Zacks Equity Research

May 14, 2010
Ann H. Heffron, CFA, CPA

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

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

FBIZ: Initiating Coverage - OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	05/12/2010
Current Price (05/13/10)	$10.49
Six- Month Target Price	**$12.00**

OUTLOOK

We are initiating coverage on First Business Financial Services, Inc. (FBIZ) with an Outperform rating and a six-month price target of $12.00, generating a total return of almost 16%. 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	**$13.95**
52-Week Low	**$7.70**
One-Year Return (%)	**-3.67**
Beta	**0.08**
Average Daily Volume (sh)	**783**
Shares Outstanding (mil)	**2.5**
Market Capitalization ($mil)	**$27**
Short Interest Ratio (days)	**0.44**
Institutional Ownership (%)	**3**
Insider Ownership (%)	**20**
Annual Cash Dividend	**$0.28**
Dividend Yield (%)	**2.67**
5-Yr. Historical Growth Rates	
Net Revenue (%)	**13.1**
Earnings Per Share (%)	**(29.6)**
Dividend (%)	**47.0**
P/E using TTM EPS	**12.5**
P/E using 2010 Estimate	**11.7**
P/E using 2011 Estimate	**8.4**
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.

© Copyright 2010, Zacks Investment Research. All Rights Reserved.

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.

STRATEGY

FBIZ has a niche strategy that focuses on business banking and providing a high level of client service. FBIZ only has about 2,000 clients compared to a much higher number of customers at a typical bank of its size. With fewer clients, FBIZ can offer custom-tailored solutions to its clients that include not only loans and deposits, but nontraditional services, such as acquisitions, information technology, human resources, and venture capital. These extra services are offered at no additional charge to the client, enhancing client loyalty and increasing the depth and strength of the client relationship.

FBIZ has an extensive client relationship management (CRM) database of companies located in its lending area that provides leads to potential clients. Often times, clients come from the ranks of larger competitors that are unable to offer the high level of service the FBIZ can. Each client relationship is staffed by two lending officers, so that there is continuity in providing services to the client. Typically, a client also knows top management, as well.

FBIZ management encourages an entrepreneurial attitude, with each lending or business development officer responsible for his loan book, which is viewed and run as an independent business. Companywide compensation is composed of 85-90% salary, with about another 10-15% bonus based upon net income (one-third of performance measurement), return on equity (another third), and adjusted net income (net income adjusted for loan loss provisions and net charge-offs, the final third). The emphasis on adjusted net income fosters a proactive attitude to credit risk management as early intervention by FBIZ typically minimizes credit losses. Moreover, since compensation is tied to credit quality, the lending officer is just as concerned with credit performance of the loan as with generating the loan to begin with.

The Company also promotes cross-selling of services, with many client relationships consisting of several different types of services, such as lending, deposits, and trust and investment services. This increases efficiency as more revenues are generated per client.

That said, FBIZ went on a hiring spree from 2006 through early 2008 across the company, including trust, treasury management, and lending, in an effort to generate more business. Since it usually takes about a year or so until these new hires can be productive, compensation expenses were incurred without any significant increase in revenues, hurting the company's efficiency ratio. In 2010 and beyond, the Company should be able to ramp up business (when demand picks up) with existing staff, and efficiency should improve as a result.

As to acquisitions, the Company has made no acquisitions to date and has little interest in acquiring failed banks (to increase in-market deposits, for example) from the FDIC for a couple of reasons. First, FBIZ does not wish to dilute its business banking strategy by acquiring a retail bank. Second, the cost of deposit funding at a failing bank is usually higher than that of FBIZ. Thus, there is no competitive advantage in pursuing acquisitions.

In fact, FBIZ has exclusively relied upon organic growth to expand its operations, in order to protect its banking culture and to safeguard credit standards. A timeline of de novo business expansion is shown below.

- Mar 1990 First Business Bank-Madison (FBB)
- May 1995 First Business Capital Corp. (FBCC)
- Oct 1998 First Business Equipment (FBEF)
- Jun 2000 First Business Bank-Milwaukee (FBB-Milwaukee)
- Dec 2001 First Business Trust & Investments (FBTI)
- Sep 2006 First Business Bank-Northeast

LOANS AND ASSET QUALITY

FBIZ's loan portfolio has a major concentration in commercial real estate, accounting for 52% of gross loans at March 31, 2010, as shown in the table below. The banks are currently in compliance with FDIC CRE guidelines, which call for greater FDIC scrutiny under certain circumstances, including CRE loans in excess of 300% of capital and construction and land development loans in excess of 100% of capital. CRE loan participations, which were purchased for properties outside of the Company's market, were halted in 2006 due to above-average credit quality problems associated with these types of loans. The rest of the loan portfolio includes other first mortgage loans (19% of gross loans), commercial (28%), and consumer and other (2% of gross loans).

	Amount ($ in Millions)				% of Total Gross Loans			
Type of Loan	**2007**	**2008**	**2009**	**1Q'10**	**2007**	**2008**	**2009**	**1Q'10**
Commercial real estate	$336.2	$390.1	$441.8	$442.8	43%	46%	52%	52%
Construction and land development	90.5	84.8	64.2	57.9	12	10	8	7
Multi-family	41.8	42.5	44.0	43.8	6	5	5	5
1-4 family	48.4	51.5	56.1	56.4	6	6	6	6
Total first mortgage loans	516.9	568.9	606.1	600.9	67	67	71	70
Commercial and industrial	147.9	152.0	126.7	211.4	19	18	15	25
Asset-based	65.9	80.4	73.0	N/A	8	10	9	N/A
Direct financing leases, net	29.4	29.7	27.6	25.5	4	3	3	3
Total commercial loans and leases	243.2	262.1	227.3	236.9	31	31	27	28
Home equity and second mortgage	9.8	7.4	7.9	6.4	1	1	1	1
Credit card	0.9	0.8	0.8	N/A	-	-	-	N/A
Personal	1.1	1.3	0.4	N/A	-	-	-	N/A
Other	9.7	12.3	12.0	11.0	1	1	1	1
Total consumer and other loans	21.5	21.8	21.1	17.4	2	2	2	2
Total gross loans	$781.6	$852.8	$854.5	$855.2	100%	100%	100%	100%

As shown in the table above, CRE loans have steadily grown from 43% of the loan portfolio at yearend 2007 to 52% at the end of the first quarter in 2010 as the Company has continued to lend to this sector due to the dearth of high-quality lending opportunities in other areas stemming from general economic weakness and as competitor banks have cut back lending to this sector to repair balance sheets damaged by the recession. CRE loans, which generally have terms up to five years and amortizations of up to 25 years, are secured by owner-occupied and investment properties, and are typically larger than other types of loans. Consequently, single-risk exposures to credit losses are also higher. While we have concerns about the commercial real estate market, the Wisconsin property market appears to be holding up fairly well, reflecting less overbuilding and a generally more conservative credit culture than in many areas of the United States. Moreover, Madison, a major market for FBIZ, is somewhat protected from cyclical contractions as it is the state capitol of Wisconsin and is home to the University of Wisconsin.

As to other first mortgage loans, FBIZ originates loans to construct commercial properties and complete land development projects, with terms generally ranging from 6-24 months and proceeds disbursed as construction progresses. The construction and land development loan book has gradually declined to 7% of total loans at the end of 2010's first quarter from 12% at December 31, 2007, largely due to a concerted effort by FBIZ to decrease exposure to this sector and as projects have completed and migrated to permanent financing. Multi-family loans are typically secured by apartment buildings in Dane (Madison) and Waukesha counties, while 1-4 family loans are secured by single-family homes held for

investment by FBIZ clients. Multi-family and 1-4 family first mortgage loans have been relatively stable over the 2007-first quarter 2010 period, accounting for roughly 5% and 7% of gross loans, respectively.

The commercial loan book includes loans that are secured by inventory, accounts receivable, equipment, machinery, and other corporate assets and typically contain a personal guarantee from the owner of the borrowing business. FBIZ is interested in expanding this business and has been taking market share from bank competitors, in part due to the high level of service offered by the Company. This was demonstrated by the 4% sequential growth in 2010's first quarter in the commercial loan portfolio to 28% of gross loans, following several years of a shrinking loan base. FBIZ finds the commercial loan business attractive due to improved cross-selling opportunities for other nonloan business, such as treasury management and deposit-taking.

Finally, the Company has a small consumer and other loan portfolio (accounting 2% of total loans), largely consisting of second mortgage and home equity loans, as well as other types of lending.

FBIZ employs a rigorous loan underwriting and approval process using a tiered lending limit that is based upon nine internal risk ratings, as determined by the credit committee. Since business development officers have relatively low lending authority limits, most loans must be approved by the credit committee. The credit committee, which includes the chief executive officer and the chief credit officer, meets three times per week (one meeting for each of the three geographic areas of Madison, Milwaukee, and Northeast Wisconsin), providing quick turn-around for lending decisions. The credit committee process ensures improved lending decisions and also provides feedback to clients regarding loan approval. Moreover, during the current economic downturn, the credit committee continues to perform additional loan monitoring procedures to mitigate against risk of loss.

Loans and leases are placed on nonaccrual status when collection of contractual payments seems unlikely due to deterioration of the financial condition of the borrower. In all cases, loans and leases that are 90 days past due are placed on nonaccrual status, and most nonaccrual loans are considered impaired (certain homogeneous loans, including residential mortgage and consumer loans, are collectively evaluated for impairment and, therefore, do not have individual credit risk ratings and are excluded from impaired loans). As shown in the following table, the level of nonaccrual loans, as measured in dollar amounts and as a percentage of loans, continues to rise, reflecting prolonged economic weakness in the US and deterioration of the commercial and residential real estate markets in the US. Thus, nonperforming loans have climbed to $31.6 million at the end of 2010's first quarter from $8.9 million at yearend 2007. As a percentage of total loans, nonaccrual loans have jumped to 3.70% from 1.13% over the same period.

Nonperforming assets, which include nonaccrual loans as well as foreclosed and repossessed assets, have more than tripled, rising from $9.5 million at the end of 2007 to $33.0 million at the March 31, 2010, or from 1.22% of total loans and related assets to 3.85% of loans and related assets at March 2010 quarterend, largely due to rising nonaccrual loans. Foreclosed and repossessed assets remain relatively modest, and were $1.3 million at March 31, 2010.

Not surprisingly, the weakest loan categories are primarily concentrated in the real estate markets and include consumer home equity and second mortgage (14.99% nonaccrual loan ratio at March 31, 2010), multi-family (8.06%), 1-4 family (7.73%), and construction and land development (6.48%). The commercial real estate and commercial loan books have performed relatively well to date, registering nonaccrual loan ratios of 1.83% and 3.61%, respectively. On the other hand, consumer and other loans show a staggering 30.00% nonaccrual loan ratio at the end of March. According to FBIZ, this was due to the inclusion of a small number of poorly performing loans to nonbank financial service companies, in which single-risk exposures are relatively large. Fortunately, these loans represent an insignificant 1% of the total loan portfolio.

Nonaccrual loans hurt the Company in a couple of ways. First, net interest income and the net interest margin are lower than they otherwise would be as the Company can no longer accrue interest on these

loans. The amount of interest income forgone on nonaccrual loans and leases was $0.5 million in the March 2010 quarter, $1.6 million in 2009, and $0.7 million in 2008. Second, nonaccrual loans and leases are indicators of potential future losses in the loan portfolio. As nonaccrual loans rise, the Company must increase loan loss provisions charged against revenues in the income statement, thereby reducing net income and earnings per share.

	Amount ($ in Millions)				Nonaccrual Loans % Loans			
Nonaccrual Loans by Category	**2007**	**2008**	**2009**	**1Q'10**	**2007**	**2008**	**2009**	**1Q'10**
Commercial real estate	$0.0	$3.0	$8.4	$8.1	0.00%	0.76%	1.92%	1.83%
Construction and land development	1.8	5.3	3.3	3.8	1.97	6.23	5.17	6.48
Multi-family	5.0	0.0	1.8	3.5	11.94	0.00	4.00	8.06
1-4 family	0.4	2.1	3.0	4.4	0.88	4.04	5.37	7.73
Total first mortgage loans	7.2	10.4	16.5	19.8	1.39	1.82	2.73	3.28
Commercial and industrial	0.6	5.4	7.1	7.6	0.31	2.33	3.55	3.61
Direct financing leases, net	0.1	0.0	0.0	0.0	0.20	0.08	0.00	0.00
Total commercial loans and leases	0.7	5.4	7.1	7.6	0.30	2.07	3.12	3.22
Home equity and second mortgage	1.0	0.4	0.9	0.9	9.61	5.13	11.07	14.99
Consumer and other loans	0.0	0.1	3.3	3.3	0.00	0.90	24.83	30.00
Total consumer and other loans	1.0	0.5	4.2	4.2	4.37	2.33	19.70	24.49
Total nonaccrual loans	$8.9	$16.3	$27.8	$31.6	1.13%	1.91%	3.26%	3.70%

The loan loss allowance, which is a valuation account applied against the loan portfolio on the balance sheet, is established by the Company at a level that they deem sufficient to cover future losses in the loan book. The allowance for loan losses is increased by the provision for loan losses as charged against revenues in the income statement and decreased by net charge-offs (gross charge-offs less recoveries). Net charge-offs and loan loss provisions are cyclical in nature, usually rising in the fourth quarter as the Company completes it yearend review and declining in the first quarter, as shown in the following table. Importantly, net charge-offs as a % of loans are relatively low when compared with other regional banks. This reflects the fact that almost all of FBIZ's loan portfolio is secured, usually by real estate, inventory, accounts receivable, equipment, machinery, or corporate assets.

	2008				2009				2010
	Q1 A	**Q2 A**	**Q3 A**	**Q4 A**	**Q1 A**	**Q2 A**	**Q3 A**	**Q4 A**	**Q1 A**
Amount ($ in Millions)									
Beginning loan loss allowance	9.9	10.2	10.7	10.8	11.8	12.9	12.7	12.8	14.1
Loan loss provision	0.5	0.7	0.0	3.0	2.2	1.7	1.4	3.0	1.3
Less: net charge-offs (recoveries)	0.2	0.2	(0.1)	2.0	1.1	1.9	1.3	1.7	0.1
Ending loan loss allowance	10.2	10.7	10.8	11.8	12.9	12.7	12.8	14.1	15.3
Net charge-offs % avg loans (annualized)	0.11%	0.10%	(0.04)%	0.92%	0.52%	0.88%	0.58%	0.78%	0.06%
Loss provision % avg assets (annualized)	0.24%	0.31%	0.01%	1.23%	0.87%	0.63%	0.52%	1.14%	0.49%

FBIZ uses a number of factors to establish the appropriate level of loan loss allowance, including delinquencies, volume and average size loan relationships, average risk rating, technical defaults, geographic concentrations, loans and leases on management attention watch lists, unemployment rates

in its market areas, experience in the credit-granting functions, changes in underwriting standards, and level of nonperforming assets and related fair value of underlying collateral.

Typically, FBIZ applies a three-step process to establish the loan loss allowance as follows.

1. For a specific loan that has become impaired, the Company stops accruing interest on the loan and looks to the underlying loan collateral to determine if the collateral is sufficient to cover the loan principal amount. If it is not, FBIZ determines the amount of the shortfall through an appraisal of the property, the present value of expected cash flows, or other methods as appropriate to the loan type. For borrowers that are slow in paying off their loans, FBIZ establishes a reserve to cover the shortfall. For borrowers that have completely stopped paying their loans, the amount of the shortfall is immediately charged off against the loan loss allowance.
2. FBIZ also employs an historical charge-off migration analysis, with these percentages applied to the loan portfolio by category and risk rating. The historical charge-off migration analysis averages the most recent five years of net charge-offs for each risk rating for each subsidiary and traces the migration of the risk rating from origination through charge-off, with greater weight given to the most recent years.
3. FBIZ also incorporates subjective factors in calculating the amount of the loan loss allowance. For example, a weaker risk rating or a rising unemployment rate will require a higher loan loss allowance.

FBIZ has been strengthening the loan loss allowance over the last few years due to weakening asset quality, as reflected in the higher level of nonperforming loans. Thus, the Companywide loan loss allowance was 1.79% of total loans at the end of March 2010 compared to 1.65% at the end 2009 and 1.39% at December 31, 2008. By loan category, the loan loss allowance at December 31, 2009 (latest available data) was greatest for consumer and other loans at 3.53% versus 1.97% for commercial, and 1.47% for real estate first mortgage loans. As is typical during periods of economic weakness, the loan loss allowance as measured against nonperforming assets continued to decline, falling to 47% of nonperforming assets at March quarterend from 48% at yearend 2009, 61% at December 31, 2008, and 103% at the end of 2007, as increases in nonaccrual loans outpaced gains in the loan loss allowance.

	Amount ($ in Millions)			Allowance % Loans		
Loan Loss Allowance by Category	**2007**	**2008**	**2009**	**2007**	**2008**	**2009**
Commercial real estate	$3.9	$4.7	$6.4	1.14%	1.21%	1.45%
Construction and land development	1.3	1.4	1.0	1.47	1.60	1.55
Multi-family	0.4	0.5	0.6	1.01	1.21	1.37
1-4 family	0.6	0.6	0.9	1.15	1.18	1.57
Total first mortgage loans	6.2	7.2	8.9	1.19	1.26	1.47
Commercial and industrial	3.0	4.0	4.1	1.42	1.71	2.07
Direct financing leases, net	0.4	0.3	0.4	1.21	1.11	1.29
Total commercial loans and leases	3.4	4.3	4.5	1.40	1.65	1.97
Home equity and second mortgage	0.2	0.1	0.3	1.78	2.14	3.69
Consumer and other loans	0.1	0.2	0.4	1.09	1.29	3.43
Total consumer and other loans	0.3	0.3	0.7	1.40	1.58	3.53
Total loan loss allowance	$9.9	$11.8	$14.1	1.26%	1.39%	1.65%

LIQUIDITY AND FUNDING

FBIZ currently maintains a liquid balance sheet, with liquid assets (consisting of cash, short-term investments, and US agency mortgage obligations) at $219.0 million at March 31, 2010, representing about 20% of total assets. The Company significantly boosted its liquidity in 2009 in response to financial markets turmoil by adding almost $100 million to its deposit account at the Federal Reserve Bank, bringing it to $104 million, before cutting it by $25 million in the first quarter. At the same time, FBIZ reduced its reliance on purchased funds (composed of confidence-sensitive financing, such as foreign deposits, deposits greater than $100,000, and short-term obligations, like commercial paper, current maturities of long-term debt, and fed funds purchased), which fell more by 55% from a peak of $129.5 million at the end of 2008 to $58.2 million at yearend 2009, before rising modestly to $60.2 million at the end of 2010's first quarter. As measured against purchased funds, liquid assets represented a very solid 364% of purchased funds at March 31, 2010, down a bit from 404% at yearend 2009, but a sizable increase over the 103% reported at the end of 2008. This increased liquidity came at a cost, however, shaving off about 10 basis points from the net interest margin in 2009 due to the large amount of lower yielding, immediately available deposits at the Federal Reserve Bank.

The Company has been slowly migrating its available-for-sale securities portfolio from FNMA/FHLMC mortgage securities to GNMA collateralized mortgage securities due to their more favorable capital treatment. GNMA securities, which were $131.9 million at March quarterend and now account for about 98% of total available-for-sale securities, are fully guaranteed by the US government and require a zero risk weighting under FDIC regulatory guidelines, while FNMA/FHLMC mortgage securities require 10% risk weighting (and compare to risk weightings of 50% for municipal debt and 100% for corporate debt). In addition to liquidity, the GNMA portfolio offers two other benefits: (1) protecting the Company's net interest margin and (2) aiding in asset/liability management as prepayment streams from these securities are matched against the Company's short-term liabilities.

On the funding side, the majority of funding comes from the Company's deposit base. Core deposits, which equal total deposits less foreign deposits and certificates of deposit over $100,000, have been increasing over the last few years and now cover over 100% of loans.

Unlike the typical regional bank, FBIZ has no branch network, inhibiting its ability to gather in-market deposits that the Company believes contribute to increased cross-selling opportunities and greater depth of client relationships. Therefore, the Company relies on the wholesale-brokered deposit market to a significant extent. FBIZ considers brokered deposits, which are limited by Company policy to 75% of total deposits and currently represent about one-half of total deposits, attractive for a few reasons:

1. the ease of gathering a significant amount of brokered deposits at attractive interest rates and maturities over a short period of time;
2. brokered deposits have lower administrative costs relative to a like amount of local deposits with a similar maturity structure;
3. the Company's brokered deposits consist only of certificates of deposit (CDs) that do not permit withdrawal before the stated maturity date, enhancing the stability of these deposits in periods of market turmoil. Importantly, a bank must remain well capitalized as defined under FDIC regulations to participate in the brokered CD market, though a downgrade from well capitalized does not affect existing deposits; and
4. brokered deposits aid in the Company's asset/liability management process, in which FBIZ match funds its loans and deposits, limiting interest-rate risk. For example, the company typically funds fixed-rate loans (accounting for roughly 55% of total loans) with fixed-rate brokered CDs of a similar maturity, thereby locking in the interest-rate spread. In-market deposits, which tend to be shorter term and variable rate, are used to fund the floating rate loan book (26% of which contain interest-rate floors, protecting the Company's net interest margin in a low rate environment), as well as the investment portfolio. Importantly, the Company employs derivatives only sparingly and prefers to manage interest-rate risk through the use of laddered deposits and the investment portfolio.

As is true for banks generally, the Company has benefitted from increases in FDIC guarantee limits. Through December 31, 2010, the FDIC insures 100% of noninterest-bearing deposit transaction and NOW accounts that have an interest rate of 0.50% or less through June 30, 2010 and 0.25% or less thereafter, and has raised the deposit insurance coverage limit through December 31, 2013 to $250,000 per depositor from $100,000. Moreover, since FBIZ owns two separately chartered banks, this effectively doubles FDIC insurance coverage at the Company to $500,000. This has helped FBIZ to increase its share of in-market deposits, an important priority for the Company. Thus, in-market deposits rose to 51% of total deposits at the end of March from 43% at the yearend 2008, while brokered deposits fell to 49% from 57% over the same period.

The Company has two long-term debt issues: (1) $10.3 million of 10.5% junior subordinated notes due on September 26, 2038 that were issued with proceeds from the sale of a similar amount of trust preferred securities, which count as Tier 1 capital, and (2) $39.0 million of subordinated notes, maturing from June 2015 to April 2016, carrying an interest rate of one-month LIBOR plus 4.25%, and qualifying as Tier 2 capital. These subordinated notes are renegotiated and renewed every two years and mature seven years from the renewal date. In addition, FBIZ has a $10.5 million 365-day revolving line of credit that carries an interest rate of one-month LIBOR plus 2.75% and which contains covenants pertaining to asset quality and profitability. FBIZ was in violation of these covenants at December 31, 2009, for which it received waivers from the lending institution. The credit line matured on March 12, 2010 and was subsequently renewed for an additional year. FBIZ is currently in compliance with these debt covenants. The Company has no debt outstanding under the Debt Guarantee Program, in which the US government guaranteed senior unsecured debt issued during the period from October 14, 2008 through June 30, 2009.

FBIZ has a $53.2 million FHLB line of credit, with advances on the credit line collateralized by certain loans and securities. At March 31, 2010, FHLB advances under this line were $18.5 million and were collateralized by $21.1 million of loans and $32.1 million of collateralized mortgage obligations. FHLB advances carry 4.50-6.06% interest rates and are subject to prepayment fees if repaid prior to maturity.

The five-year debt maturity schedule is manageable, with debt maturities of $18.0 million in 2010, $0.5 million in 2011, and $0.5 million in 2013. The maturity schedule for CDs is heavily weighted in 2010 and 2011, with maturities of $239.5 million and $148.6 million, respectively, and maturities of $96.4 million in 2012, $73.3 million in 2013, and $11.5 million in 2014.

In the event of a funding crisis, the Company would first draw down its $79 million deposit account at the Federal Reserve Bank and then borrow from the FHLB or Federal Reserve Discount Window, using unencumbered securities as collateral. FBIZ's funding is structured so that at least 120 days of maturing brokered CDs could be financed with borrowing from the FHLB or Fed, enhancing the Company's funding profile.

CAPITAL ADEQUACY AND DIVIDENDS

FBIZ and its subsidiary banks are considered well capitalized, the highest rating possible under the FDIC's four-risk category rating system, as shown in the following table. Under the FDIC's risk-based capital guidelines, different categories of assets (including certain off-balance sheet items) are assigned different risk weights, based on the credit risk of the asset. These risk-weighted assets are added together to derive the risk weight of the entire asset base and then measured against Tier 1 and Total capital to determine capital adequacy. Total capital is the sum of Tier 1 and Tier 2 capital, with Tier 2 capital being limited to 100% of Tier 1 capital. Tier 1 capital includes common stockholders' equity, any perpetual preferred stock, qualifying trust preferred securities, and minority interests in unconsolidated subsidiaries. Tier 2 capital includes any perpetual preferred stock and trust preferred securities not included in Tier 1 capital, subordinated debt, specific maturing capital instruments, and the allowance for loan and lease losses (limited to 1.25% of risk-weighted assets).

At March 31, 2010	FBIZ	FBB	FBB-Milwaukee	FDIC- Well Capitalized
Total capital ratio	12.25%	11.88%	14.06%	≥10%
Tier 1 capital ratio	6.71%	10.62%	12.80%	≥6%
Tier 1 leverage ratio*	5.59%	9.28%	7.75%	≥5%

*Tier 1 capital to average assets

Capital adequacy ratios had been on a declining trend, with the Tier 1 capital ratio falling from 8.45% at yearend 2005 to 5.42% at the end of 2007 and the Total capital ratio slumping from 10.43% to 10.22% over the same period, largely due to the redemption of $10.0 million of floating-rate trust preferred securities in December 2006 and a significant increase in risk-weighted assets, reflecting growth in the loan portfolio. In 2008, the Company took several steps to strengthen its capital levels. These included: (1) selling $10.0 million of fixed-rate trust preferred securities, which are counted as Tier 1 capital and (2) issuing an additional $8.0 million of subordinated debt (for a total of $39.0 million), which is counted as Tier 2 capital. Because of these actions and the continuing growth in retained earnings, the Company's capital ratios have improved, with the Tier 1 capital ratio and Total capital ratio rising to 6.71% and 12.25%, respectively, at March 31, 2010. Notably, the Tier 1 capital ratio remains significantly below 2005's 8.45%.

Looking at the Parent Company alone, the Parent employs a high amount of double leverage (defined as the Parent's investments in subsidiaries divided by total stockholders' equity), which is an important indicator of a Parent Company's debt burden and financial flexibility, measuring the degree to which subsidiary banks' equity capital is being financed with Parent Company debt. At FBIZ, the double leverage ratio was 187% at December 31, 2009 (the latest data available since it is published only annually), compared to a more typical ratio of 105-120% for regional banks. Furthermore, double leverage has increased from 144.0% in 2005 to its current level as the Parent has added junior subordinated and subordinated debt to its balance sheet to finance long-term growth.

In addition, liquidity at the Parent Company is somewhat weak as it holds only $1.9 million of cash. While this combined with consulting and rental income the Parent receives from subsidiaries ($7.7 million in 2009, up from $4.9 million in 2008) is sufficient to cover immediate cash needs of $10,000 of short-term debt and roughly $3.0 million of interest payments on subordinated debt obligations, it still results in subpar interest coverage, which was only 0.3X in 2009.

However, the Parent's financial position improves dramatically when including potential dividend payments from subsidiaries. Cash dividends of $45.4 million could be upstreamed from subsidiary banks to the Parent without prior regulatory approval as of December 31, 2009 and are almost sufficient to retire the Parent's entire debt burden right now, even though these obligations mature many years from now. From a practical perspective, it is unlikely the Parent would do so because this would leave the subsidiary banks too thinly capitalized. Furthermore, regulators can restrict bank dividend payments under adverse conditions, which means that these funds might not be available to the Parent Company when they are likely to be needed most.

FBIZ began paying dividends to its shareholders in 2005, and the current annual dividend is $0.28 per share, payable at $0.07 per share quarterly. The Company maintained the dividend throughout 2009, though it was not earned in the first and fourth quarters, as a demonstration of good faith in its financial strength and future prospects.

EARNING POWER AND PROFITABILITY

The Company's net revenue stream is dominated by net interest income, which typically accounts for about 83-84% of total net revenues, though this fell to 81% in 2009. Net interest income is determined by multiplying the amount of average interest-earning assets on the balance sheet, including loans (typically over 80% of total interest-earning assets for FBIZ), securities (usually about 10-11%), and short-term investments, and the net interest margin. The net interest margin measures the difference between interest the Company earns on its assets and the interest it must pay on its liabilities, which include deposits, purchased funds, and long-term debt, expressed as a percentage of average total assets.

Since the Company is primarily a business lender, its net interest margin is lower than that of banks, which have a large proportion of consumer loans in its loan mix. Business loans tend to have lower net interest margins than consumer loans, but this is somewhat mitigated by the lower level of net charge-offs associated with business lending.

Net interest income has been rising over the last few years, growing at a compound annual growth rate of 12.1% since 2005, largely the result of gains in the interest-earning asset base since the net interest margin has been on a declining trend, falling from 3.03% in 2005 to 2.77% in 2009. The net interest margin decrease primarily reflected a growing number of nonaccrual loans, competitive loan and deposit pricing pressures, and the increasing proportion of lower yielding Federal Reserve deposits on the balance sheet.

Positively, this trend reversed in the first quarter of 2010, with the net interest margin rising 35 basis points year over year to 3.00% from 2.65% in the comparable 2009 quarter as funding costs 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 Company believes better loan and deposit pricing will more than offset high levels of nonaccrual loans and the volatility of fees in lieu of interest to contribute to a stable net interest margin in 2010.

Other important sources of net revenue are trust and investment services income (generating about 5-6% of net revenue), services charges on deposits (3-4%), loan fees (2-3%), and increases in cash value of life insurance policies (2-3%), as shown in the following table. Trust and investment services fee income is based upon the amount of assets under management, which are affected by the ability of FBIZ to add additional clients to its client base, and the general level of equity markets. Since equity markets have been somewhat volatile over the last few years, this has contributed to fluctuations in the level of fee income from this source, a trend we expect to continue over the near future.

Service charges have risen steadily over the last few years, due to increasing charges for demand deposits, expansion of the product line, and the promotion of treasury management services to existing bank clients. Importantly, FBIZ is not affected by new banking legislation that limits fees from overdraft and credit card services as these apply only to retail bank customers.

The increase in cash surrender value of bank-owned life insurance and loan fees have been relatively stable, though in 2009 loan fees jumped 65%, stemming from additional audit fee income related to the examination of collateral that secures client loans, a trend that should continue given the impact of current economic stresses on the Company's client base.

Noninterest Income	Amount ($ in Millions) 2005	2006	2007	2008	2009	1Q'10	% of Net Revenues 2005	2006	2007	2008	2009	1Q'10
Trust and investment income	1.1	1.4	1.9	2.0	1.9	0.6	5.0%	6.0%	6.9%	6.3%	5.5%	6.0%
Service charges on deposits	0.8	0.8	0.7	1.1	1.5	0.4	4.0%	3.3%	2.6%	3.5%	4.5%	4.2%
Loan fees	0.6	0.6	0.6	0.6	1.1	0.2	3.0%	2.8%	2.3%	2.0%	3.1%	2.6%
Increase in value of insurance	0.4	0.6	0.7	0.7	0.7	0.1	2.0%	2.7%	2.5%	2.3%	2.0%	1.7%
Card fees	0.2	0.2	0.2	0.2	0.2	0.1	0.7%	0.8%	0.8%	0.7%	0.6%	0.6%
Other noninterest income	0.2	0.1	0.3	0.5	0.7	0.2	0.8%	0.6%	0.9%	1.5%	2.1%	2.1%
Investment gain (loss)	-----	-----	-----	-----	0.3	-----	-----	-----	-----	-----	0.9%	-----
Total noninterest income	3.3	3.7	4.4	5.1	6.4	1.6	15.5%	16.2%	16.0%	16.3%	18.7%	17.2%

In total, noninterest income has grown at an 18.5% compound annual growth rate (CAGR) since 2005, and has contributed to a 13.1% CAGR for total net revenues. This is about a percentage point below the 14.2% CAGR of noninterest expense, which has been inflated by costs associated with weaker asset quality (collateral liquidation costs and net loss on foreclosed properties) and increased FDIC insurance premiums, stemming from the financial crisis in the US. Excluding these items, noninterest expense would have grown at a compound annual rate of 9.0%, or about 4 percentage points lower than that for total net revenues.

Thus, the Company has displayed strong cost control over its recurring expense base. This is most clearly demonstrated when viewing compensation expense, the largest component of noninterest expense, which fell from a recent peak of 43.9% of net revenues in 2007 to 35.8% of net revenues in 2009. This reflects expansion of the payroll as the Company added a significant amount of staff from 2006 through early 2008 to beef up business development, followed by a drop in headcount in 2009 and decreasing bonus accruals over the 2008-2009 period, the result of declining Company performance. In the first quarter of 2010, this trend began to reverse, and compensation expense rose to 36.9% of net revenues, reflecting higher base salaries and bonuses on improved Company performance metrics.

Also noteworthy is the large jump in FDIC insurance premiums, which were only nominal until 2009, when the FDIC enacted new regulations calling for increased premiums to replenish FDIC coffers. This consisted of a special $0.5 million in 2009's second quarter and a 2009 prepayment of $5.4 million for 2010-2012 premiums, which FBIZ is amortizing over 2010-2012 period. As a result, FDIC insurance premiums rose from 1.9% of net revenues in 2008 to 8.3% of net revenues in the first quarter of 2010.

Noninterest Expense	Amount ($ in Millions) 2005	2006	2007	2008	2009	1Q'10	% of Net Revenues 2005	2006	2007	2008	2009	1Q'10
Compensation	8.5	9.3	12.1	12.4	12.4	3.5	40.4%	41.0%	43.9%	39.5%	35.8%	36.9%
Occupancy	1.0	1.0	1.0	1.3	1.5	0.4	4.5%	4.4%	3.8%	4.3%	4.3%	3.9%
Equipment	0.4	0.5	0.5	0.7	0.6	0.1	2.1%	2.3%	1.8%	2.1%	1.7%	1.5%
Data processing	0.8	1.0	1.1	1.0	1.1	0.3	3.8%	4.4%	3.8%	3.1%	3.3%	3.2%
Marketing	0.8	0.9	1.1	1.0	0.6	0.2	3.8%	4.1%	3.9%	3.1%	1.8%	2.1%
Professional fees	1.4	1.3	1.4	1.7	1.6	0.5	6.6%	5.7%	5.1%	5.5%	4.8%	5.5%
Collateral liquidation costs	-----	-----	-----	0.0	1.3	0.2	-----	-----	-----	0.1%	3.9%	2.3%
FDIC insurance	-----	-----	-----	0.6	2.2	0.8	-----	-----	-----	1.9%	6.3%	8.3%
Net loss on foreclosed properties	-----	-----	-----	1.0	0.7	0.1	-----	-----	-----	3.3%	2.0%	1.2%
Other noninterest expense	1.5	1.7	2.5	2.2	2.5	0.4	7.2%	7.4%	8.9%	6.9%	7.2%	4.2%
Total noninterest expense	14.4	15.7	19.7	21.9	24.5	6.5	**68.4%**	**69.3%**	**71.2%**	**69.8%**	**71.1%**	**69.1%**

However, the biggest reason for steadily declining net income, which has decreased at a 29.1% compound rate to $1.0 million in 2009 from $4.1 million in 2005, is the startling increase in loan loss

provisions, the result of deteriorating asset quality stemming from the recession. Loan loss provisions rose from $0.4 million in 2005 to $8.2 million in 2009, or as a percentage of net revenues from 1.9% in 2005 to 23.9% in 2009. Positively, in 2010's first quarter, the loan loss provision fell 39% year over year to $1.3 million, or 14.2% of net revenue, and net income grew to $0.9 million from a net loss of $0.2 million in the year-ago quarter.

As to profitability measures, both return on average equity (ROE) and return on average assets (ROA) are weak and have steadily declined due to slumping net income, primarily the result of costs associated with deteriorating asset quality and higher FDIC insurance premiums. Thus, ROE has fallen to 1.9% in 2009 from 10.2% in 2005 and ROA to 0.10% from 10.19% over this period. Notably, 2010's first quarter witnessed the beginnings of a turnaround as net income rose and ROE and ROA along with it--to 6.5% and 0.33%, respectively.

RECENT NEWS

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.

MANAGEMENT, INSIDER TRADING, AND OWNERSHIP

Below is a list of top management of First Business Financial Services, Inc., as contained in the Company's 2009 Form 10-K.

Corey A. Chambas, age 47, has served as the President and Chief Executive Officer of First Business Financial Services, Inc. since December 2006. Mr. Chambas joined the Corporation in 1993 and has held various positions including Chief Operating Officer, Executive Vice President, and Chief Executive Officer of First Business Bank. Mr. Chambas has over 25 years of commercial banking experience. Prior to joining the Corporation, he was a Vice President of Commercial Lending with M&I Bank in Madison, Wisconsin.

James F. Ropella, age 50, has served as Senior Vice President and Chief Financial Officer of the Corporation since September 2000. Mr. Ropella also serves as the Chief Financial Officer of the subsidiaries of the Corporation. Mr. Ropella has 22 years of experience in finance and accounting, primarily in the banking industry. Prior to joining First Business Financial Services, Inc., Mr. Ropella was Treasurer of a consumer products company. Prior to that, he was Treasurer of Firstar Corporation, now known as US Bank.

Michael J. Losenegger, age 52, has served as Chief Operating Officer of First Business Financial Services, Inc. since September 2006. Mr. Losenegger joined the Corporation in 2003 and has held various positions with First Business Bank including Chief Executive Officer, Chief Operating Officer and Senior Vice President of Business Development. Mr. Losenegger has over 23 years of experience in commercial lending. Prior to joining the Corporation, Mr. Losenegger was Senior Vice President of Lending at M&I Bank in Madison, Wisconsin.

Barbara M. Conley, age 56, joined First Business Financial Services, Inc. in December 2007 as Senior Vice President, General Counsel and Corporate Secretary. Ms. Conley has over 25 years of experience in commercial banking. Directly prior to joining the Corporation in 2007, Ms. Conley was a Senior Vice President in Corporate Banking with Associated Bank. She had been employed at Associated Bank since May 1976.

Mark J. Meloy, age 48, has served as President and Chief Executive Officer of First Business Bank since December 2007. Mr. Meloy joined the Corporation in 2000 and has held various positions including Executive Vice President of First Business Bank and President and Chief Executive Officer of First Business Bank – Milwaukee. Mr. Meloy has over 25 years of commercial lending experience. Prior to joining the Corporation, Mr. Meloy was a Vice President and Senior Relationship Manager with Firstar Bank, NA, Cedar Rapids, Iowa and Milwaukee, Wisconsin, working in their financial institutions group with mergers and acquisition financing.

Joan A. Burke, age 58, has served as President of First Business Bank's Trust Division since September 2001. Ms. Burke has over 30 years of experience in providing trust and investment advice. Prior to joining the Corporation, Ms. Burke was the President, Chief Executive Officer and Chairperson of the Board of Johnson Trust Company and certain of its affiliates.

Charles H. Batson, age 56, has served as the President and Chief Executive Officer of First Business Capital Corp since January 2006. Mr. Batson has 32 years of experience in asset-based lending. Directly prior to joining First Business Capital Corp., Mr. Batson served as Vice President and Business Development Manager for Wells Fargo Business Credit, Inc. since 1990.

David J. Vetta, age 55, has served as President and Chief Executive Officer of First Business Bank-Milwaukee since January 2007. Directly prior to joining First Business Bank – Milwaukee, Mr. Vetta was Managing Director at JP Morgan Chase since 1992 and affiliated with JP Morgan Chase and its predecessor companies since 1976.

Institutional holders own about 3% of outstanding shares. The four institutional shareholders include Dimensional Fund Advisors LP (2.03% of the total shares outstanding at December 31, 2009), Fiduciary Management, Inc. (0.98%), UBS AG (0.13%), and U.S. Bancorp (0.04%).

Insiders own roughly 20% of the Company's total shares outstanding, and were net purchasers of 2,100 shares during the prior six months, representing approximately 0.3% of total insider shares held.

PEER COMPARISONS

Peer comparisons with First Business for the quarter ending March 31, 2010 are shown in the table below. Several items are noteworthy. First, FBIZ's asset quality measures are among the best for this group (except for QCR Holdings)—its net-charge-off ratio is 0.06%, its level of nonperforming assets to loans and related assets is 3.85%, and its loan loss allowance is commensurate with the level of risk in its loan portfolio. Second, FBIZ's capital adequacy metrics are significantly worse than those for the bank holding companies listed on this table, as demonstrated by its Tier 1 capital ratio of 6.71% and Tier 1 leverage ratio of 5.59%, with its next nearest competitor, QCR Holdings, posting ratios of 11.18% and 8.71%, respectively. This means that FBIZ has a smaller cushion of protection during periods of adversity. Finally, FBIZ's return on equity compares favorably with its competitors (except for West Bancorp.), in part due to the higher degree of leverage FBIZ employs.

Quarter Ending March 31, 2010	**First Business FBIZ**	Guaranty Federal GFED	Mackinac Financial MFNC	QCR Holdings QCRH	West Bancorp. WTBA
Total loans	**$855.2**	$517.6	$377.3	$1,238.6	$992.1
Total assets	**$1,101.8**	$734.4	$502.2	$1,832.2	$1,691.3
Net income	**$0.9**	$0.5	$0.3**	$1.2	$3.3
ROE (annualized)	**6.46%**	3.69%	0.54%**	1.53%	10.04%
ROA (annualized)	**0.33%**	0.27%	0.06%**	0.29%	0.83%
Net interest margin	**3.00%**	2.41%	3.51%	3.07%	2.84%
Efficiency ratio	**69.06%**	68.60%	78.12%	79.49%	46.05%
Net charge-offs % avg loans (annualized)	**0.06%**	N/A	0.36%	0.10%	0.08%
Nonperforming assts % loans+related assts	**3.85%**	7.32%	4.58%	3.44%	5.53%
Loan loss allowance % loans	**1.79%**	2.40%	1.26%	1.85%	2.04%
Tier 1 capital ratio	**6.71%**	11.20%*	12.48%	11.18%	13.50%
Tier 1 leverage ratio	**5.59%**	8.80%*	9.85%	8.71%	9.70%

* At December 31, 2010
** Excludes tax benefit

PROJECTIONS

Our annual and quarterly projections are shown on pages 18 and 19, respectively. We are estimating 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. Key highlights include:

- A net interest margin of 3.00%, the same as that achieved in 2010's first quarter, throughout the forecast period, up 23 basis points from 2.77% in 2009, as there are several countervailing factors at work. FBIZ's balance sheet is currently asset-sensitive, meaning there are a greater amount of assets that reprice than liabilities, which will increase net interest income and the net interest margin in a rising interest rate environment. However, the impact of this will be lessened somewhat since current interest-rate floors on the floating-rate portion of the loan portfolio (about one-fourth of total loans) are above market interest rates, meaning that interest rates on these loans are capped, at least initially. With rising rates on certain FBIZ liabilities, margins on the floating rate loan portfolio would normally be squeezed. But, FBIZ believes it can hold the line on interest rates it must pay for these liabilities, thereby partly offsetting the impact of interest-rate floors on affected loans.
- Essentially no loan growth in 2010, followed by a 6% gain in loans outstanding in 2011.
- Continuing, though slowing, asset quality deterioration throughout 2010, with modest improvement expected in 2011.
- A decrease in the loan loss provision from $8.2 million in 2009 to $7.1 million in 2010 and $6.6 million in 2011.
- Slight improvement in the efficiency ratio, falling to 71% in 2010-2011 from 72% in 2009.
- A reduction in the effective tax rate to 38% beginning in 2010's fourth quarter from 43.4% in 2010's first quarter following expected resolution of a tax matter with the Wisconsin Department of Revenue about taxation of FBIZ's Nevada investment subsidiaries.
- No change in the $0.28 annual dividend through 2011, as we believe FBIZ will use retained earnings to support future loan growth. The Company's internal rate of growth, based upon median values for ROE and dividend payout over the last five years, is about 5 ½%. Long-term asset growth in excess of this rate will result in higher leverage. Since FBIZ is committed to remaining well capitalized as defined under FDIC regulations, we would expect the Company to take steps to alleviate balance sheet pressure, including the potential sale of additional common stock, if necessary.

Major risks include:

- A halt in the fledgling recovery in the US, which would depress loan demand and hurt asset quality.
- Greater-than-expected asset quality deterioration due to weaker-than-expected real estate markets.
- Reliance on confidence-sensitive brokered deposits, currently representing about one-half of the Company's total deposit base.
- Political risk, including increased regulation.

VALUATION

FBIZ stock has underperformed the industry, with a year-to-date price gain of only 9.0% compared to a median increase of 16.6% 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 27% in 2010 and 42% in 2011, 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 0.5X versus the industry median of 0.6X. This represents a 25% 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, or up about 14 ½% from its current level. Combined with the dividend yield, this results in a total return of almost 16% over the next six months. Thus, we are initiating coverage on FBIZ with an Outperform rating and a six-month price target of $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	**9.0**	**12.5**	**11.7**	**8.4**	**14.2**	**0.5**	**3.9**	**6.7**	**0.20**	**0.39**	**2.7**
S&P 500	5.1	29.6	14.7	12.6	18.7	3.3	23.9	-----	8.3	-----	1.9
Median	**16.6**	**18.7**	**16.1**	**14.6**	**15.7**	**0.6**	**1.0**	**6.2**	**0.09**	**0.58**	**-----**
Average	34.4	20.9	31.6	17.3	18.1	0.8	(8.5)	5.4	(0.27)	0.60	1.3
High	405.4	57.5	298.0	45.6	33.3	1.7	11.7	17.3	2.48	2.76	5.6
Low	(24.0)	4.7	10.1	8.1	10.9	0.2	(148.8)	(14.2)	(5.13)	(0.93)	-----

*Trailing twelve months

First Business Financial Services, Inc.

Income Statement and Balance Sheet

(Dollars in millions, except per share data)

Summary Financial Data	12/05	12/06	12/07	12/08	12/09	12/10 E	12/11 E
Net interest income	17.7	18.9	23.2	26.3	28.1	32.1	33.0
Non-interest income	3.3	3.7	4.4	5.1	6.4	6.5	6.8
Total net revenue	21.0	22.6	27.6	31.4	34.5	38.6	39.8
Loan loss provision	0.4	1.5	2.9	4.3	8.2	7.1	6.6
Non-interest expense	14.4	15.7	19.7	21.9	24.5	27.5	28.3
Income taxes & other	2.1	1.7	1.7	2.1	0.8	1.8	1.8
Zacks adjusted income before NRI	4.1	3.7	3.3	3.1	1.0	2.2	3.1
GAAP net income	4.8	3.7	3.3	3.1	1.0	2.2	3.1
Diluted EPS before NRI	1.67	1.52	1.32	1.28	0.41	0.90	1.25
Reported EPS	1.93	1.52	1.32	1.28	0.41	0.90	1.25
Dividends per share	0.06	0.24	0.26	0.28	0.28	0.28	0.28
Liquid assets	108.5	119.3	114.9	132.8	235.0	218.3	205.5
Loans & leases, gross	539.7	648.3	781.6	852.8	854.5	857.8	910.4
Total assets	669.2	788.3	918.4	1,010.8	1,117.4	1,105.1	1,150.0
Core deposits	516.5	604.3	703.6	746.4	942.2	927.9	966.5
Purchased funds	73.2	88.4	105.0	129.5	58.2	60.0	60.0
Long-term debt	27.8	40.5	49.5	67.8	51.8	50.0	50.0
Shareholders' equity	41.8	45.8	48.6	53.0	54.4	56.3	58.7
Profitability							
Return on avg assets	0.67%	0.54%	0.39%	0.32%	0.10%	0.20%	0.28%
Return on avg equity	10.19%	8.65%	6.86%	6.11%	1.90%	3.99%	5.42%
Net interest margin	3.03%	2.87%	2.87%	2.81%	2.77%	3.00%	3.00%
Loan loss provision % avg assets	0.07%	0.22%	0.35%	0.44%	0.78%	0.65%	0.58%
Noninterest income % avg assets	0.54%	0.53%	0.53%	0.53%	0.61%	0.59%	0.60%
Noninterest expense % avg assets	2.36%	2.27%	2.34%	2.26%	2.33%	2.49%	2.51%
Preprovision pretax income % avg assets	1.09%	1.00%	0.95%	0.98%	0.95%	1.01%	1.03%
Tangible efficiency ratio	68%	69%	71%	70%	72%	71%	71%
Payout ratio	3%	16%	20%	22%	66%	31%	22%
Asset Quality							
Net charge-offs % avg loans	0.00%	(0.00)%	0.19%	0.28%	0.69%	0.59%	0.55%
Allowance % loans	1.25%	1.28%	1.26%	1.39%	1.65%	1.89%	1.97%
NPAs % loans & related assets	0.29%	0.17%	1.22%	2.25%	3.45%	4.17%	3.70%
Allowance % NPAs	439%	748%	103%	61%	48%	45%	53%
Liquidity & Funding							
Liquid assets % purchased funds	148%	135%	109%	103%	404%	364%	343%
Core deposits % loans	96%	93%	90%	88%	110%	108%	106%
Liquid assets % assets	16%	15%	13%	13%	21%	20%	18%
Loans % assets	81%	82%	85%	84%	76%	78%	79%
Capital Adequacy							
Total equity % assets	6.25%	5.80%	5.29%	5.24%	4.87%	5.09%	5.10%
Tangible equity % assets	5.85%	5.47%	5.00%	4.98%	4.63%	4.86%	4.88%
Tier 1 capital ratio	8.45%	6.24%	5.42%	6.48%	6.61%		
Total capital ratio	10.43%	10.40%	10.22%	12.00%	12.15%		
Parent Company Statistics							
Interest coverage	(1.2)X	(0.9)X	(1.1)X	(0.9)X	0.3X	0.3X	0.3X
Interest & dividend coverage	(1.1)X	(0.7)X	(0.9)X	(0.7)X	0.2X	0.3X	0.3X
Short-term debt coverage	8.7X	19.2X	16.9X	Lge	Lge	Lge	Lge
Total debt coverage	1.3X	1.4X	1.1X	0.9X	1.0X	1.0X	1.1X
Double leverage	144.0%	150.2%	169.1%	185.6%	187.0%	184.7%	182.4%

First Business Financial Services, Inc.

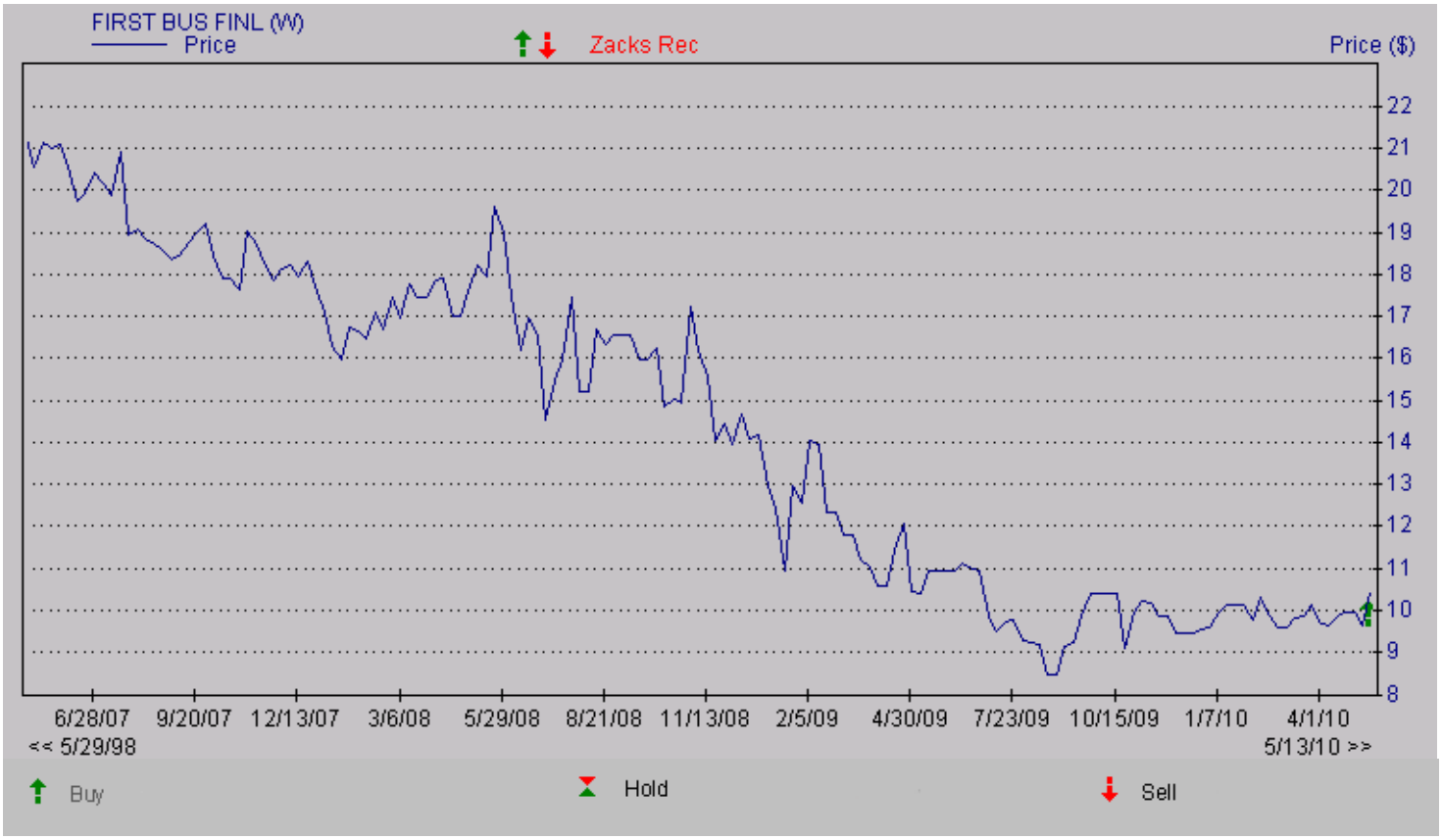
Income Statement and Balance Sheet

(Dollars in millions, except per share data)

	2009				2010			
Summary Financial Data	**Q1 A**	**Q2 A**	**Q3 A**	**Q4 A**	**Q1 A**	**Q2 E**	**Q3 E**	**Q4 E**
Net interest income	6.4	6.8	7.3	7.4	7.9	8.1	8.1	8.1
Non-interest income	1.6	1.5	1.9	1.5	1.6	1.6	1.6	1.6
Total net revenue	8.0	8.3	9.2	8.9	9.5	9.7	9.7	9.7
Loan loss provision	2.2	1.6	1.4	3.0	1.3	1.5	1.6	2.8
Non-interest expense	6.2	6.3	5.5	6.6	6.5	6.9	6.8	7.1
Income taxes & other	(0.2)	0.1	0.9	(0.3)	0.8	0.6	0.6	(0.1)
Zacks adjusted income before NRI	(0.2)	0.3	1.4	(0.4)	0.9	0.7	0.7	(0.1)
GAAP net income	(0.2)	0.3	1.4	(0.4)	0.9	0.7	0.7	(0.1)
Diluted EPS before NRI	(0.08)	0.10	0.53	(0.14)	0.35	0.30	0.30	(0.05)
Reported EPS	(0.08)	0.10	0.53	(0.14)	0.35	0.30	0.30	(0.05)
Dividends per share	0.07	0.07	0.07	0.07	0.07	0.07	0.07	0.07
Liquid assets	139.6	172.6	178.1	235.0	219.0	218.8	218.5	218.3
Loans & leases, gross	861.9	858.9	871.1	854.5	855.2	856.0	856.9	857.8
Total assets	1,026.0	1,055.5	1,073.7	1,117.4	1,101.8	1,102.9	1,104.0	1,105.1
Core deposits	797.9	829.8	844.2	942.2	922.3	924.7	927.0	927.9
Purchased funds	92.5	92.5	108.5	58.2	60.2	60.0	60.0	60.0
Long-term debt	67.8	67.8	51.8	51.8	49.8	50.0	50.0	50.0
Shareholders' equity	53.4	53.5	55.1	54.4	55.5	56.0	56.6	56.3
Profitability								
Return on avg assets*	(0.08)%	0.10%	0.51%	(0.14)%	0.33%	0.26%	0.27%	(0.04)%
Return on avg equity *	(1.43)%	1.92%	9.88%	(2.71)%	6.46%	5.11%	5.28%	(0.84)%
Net interest margin	2.65%	2.72%	2.88%	2.77%	3.00%	3.00%	3.00%	3.00%
Loan loss provision % avg assets*	0.87%	0.63%	0.52%	1.10%	0.49%	0.54%	0.56%	1.00%
Noninterest income % avg assets*	0.62%	0.56%	0.71%	0.56%	0.59%	0.59%	0.59%	0.59%
Noninterest expense % avg assets*	2.43%	2.40%	2.09%	2.40%	2.39%	2.52%	2.48%	2.59%
Preprovision pretax inc.% avg assets*	0.74%	0.78%	1.39%	0.86%	1.07%	1.00%	1.03%	0.93%
Tangible efficiency ratio	77%	75%	62%	74%	69%	72%	71%	74%
Payout ratio	(89)%	66%	13%	(46)%	19%	24%	23%	(147)%
Asset Quality								
Net charge-offs % avg loans*	0.52%	0.88%	0.58%	0.78%	0.06%	0.65%	0.70%	0.93%
Allowance % loans	1.50%	1.48%	1.47%	1.65%	1.79%	1.80%	1.81%	1.89%
NPAs % loans & related assets	2.53%	2.75%	2.78%	3.45%	3.85%	3.94%	4.06%	4.17%
Allowance % NPAs	59%	54%	53%	48%	47%	46%	44%	45%
Liquidity & Funding								
Liquid assets % purchased funds	151%	187%	164%	404%	364%	365%	364%	364%
Core deposits % loans	93%	97%	97%	110%	108%	108%	108%	108%
Liquid assets % assets	14%	16%	17%	21%	20%	20%	20%	20%
Loans % assets	84%	81%	81%	76%	78%	78%	78%	78%
Capital Adequacy								
Total equity % assets	5.20%	5.07%	5.13%	4.87%	5.04%	5.08%	5.13%	5.09%
Tangible equity % assets	4.95%	4.82%	4.88%	4.63%	4.80%	4.84%	4.89%	4.86%
Tier 1 capital ratio	6.34%	6.52%	6.62%	6.61%	6.71%			
Total capital ratio	11.78%	12.06	12.15	12.15%	12.25			

*Annualized.

HISTORICAL ZACKS RECOMMENDATIONS



DISCLOSURES

The analysts contributing to this report do not hold any shares of FBIZ. Zacks EPS and revenue forecasts are not consensus forecasts. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts' personal views as to the subject securities and issuers. Zacks certifies that no part of the analysts' compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report. Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Because of individual objectives, the report should not be construed as advice designed to meet the particular investment needs of any investor. Any opinions expressed herein are subject to change. This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. Zacks or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. Zacks uses the following rating system for the securities it covers. **Outperform**- Zacks expects that the subject company will outperform the broader U.S. equity market over the next one to two quarters. **Neutral**- Zacks expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters. **Underperform**- Zacks expects the company will under perform the broader U.S. Equity market over the next one to two quarters. The current distribution of Zacks Ratings is as follows on the 988 companies covered: Outperform- 13.3%, Neutral- 79.0%, Underperform – 7.1%. Data is as of midnight on the business day immediately prior to this publication.