

FIRST BUSINESS FINANCIAL SERVICES, INC.

Form 10-Q

April 26, 2013

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the quarterly period ended March 31, 2013

OR

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

Commission file number 001-34095

FIRST BUSINESS FINANCIAL SERVICES, INC.

(Exact name of registrant as specified in its charter)

Wisconsin

39-1576570

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

401 Charmany Drive Madison, WI

53719

(Address of Principal Executive Offices)

(Zip Code)

(608) 238-8008

Registrant's telephone number, including area code

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities and Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

The number of shares outstanding of the registrant's sole class of common stock, par value \$0.01 per share, on April 18, 2013 was 3,918,758 shares.

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PART I. Financial Information

Item 1. Financial Statements

First Business Financial Services, Inc.

Consolidated Balance Sheets

	March 31, 2013 (unaudited)	December 31, 2012
	(In Thousands, Except Share Data)	
Assets		
Cash and due from banks	\$12,769	\$21,626
Short-term investments	62,443	63,960
Cash and cash equivalents	75,212	85,586
Securities available-for-sale, at fair value	201,804	200,596
Loans and leases receivable, net of allowance for loan and lease losses of \$15,507 and \$15,400, respectively	901,149	896,560
Leasehold improvements and equipment, net	1,128	968
Foreclosed properties	905	1,574
Cash surrender value of bank-owned life insurance	22,479	22,272
Investment in Federal Home Loan Bank stock, at cost	1,144	1,144
Accrued interest receivable and other assets	16,466	17,408
Total assets	\$1,220,287	\$1,226,108
Liabilities and Stockholders' Equity		
Deposits		
Federal Home Loan Bank and other borrowings	\$1,071,786	\$1,092,254
Junior subordinated notes	26,936	12,405
Accrued interest payable and other liabilities	10,315	10,315
Total liabilities	9,103	11,595
Commitments and contingencies	1,118,140	1,126,569
Stockholders' equity:		
Preferred stock, \$0.01 par value, 2,500,000 shares authorized, none issued or outstanding	—	—
Common stock, \$0.01 par value, 25,000,000 shares authorized, 4,063,070 and 4,011,370 shares issued, 3,918,758 and 3,916,667 shares outstanding at March 31, 2013 and December 31, 2012, respectively	41	40
Additional paid-in capital	54,790	53,504
Retained earnings	48,294	45,599
Accumulated other comprehensive income	1,982	2,183
Treasury stock (144,312 and 94,703 shares at March 31, 2013 and December 31, 2012, respectively), at cost	(2,960) (1,787
Total stockholders' equity	102,147	99,539
Total liabilities and stockholders' equity	\$1,220,287	\$1,226,108

See accompanying Notes to Unaudited Consolidated Financial Statements.

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First Business Financial Services, Inc.

Consolidated Statements of Income (Unaudited)

	For the Three Months Ended March 31,	
	2013	2012
	(In Thousands, Except Per Share Data)	
Interest income:		
Loans and leases	\$ 12,453	\$ 12,726
Securities income	810	831
Short-term investments	56	76
Total interest income	13,319	13,633
Interest expense:		
Deposits	2,598	3,744
Notes payable and other borrowings	218	686
Junior subordinated notes	274	277
Total interest expense	3,090	4,707
Net interest income	10,229	8,926
Provision for loan and lease losses	80	504
Net interest income after provision for loan and lease losses	10,149	8,422
Non-interest income:		
Trust and investment services fee income	827	687
Service charges on deposits	483	479
Loan fees	358	398
Increase in cash surrender value of bank-owned life insurance	207	170
Credit, merchant and debit card fees	33	55
Other	45	61
Total non-interest income	1,953	1,850
Non-interest expense:		
Compensation	4,726	4,005
Occupancy	328	332
Professional fees	572	432
Data processing	402	317
Marketing	285	266
Equipment	139	112
FDIC insurance	205	587
Net collateral liquidation (recoveries) costs	(14) 108
Net (gain) loss on foreclosed properties	(30) 175
Other	565	498
Total non-interest expense	7,178	6,832
Income before income tax expense	4,924	3,440
Income tax expense	1,680	1,230
Net income	\$3,244	\$2,210
Earnings per common share:		
Basic	\$0.83	\$0.84
Diluted	0.83	0.84
Dividends declared per share	0.14	0.07

See accompanying Notes to Unaudited Consolidated Financial Statements.

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First Business Financial Services, Inc.
 Consolidated Statements of Comprehensive Income (Unaudited)

	For the Three Months Ended March 31,	
	2013	2012
	(In Thousands)	
Net income	\$3,244	\$2,210
Other comprehensive income, before tax		
Unrealized securities (losses) gains arising during the period	(305) 102
Income tax benefit (expense)	104	(39
Comprehensive income	\$3,043	\$2,273

See accompanying Notes to Unaudited Consolidated Financial Statements.

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First Business Financial Services, Inc.

Consolidated Statements of Changes in Stockholders' Equity (Unaudited)

	Common shares outstanding	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Treasury stock	Total
(In Thousands, Except Share Data)							
Balance at December 31, 2011	2,625,569	\$27	\$25,843	\$37,501	\$ 2,491	\$(1,648)	\$64,214
Net income	—	—	—	2,210	—	—	2,210
Other comprehensive income	—	—	—	—	63	—	63
Share-based compensation - restricted shares	—	—	134	—	—	—	134
Share-based compensation - tax benefits	—	—	1	—	—	—	1
Cash dividends (\$0.07 per share)	—	—	—	(184)	—	—	(184)
Treasury stock purchased	(281)	—	—	—	—	(4)	(4)
Balance at March 31, 2012	2,625,288	\$27	\$25,978	\$39,527	\$ 2,554	\$(1,652)	\$66,434

	Common shares outstanding	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Treasury stock	Total
(In Thousands, Except Share Data)							
Balance at December 31, 2012	3,916,667	\$40	\$53,504	\$45,599	\$ 2,183	\$(1,787)	\$99,539
Net income	—	—	—	3,244	—	—	3,244
Other comprehensive income	—	—	—	—	(201)	—	(201)
Exercise of stock options	51,700	1	1,137	—	—	—	1,138
Share-based compensation - restricted shares	—	—	145	—	—	—	145
Share-based compensation - tax benefits	—	—	4	—	—	—	4
Cash dividends (\$0.14 per share)	—	—	—	(549)	—	—	(549)
Treasury stock purchased	(49,609)	—	—	—	—	(1,173)	(1,173)
Balance at March 31, 2013	3,918,758	\$41	\$54,790	\$48,294	\$ 1,982	\$(2,960)	\$102,147

See accompanying Notes to Unaudited Consolidated Financial Statements.

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First Business Financial Services, Inc.

Consolidated Statements of Cash Flows (Unaudited)

	For the Three Months Ended	
	March 31,	
	2013	2012
	(In Thousands)	
Operating activities		
Net income	\$3,244	\$2,210
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income taxes, net	(110)	(45)
Provision for loan and lease losses	80	504
Depreciation, amortization and accretion, net	691	781
Share-based compensation	145	134
Increase in cash surrender value of bank-owned life insurance	(207)	(170)
Origination of loans for sale	—	(402)
Net (gain) loss on foreclosed properties, including impairment valuation	(30)	175
Excess tax benefit from share-based compensation	(4)	(1)
Decrease in accrued interest receivable and other assets	973	1,200
Decrease in accrued interest payable and other liabilities	(2,761)	(1,022)
Net cash provided by operating activities	2,021	3,364
Investing activities		
Proceeds from maturities of available-for-sale securities	15,719	13,994
Purchases of available-for-sale securities	(17,829)	(14,746)
Proceeds from sale of foreclosed properties	699	657
Net (increase) decrease in loans and leases	(4,669)	18,102
Investment in limited partnerships	(500)	—
Distributions from limited partnerships	664	—
Proceeds from sale of FHLB Stock	—	619
Purchases of leasehold improvements and equipment, net	(236)	(228)
Net cash (used in) provided by investing activities	(6,152)	18,398
Financing activities		
Net decrease in deposits	(20,468)	(17,523)
Repayment of FHLB advances	(469)	(3)
Proceeds from FHLB advances	15,000	—
Net increase in short-term borrowed funds	—	1,209
Proceeds from issuance of subordinated notes payable	—	6,215
Repayment of subordinated notes payable	—	(6,215)
Excess tax benefit from share-based compensation	4	1
Cash dividends paid	(274)	(184)
Exercise of stock options	1,137	—
Purchase of treasury stock	(1,173)	(4)
Net cash used in financing activities	(6,243)	(16,504)
Net (decrease) increase in cash and cash equivalents	(10,374)	5,258
Cash and cash equivalents at the beginning of the period	85,586	130,093
Cash and cash equivalents at the end of the period	\$75,212	\$135,351
Supplementary cash flow information		
Interest paid on deposits and borrowings	\$2,995	\$4,528
Income taxes paid	1,974	600
Transfer to foreclosed properties	—	1,186

See accompanying Notes to Unaudited Consolidated Financial Statements.

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Notes to Unaudited Consolidated Financial Statements

Note 1 — Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations. The accounting and reporting practices of First Business Financial Services (the “Corporation”), its wholly-owned subsidiaries, First Business Bank (“FBB”) and First Business Bank – Milwaukee (“FBB – Milwaukee”) have been prepared in accordance with U.S. generally accepted accounting principles. FBB and FBB – Milwaukee are sometimes referred to together as the “Banks.” FBB operates as a commercial banking institution in the Madison, Wisconsin market, consisting primarily of Dane County and the surrounding areas, with loan production offices in Oshkosh, Appleton, and Green Bay, Wisconsin. FBB also offers trust and investment services through First Business Trust & Investments (“FBTI”), a division of FBB. FBB – Milwaukee operates as a commercial banking institution in the Milwaukee, Wisconsin market, consisting primarily of Waukesha County and the surrounding areas. The Banks provide a full range of financial services to businesses, business owners, executives, professionals and high net worth individuals. The Banks are subject to competition from other financial institutions and service providers and are also subject to state and federal regulations. FBB has the following subsidiaries: First Business Capital Corp. (“FBCC”), First Madison Investment Corp. (“FMIC”), First Business Equipment Finance, LLC (“FBEF”) and FBB Real Estate, LLC (“FBBRE”). FMIC is located in and was formed under the laws of the state of Nevada. FBB-Milwaukee has one subsidiary, FBB – Milwaukee Real Estate, LLC (“FBBMRE”).

Basis of Presentation. The accompanying unaudited consolidated financial statements were prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The unaudited Consolidated Financial Statements include the accounts of the Corporation and its wholly-owned subsidiaries. In accordance with the provisions of Accounting Standards Codification (“ASC”) Topic 810, the Corporation’s ownership interest in FBFS Statutory Trust II (“Trust II”) has not been consolidated into the financial statements. All significant intercompany balances and transactions have been eliminated in consolidation. Management of the Corporation is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements as well as reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. Material estimates that could experience significant changes in the near-term include the value of foreclosed property, lease residuals, property under operating leases, securities, income taxes and the level of the allowance for loan and lease losses. The results of operations for the three-month period ended March 31, 2013 are not necessarily indicative of results that may be expected for any other interim period or the entire fiscal year ending December 31, 2013. Certain amounts in prior periods may have been reclassified to conform to the current presentation. Subsequent events have been evaluated through the date of the issuance of the Consolidated Financial Statements. No significant subsequent events have occurred through this date requiring adjustment to the financial statements or disclosures.

The Corporation has not changed its significant accounting and reporting policies from those disclosed in the Corporation’s Form 10-K for the year ended December 31, 2012 except as described further below in this Note 1. Recent Accounting Pronouncements. In January 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-01, “Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities.” This ASU amends the scope of FASB ASU No. 2011-11, “Disclosures about Offsetting Assets and Liabilities,” which requires additional disclosure regarding offsetting of assets and liabilities to enable users of financial statements to evaluate the effect or potential effect of netting arrangements on an entity’s financial position. The provisions of the ASUs were effective for annual and interim reporting periods beginning on or after January 1, 2013. The Corporation’s disclosure under the ASU’s are provided in Note 9 - Derivative Financial Instruments. As the ASUs address financial statement disclosures only, their adoption effective January 1, 2013 did not impact the Corporation’s consolidated financial position or results of operations.

In February 2013, the FASB issued ASU No. 2013-02, “Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.” This ASU adds new disclosure requirements for items reclassified out of accumulated other

comprehensive income to be in a single location in the financial statements. The Corporation's disclosures of the components of accumulated other comprehensive income are disclosed in its Statement of Comprehensive Income. For the three months ended March 31, 2013, there were no items requiring reclassification out of accumulated other comprehensive income. The new guidance became effective for all interim and annual periods beginning January 1, 2013 and is to be applied prospectively. Since this ASU addresses financial statement disclosures only, the adoption of this guidance effective January 1, 2013 did not have an impact on the Corporation's consolidated financial position or results of operations.

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Note 2 — Earnings Per Common Share

Earnings per common share are computed using the two-class method. Basic earnings per common share are computed by dividing net income allocated to common shares by the weighted average number of shares outstanding during the applicable period, excluding outstanding participating securities. Participating securities include unvested restricted shares. Unvested restricted shares are considered participating securities because holders of these securities receive non-forfeitable dividends at the same rate as holders of the Corporation's common stock. Diluted earnings per share are computed by dividing net income allocated to common shares adjusted for reallocation of undistributed earnings of unvested restricted shares by the weighted average number of shares determined for the basic earnings per common share computation plus the dilutive effect of common stock equivalents using the treasury stock method. For the three month periods ended March 31, 2013 and 2012, average anti-dilutive employee share-based awards totaled 12,000 and 115,050, respectively.

	For the Three Months Ended March 31,	
	2013	2012
	(Dollars in Thousands, Except Share and Per Share Data)	
Basic earnings per common share		
Net income	\$3,244	\$2,210
Less: earnings allocated to participating securities	78	80
Basic earnings allocated to common shareholders	\$3,166	\$2,130
Weighted-average common shares outstanding, excluding participating securities	3,824,052	2,530,084
Basic earnings per common share	\$0.83	\$0.84
Diluted earnings per common share		
Earnings allocated to common shareholders	\$3,166	\$2,130
Reallocation of undistributed earnings	—	—
Diluted earnings allocated to common shareholders	\$3,166	\$2,130
Weighted-average common shares outstanding, excluding participating securities	3,824,052	2,530,084
Dilutive effect of share-based awards	5,519	863
Weighted-average diluted common shares outstanding, excluding participating securities	3,829,571	2,530,947
Diluted earnings per common share	\$0.83	\$0.84

Note 3 — Share-Based Compensation

The Corporation adopted the 2012 Equity Incentive Plan (the "Plan") during the quarter ended June 30, 2012. The Plan is administered by the Compensation Committee of the Board of Directors of the Corporation and provides for the grant of equity ownership opportunities through incentive stock options and nonqualified stock options (together, "Stock Options"), restricted stock, restricted stock units, dividend equivalent unit, and any other type of award permitted by the Plan. As of March 31, 2013, 218,115 shares were available for future grants under the Plan. Shares covered by awards that expire, terminate or lapse will again be available for the grant of awards under the Plan. The Corporation may issue new shares and shares from treasury for shares delivered under the Plan.

Stock Options

The Corporation may grant Stock Options to senior executives and other employees under the Plan. Stock Options generally have an exercise price that is equal to the fair value of the common shares on the date the option is awarded. Stock Options granted under the plans are subject to graded vesting, generally ranging from