1.8 | 2.2 | 2.4 | 2.2 | 1.6 | 2.3 | 2.5 |
| GAAP net income | 1.3 | 2.5 | 2.2 | 2.4 | 2.2 | 1.6 | 2.3 | 2.5 |
| Diluted EPS before NRI | 0.52 | 0.68 | 0.83 | 0.90 | 0.84 | 0.60 | 0.88 | 0.93 |
| Reported EPS | 0.52 | 0.97 | 0.83 | 0.90 | 0.84 | 0.60 | 0.88 | 0.93 |
| Dividends per share | 0.07 | 0.07 | 0.07 | 0.07 | 0.07 | 0.07 | 0.07 | 0.07 |
| | | | | | | | | |
| Liquid assets | 220.1 | 211.2 | 248.8 | 297.6 | 301.4 | 266.5 | 259.9 | 260.2 |
| Loans & leases, gross | 868.7 | 861.4 | 861.5 | 851.5 | 832.5 | 863.2 | 871.8 | 880.5 |
| Total assets | 1,112.9 | 1,096.4 | 1,135.6 | 1,177.2 | 1,162.0 | 1,160.0 | 1,163.5 | 1,172.8 |
| Core deposits | 956.9 | 938.3 | 973.9 | 997.3 | 979.8 | 975.2 | 978.2 | 990.4 |
| Purchased funds | 39.2 | 39.2 | 39.2 | 54.8 | 56.5 | 57.4 | 55.0 | 55.0 |
| Long-term debt | 49.8 | 49.8 | 49.8 | 49.8 | 49.3 | 49.3 | 49.0 | 49.0 |
| Shareholders' equity | 56.3 | 59.8 | 61.8 | 64.2 | 66.4 | 67.8 | 69.9 | 72.2 |
| | | | | | | | | |
| **Profitability** | | | | | | | | |
| Return on avg assets* | 0.48% | 0.65% | 0.78% | 0.82% | 0.74% | 0.54% | 0.80% | 0.85% |
| Return on avg equity * | 9.62% | 12.27% | 14.02% | 15.00% | 13.43% | 9.16% | 13.56% | 14.02% |
| Net interest margin | 3.14% | 3.39% | 3.40% | 3.23% | 3.15% | 3.49% | 3.35% | 3.35% |
| Loan loss provision % avg assets* | 0.50% | 0.53% | 0.16% | 0.32% | 0.17% | 0.71% | 0.24% | 0.21% |
| Noninterest income % avg assets* | 0.59% | 0.63% | 0.62% | 0.66% | 0.62% | 0.66% | 0.68% | 0.69% |
| Noninterest expense % avg assets* | 2.39% | 2.40% | 2.41% | 2.16% | 2.30% | 2.47% | 2.49% | 2.46% |
| Preprovision pretax inc.% avg assets* | 1.20% | 1.48% | 1.46% | 1.58% | 1.33% | 1.52% | 1.45% | 1.49% |
| Tangible efficiency ratio | 67% | 62% | 62% | 58% | 63% | 62% | 63% | 62% |
| Payout ratio | 13% | 7% | 8% | 8% | 8% | 12% | 8% | 8% |
| | | | | | | | | |
| **Asset Quality** | | | | | | | | |
| Net charge-offs % avg loans* | 0.40% | 1.09% | 1.04% | 0.43% | 0.10% | 0.80% | 0.46% | 0.46% |
| Allowance % loans | 1.93% | 1.85% | 1.64% | 1.66% | 1.74% | 1.72% | 1.67% | 1.60% |
| NPAs % loans & related assets | 4.77% | 4.18% | 3.37% | 2.81% | 2.73% | 2.01% | 1.98% | 1.95% |
| Allowance % NPAs | 40% | 44% | 49% | 59% | 63% | 85% | 84% | 82% |
| | | | | | | | | |
| **Liquidity & Funding** | | | | | | | | |
| Liquid assets % purchased funds | 561% | 539% | 634% | 543% | 533% | 464% | 472% | 473% |
| Core deposits % loans | 110% | 109% | 113% | 117% | 118% | 113% | 112% | 112% |
| Liquid assets % assets | 20% | 19% | 22% | 25% | 26% | 23% | 22% | 22% |
| Loans % assets | 78% | 79% | 76% | 72% | 72% | 74% | 75% | 75% |
| | | | | | | | | |
| **Capital Adequacy** | | | | | | | | |
| Total equity % assets | 5.06% | 5.46% | 5.44% | 5.45% | 5.72% | 5.84% | 6.01% | 6.16% |
| Tangible equity % assets | 5.06% | 5.46% | 5.44% | 5.45% | 5.72% | 5.84% | 6.01% | 6.16% |
| Tier 1 capital ratio | 6.92% | 7.29% | 7.60% | 7.91% | 8.21% | 8.04% | | |
| Total capital ratio | 11.64% | 12.20% | 12.66% | 13.11% | 13.56% | 13.31% | | |

*Annualized.

## HISTORICAL ZACKS RECOMMENDATIONS

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