Zacks Equity Research

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Ann H. Heffron, CFA, CPA

www.zacks.com
111 North Canal Street • Chicago, IL 60606

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

FBIZ: Zacks Company Report - OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	05/12/2010
Current Price (08/09/10)	$9.18
Six- Month Target Price	**$12.00**

OUTLOOK

We are continuing our Outperform rating on First Business Financial Services, Inc. (FBIZ), as well as our $12 target price. FBIZ is expected to report second quarter earnings within the next couple of weeks. FBIZ's year-to-date stock performance has lagged behind the Zacks small-cap bank index, and the Company is undervalued, relative to both the index and FBIZ's historical record, which we don't believe is justified by its earnings outlook. We have estimated diluted EPS of $0.90 in 2010, an increase of 120% over 2009's $0.41, and of $1.25 in 2011, a 39% gain over our 2010 estimate, largely due to growth in net interest income on improved margins and modest loan growth in 2011, as well as slowing deterioration in asset quality in 2010 and slight improvement in 2011, leading to reduced loan loss provisions. Near-term risks include a halt in the US economic recovery, greater-than-expected asset quality deterioration, and increased political risk, with longer term risks including reliance on the confidence-sensitive brokered deposit market and potential dilution from sale of additional common stock should loans grow excessively.

SUMMARY DATA

52-Week High	**$11.00**
52-Week Low	**$7.70**
One-Year Return (%)	**-0.32**
Beta	**0.07**
Average Daily Volume (sh)	**166**
Shares Outstanding (mil)	**2.5**
Market Capitalization ($mil)	**$23**
Short Interest Ratio (days)	**3.78**
Institutional Ownership (%)	**3**
Insider Ownership (%)	**20**
Annual Cash Dividend	**$0.28**
Dividend Yield (%)	**3.05**
5-Yr. Historical Growth Rates	
Net Revenue (%)	**13.1**
Earnings Per Share (%)	**(29.6)**
Dividend (%)	**47.0**
P/E using TTM EPS	**10.9**
P/E using 2010 Estimate	**10.2**
P/E using 2011 Estimate	**7.3**
Zacks Rank	**N/A**

Risk Level	**Average**
Type of Stock	**Small-Value**
Industry	**Banks-Midwest**
Zacks Rank in Industry	**N/A**

ZACKS ESTIMATES

Net Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2008	7.2 A	7.9 A	7.9 A	8.4 A	31.4 A
2009	8.0 A	8.3 A	9.2 A	8.9 A	34.5 A
2010	9.5 A	9.7 E	9.7 E	9.7 E	38.6 E
2011					39.8 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2008	0.32 A	0.44 A	0.48 A	0.05 A	1.28 A
2009	(0.08) A	0.10 A	0.53 A	(0.14) A	0.41 A
2010	0.35 A	0.30 E	0.30 E	(0.05) E	0.90 E
2011					1.25 E

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

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OVERVIEW

First Business Financial Services, Inc. (FBIZ or the Company) is a bank holding company headquartered in Madison, Wisconsin, with $1.1 billion in total assets at March 31, 2010. 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 five single-person business development offices, which are located in Minneapolis, Minnesota; Chicago, Illinois; St. Louis, Missouri; Detroit, Michigan; and Cleveland, Ohio. These subsidiaries include: First Business Capital Corp. (FBCC, with net income of $1.4 million in 2009), 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 a net loss of $25,000 in 2009), which is a commercial finance company that finances equipment for small and middle market companies.

In addition, the Company has four non-bank subsidiaries that help manage other aspects of its business. These include: First Business Real Estate LLC (FBBRE, owned by FBB and having an $8,000 net loss in 2009), and First Business Bank-Milwaukee Real Estate LCC (FBBMRE, owned by FBB-Milwaukee and posting net income of $8,000 in 2009), which are limited liability companies that dispose of real estate and other assets acquired through foreclosure; First Madison Investment Corp. (FMIC, owned by FBB, earning net income of $5.9 million in 2009), which is located in the state of Nevada and manages a portion of the Bank's investment portfolio; and First Madison Capital Corp Nevada Corp (FMCCNC, owned by FBCC and generating net earnings of $802,000 in 2009), which is domiciled in Nevada and invests in loans purchased from 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, accounting for 52% of total loans at March 31, 2010. The rest of the lending book consists of commercial and industrial (accounting for 25% of total gross loans), construction and land development (7%), 1-4 family (6%), multi-family (5%), commercial financing leases (3%), 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, has increased on a relative basis, and is now a solid 20% of total assets (up from 14% a year ago). Transaction and money market accounts accounted for 43% of total deposits at March 31, 2010, with certificates of deposit (CDs) at 8%, and brokered CDs at 49% (down from 57%, 15 months ago).

In 2009, net interest income contributed 81% of net revenue. Other significant net revenue sources include trust and investment services fee income (5 ½% of net revenues), services charges on deposits (4 ½%), loan fees (3%), and increase in cash surrender value of bank-owned life insurance (2%). FBIZ's 2010 business plan includes: (1) improving the overall quality of its loan portfolio, (2) minimizing loan loss specific reserves and charge-offs, (3) generating organic growth in the loan portfolio, and (4) increasing its market share of in-market core deposits.

RECENT NEWS

FBIZ is expected to report second quarter earnings within the next couple of weeks. We have estimated diluted EPS of $0.90 in 2010, an increase of 120% over 2009's $0.41, and of $1.25 in 2011, a 39% gain over our 2010 estimate, largely due to growth in net interest income on improved margins and modest loan growth in 2011, as well as slowing deterioration in asset quality in 2010 and slight improvement in 2011, leading to reduced loan loss provisions

On April 30, 2010, FBIZ reported 2010 first quarter net earnings of $0.9 million, or diluted EPS of $0.35 per diluted share, compared to a net loss of $0.2 million, or a net loss per share of $0.08, in the year-ago quarter. This was largely driven by increased net interest income and lower credit costs (loan loss provisions and collateral liquidation costs), partly offset by higher compensation expense (up 10.1% to $3.5 million) and FDIC insurance premiums (up 133.4% to $0.8 million).

Net interest income increased 20.9% year over year, aided by a 35 basis point gain in the net interest margin to 3.00% from 2.65% and a 7.2% rise in average interest-earning assets to $1,048 million on higher average securities and short-term investment (average loans were essentially flat). The net interest margin benefitted from funding costs that fell more than loan yields. Loan yields have benefitted from improved pricing and mix of the loan portfolio, a continued increase in the volume of loans with floor interest rates in excess of current market rates, and gains in the amount of fees collected in lieu of interest.

The loan loss provision improved, falling 39% year over year to $1.3 million from $2.2 million as net charge-offs, a key component in determining the amount of the loss provision, fell to $0.1 million, or 0.10% of average loans, from $1.1 million, or 0.13% of average loans, in the comparable 2009 quarter.

Other asset quality measures deteriorated, with nonperforming assets increasing year over year to 3.85% of loans and related assets from 2.53% at March 31, 2009 and 3.45% sequentially from yearend 2009 reflecting a 51% year-over year increase in nonperforming assets to $33.0 million at the 2010 quarterend. The loan loss allowance as a percent of nonperforming assets also dropped to 47% at the end of the quarter from 59% at the end of March 2009. This was the result of higher nonaccrual loans as the loan loss allowance actually increased to $15.3 million, or 1.79% of gross loans, from $12.9 million, or 1.50% of loans.

Total noninterest expense was held in check despite higher compensation and FDIC premiums, growing only 6% to $6.5 million, well below the 17% gain in net revenues. This lead to a more than 7-point improvement in the efficiency ratio (noninterest expense as a % of net revenues), which decreased to 69.1% from 76.5% in the year-ago quarter.

The Company's capital adequacy continued to improve, and the Tier 1 capital ratio rose to 6.71% at the end of 2010's first quarter from 6.34% in the comparable period in 2009, while the Total capital ratio increased to 12.25% from 11.78%. This reflected growth in retained earnings as well as a 2% decline in risk-weighted assets, due to the shift in balance sheet composition to greater liquidity.

FBIZ posted a 6.5% ROE and 0.33% ROA for the first quarter of 2010, compared to losses in the year-ago quarter.

VALUATION

FBIZ stock has underperformed the industry, with a year-to-date price decline of 4.6% compared to a median increase of 3.5% for the banks in the Zacks small-cap index, as shown in the following table. At its current price, FBIZ is trading at discounts to the industry median P/E of 29% in 2010 and 44% in 2011 (versus discounts of 27% and 42%, respectively, at the time of our last report on May 14, 2010), based upon our FBIZ EPS estimates. This is far in excess of the average 10% P/E discount for FBIZ, based upon 5-year historical P/E averages.

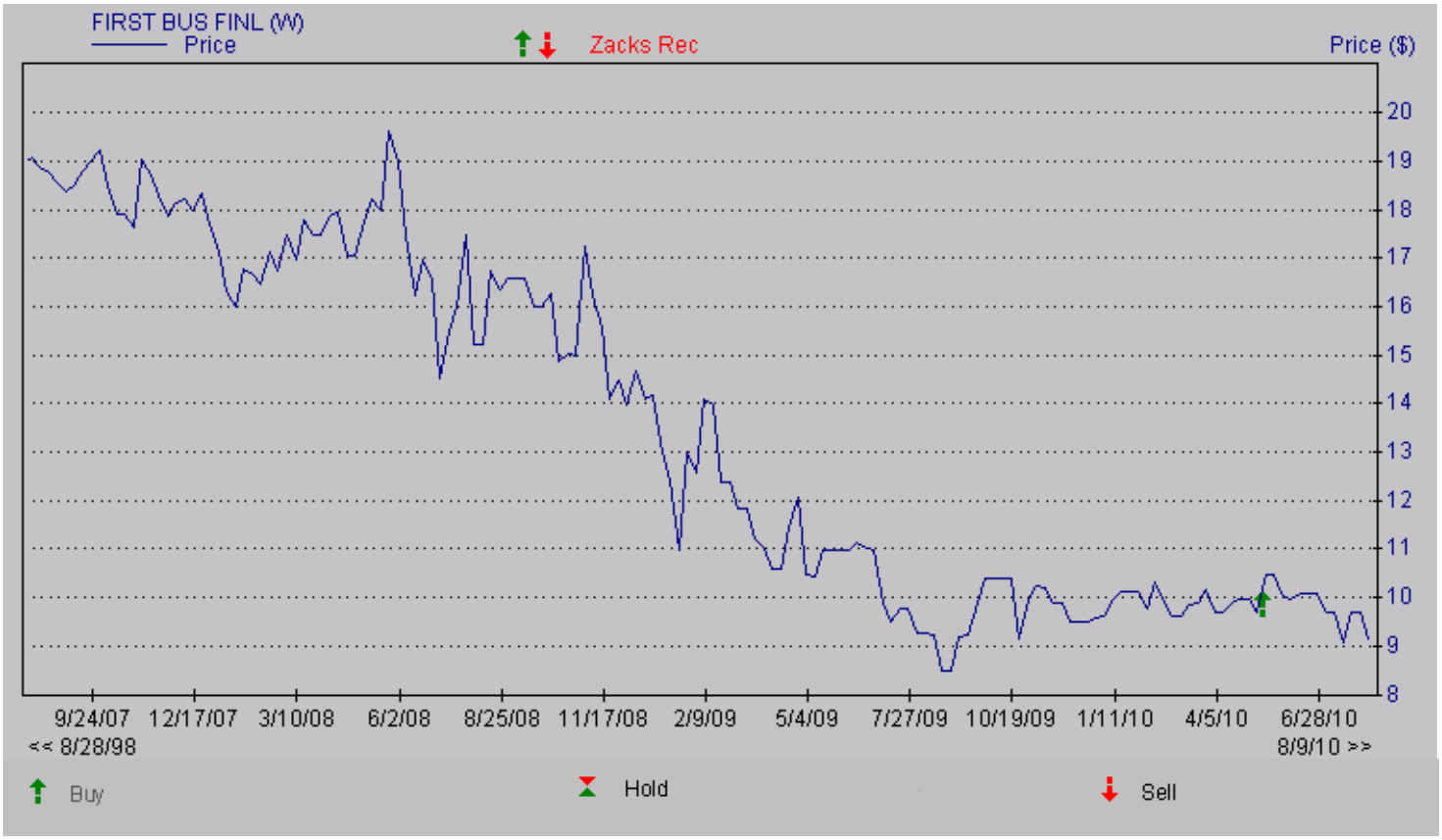
Turning to Price/Book Value, FBIZ is valued at 0.4X versus the industry median of 0.6X. This represents a 31% discount versus an average historical discount of about 15% for FBIZ since the end of 2005. Applying the average 15% discount to our estimated book value for FBIZ at December 31, 2010 results in a price target of roughly $12.00.

Industry Comparables- Small-cap Banks

		Price / Earnings Ratios					Return on Equity		Return on Assets		
	Pr Chg YTD	TTM* EPS	2010E	2011E	5-Yr Avg	Price/ Book	TTM*	5-Yr Avg	TTM*	5-Yr Avg	Div Yld
FIRST BUS FINL	**(4.6)**	**10.9**	**10.2**	**7.3**	**14.1**	**0.4**	**3.9**	**6.7**	**0.20**	**0.39**	**3.0**
S&P 500	1.1	19.8	14.2	12.4	18.1	3.5	24.7	-----	8.7	-----	2.0
Median	**3.5**	**15.4**	**15.7**	**13.1**	**15.7**	**0.6**	**1.9**	**5.2**	**0.15**	**0.49**	**-----**
Average	13.2	37.4	40.5	21.3	18.4	0.7	(8.5)	4.0	(0.17)	0.48	1.4
High	278.5	395.3	372.0	183.0	35.4	1.5	14.3	16.8	2.38	2.73	5.9
Low	(46.3)	3.9	10.2	7.3	10.7	0.2	(136.7)	(21.4)	(5.67)	(1.26)	-----

*Trailing twelve months

HISTORICAL ZACKS RECOMMENDATIONS



DISCLOSURES

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