

FSBW-FS Bancorp
Reiterating At “Outperform” and Increasing Price Target to \$60.00 (from \$54.00)

- **Increasing EPS Estimates to \$0.95 (+\$0.02) for 4Q-17, \$4.27 (+\$0.05) for '17, \$4.10 (+\$0.17) for '18, \$4.41 (+\$0.02) for '19**
- **Forecasting Strong Growth in Spread Income on Robust Loan Growth, High Percentage of Loans to Earning Assets**

Following release of the company’s 3Q-17 results, we are reiterating our rating on FSBW-FS Bancorp at “Outperform” and increasing our Price Target to \$60.00 (from \$54.00), as well as raising our forward EPS estimates to \$0.95 (from \$0.93) for 4Q-17, \$4.27 (from \$4.22) for 2017, \$4.10 (from \$3.93) for 2018 and \$4.41 (from \$4.39) for 2019. Our revised Price Target is equivalent to 15.1x our forward four quarter EPS estimate (\$3.97) and 175% of our forward tangible book value forecast (\$34.38).

FSBW reported 3Q-17 EPS of \$1.07, topping both our estimate of \$1.04 and the mean Consensus estimate of \$1.01. Results were highlighted by stronger than expected spread income and margin, marginally offset by higher operating costs and provision expense. We estimated Core Pre-Tax, Pre-Provision EPS of \$1.96 and Core Pre-Pre ROAA of 2.64%, compared to \$1.76 and 2.42% the previous quarter. Tangible book value increased 12.7% sequentially to \$31.16 and TCE-Tangible Common Equity ended the quarter at 11.56% of tangible assets. During the quarter, FSBW raised \$27.6 Mil in common equity by issuing 587,000 shares at \$47.00 per share, or 170% of trailing tangible book value.

Our forward estimates reflect ~20% annual growth in NII-Net Interest Income growth in 2018 and 2019 from a combination of robust loan growth (high teens on a percentage basis annually) and modest expansion in loan yields and NIM-Net Interest Margin. The company already benefits from a strong mix of average loans to average earning assets (85.6% in 3Q-17, up from 83.5% the previous quarter and 84.3% in the year ago quarter). In our opinion, the higher composition of high yielding earning assets (FSBW’s average loan yield of 5.84% is 400bps more than the average yield on securities) provides a base to drive stronger gains in spread income going forward.

In line with previous estimates, we do anticipate further growth in operating expenses. In the two previous years, non-interest expenses increased 20% and 34% and are on pace to grow 15% in 2017. We forecast expense growth of 11% in 2018 and 14% in 2019 as management adds lenders and incrementally expands product offerings. However, expenses as a percentage of average assets is declining. The ratio was 4.82% in 3Q-17, down from the trailing four quarter average of 4.93%. While we anticipate continued improvements in the overhead ratio, we do not anticipate the current ratio matches the trailing historical average until early 2019. Still, the growth in spread income, in addition to modest declines in gain on sale revenue from mortgage loans, should result in a lower, more consistent efficiency ratio going forward.

Please see important disclosures regarding FIG Partners’ equity rating system, distribution of ratings, and other report disclosures on the last page of this report.

FSBW: \$54.39

“Outperform” // Price Target: \$60.00

Summary Statistics

Exchange	NASDAQ
Market Cap (\$M)	\$199.9
Avg. Volume	21,720
Annual Dividend	\$0.44
Dividend Yield	0.81%
Tangible Book/Share	\$31.16
Price/Tangible Book	175%
Price/2018 EPS	13.3x
Price/2019 EPS	12.3x
Total Assets (\$000)	\$993,891
TCE/TA	11.56%
ROTCE (2018)	11.56%
ROA (2018)	1.32%

EPS Estimates (Core in Blue)

	2016	2017	2018	2019
Q1	\$0.55	\$0.85	\$0.84	\$0.92
Q2	\$0.96	\$1.41	\$1.09	\$1.26
Q3	\$1.18	\$1.07	\$1.09	\$1.22
Q4	\$0.86	\$0.95	\$1.08	\$1.00
FY	\$3.51	\$4.27	\$4.10	\$4.41

Industry Type	Thrift
Headquarters	Mountlake Terrace, WA
Offices	12
Date Established	2012
CEO	Joseph C. Adams
CFO	Matthew D. Mullet



Below are additional details on the company's 3Q-17 results:

Spread Income and Margin: NII-Net Interest Income increased 10% sequentially to \$11 Mil and NIM-Net Interest Margin expanded 7bps to 4.70%. We had forecasted spread income of \$10.7 Mil and margin of 4.59%. Gross loans increased \$45.2 Mil, or 6.3% sequentially, to \$764 Mil with notable growth in SFR-Single Family Residential mortgages (up \$15.4 Mil), mortgage warehouse lending (up \$11.3 Mil) and C&D-Construction & Development loans (up \$10 Mil). Loan growth excluding mortgage warehouse lending was 5% sequentially. Average loans ended the quarter at \$803 Mil, or 85.6% of average earning assets, up from 83.5%. Loan yields expanded 6bps to 5.84%.

Total Funding: Total deposits increased 7% sequentially to \$840.6 Mil. Non-interest bearing deposits increased 2.2% sequentially to \$156 Mil, or 18.6% of total deposits, and non-CD deposits declined 0.4% sequentially to \$581 Mil, or 69.1% of total deposits. The company's average cost of interest-bearing deposits expanded 4bps to 0.51%. The cost of interest-bearing deposits are up 3bps since year-end 2016.

Credit Quality: FSBW booked a provision expense of \$450,000, due mainly to loan growth. NPA-Non-Performing Assets increased by \$500,000 to \$1.3 Mil, or 0.17% of Loans+OREO. The company also booked net recoveries of \$5,000. Reserves ended the quarter at \$10.6 Mil, or 1.39% of Loans and 815% of NPAs.

Non-Interest Items: Core non-interest income declined 6% sequentially to \$1.2 Mil, or 0.51% of average assets, down from the trailing four quarter average of 0.55%. The decline was the result of lower service fees and charges. FSBW also booked gains on the sale of mortgage loans of \$5 Mil, down from \$5.9 Mil in the year ago quarter. Loans sold were \$204.3 Mil, essentially in-line with \$205.1 Mil in the year ago quarter. The company also booked gains on the sale of securities of \$143,000 and on sale of MSRs of \$38,000. Non-interest expenses increased 6% sequentially to \$11.6 Mil, or 4.82% of average assets, down from the trailing average of 4.93%. We estimated the company's core efficiency ratio was 66.5%, compared to 69.0% the previous quarter.

FSBW (Mountlake Terrace, WA--\$200 Mil. Mkt. Cap, \$994 Mil. Assets, \$54.39, 0.8% Yld)

	2Q-2017	Δ	3Q-2017	Consensus	Variance Per Share
EPS	\$1.41	-	\$1.07	\$1.01	\$0.06
Operating/Core EPS	\$0.00	-	\$1.03		
FIG Estimate	\$0.00	-	\$1.04		
Net Interest Income (FTE)	10.0	10%	11.0	10.5	\$0.16
Loan Loss Provision	0.0	NA	0.5	0.4	(\$0.02)
Core Non-Interest Income (ex. sec.)	5.8	8%	6.2	5.9	\$0.11
Core Non-Interest Expense	10.9	5.9%	11.6	11.1	(\$0.16)
Net Charge-Offs	0.0	NA	0.0		na
NCOs % of Avg Loans (bps)	0	0bps	0	NA	na
Tangible Book Per Share*	\$27.64	12.7%	\$31.16	\$31.40	(\$0.24)
Net Interest Margin (FTE)	4.63%	7bps	4.70%	4.60%	0.10%
Total Loans (\$Mil.)	719.0	6.3%	764.0	749.0	15.0
TCE Ratio (TCE/TA)*	9.2%	237bps	11.6%		
NPAs % of Loans + OREO	0.11%	6bps	0.17%		

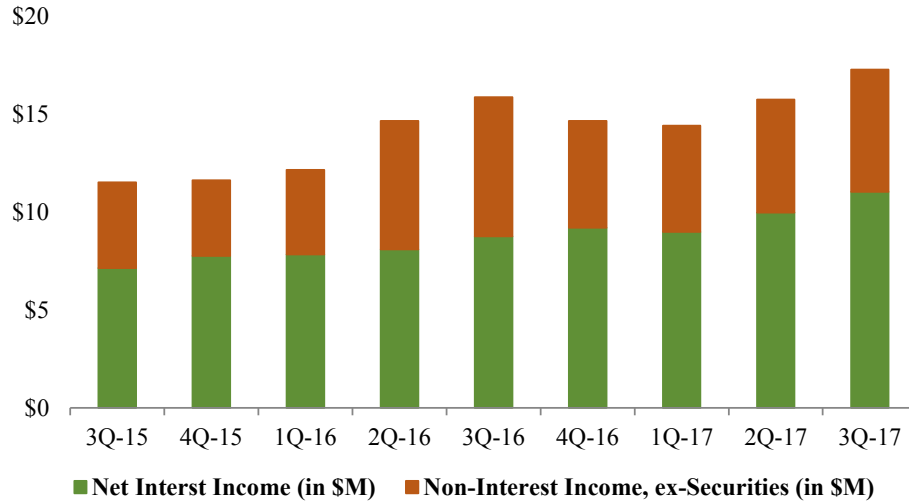
*As Reported by the company // [Core EPS add back non-recurring items](#)

Source: FIG Partners Research, Company Disclosure



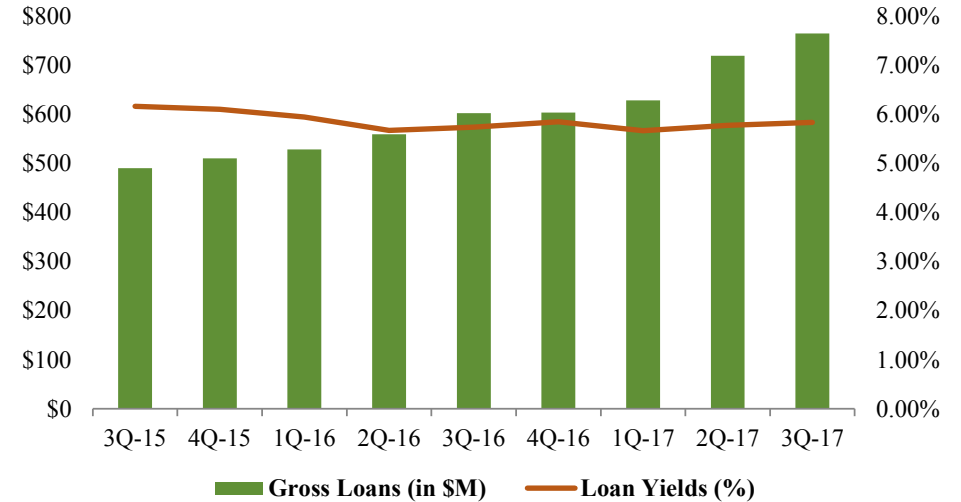
The charts on this page show important performance data for FSBW over the last two(2) years

Core Operating Revenue



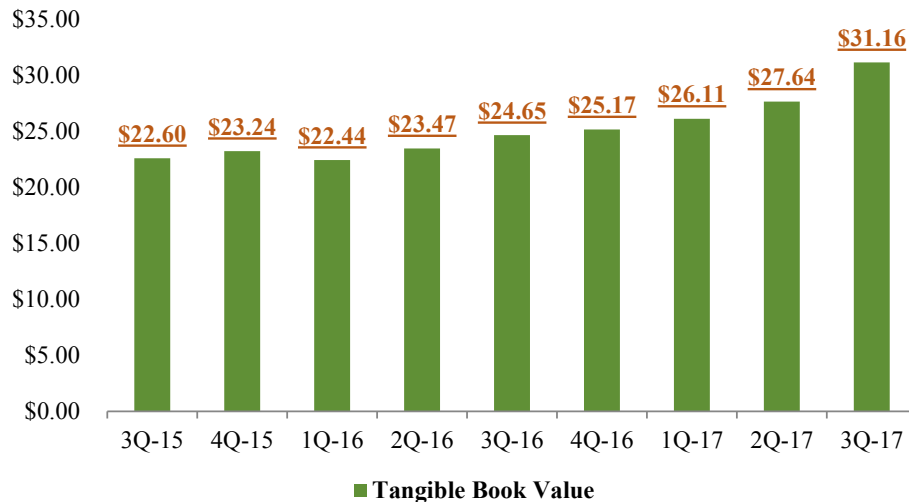
Source: FIG Partners Research, S&P Global Market Intelligence

Gross Loans and Loan Yields



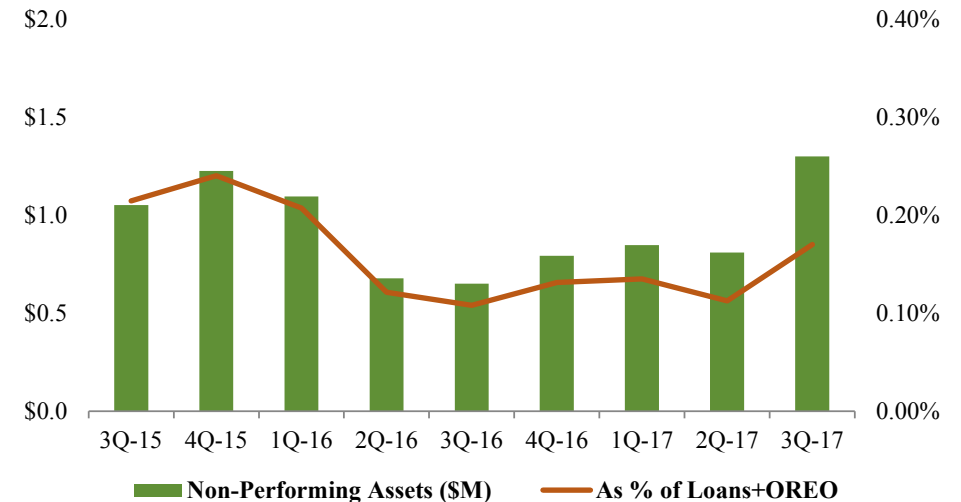
Source: FIG Partners Research, S&P Global Market Intelligence

Tangible Book Value Growth Since 3Q-15



Source: FIG Partners Research, S&P Global Market Intelligence

Credit Quality Trends



Source: FIG Partners Research, S&P Global Market Intelligence



FS Bancorp, Inc. (FSBW) - Price Target Analysis

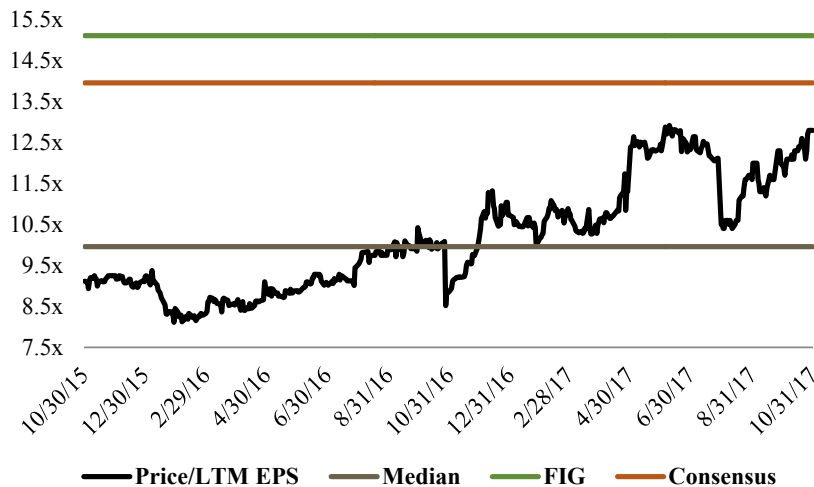
	4Q 2017	+	1Q 2018	+	2Q 2018	+	3Q 2018	=	1-Year Fwd Value	x	Terminal Multiple	=	1-Year Price Target
Earnings per Share	\$0.95		\$0.84		\$1.09		\$1.09		\$3.97		15.1x		\$60.00
Pre-Pre EPS	\$1.72		\$1.41		\$1.55		\$1.77		\$6.45		9.3x		\$60.00
Core EPS	\$0.95		\$0.84		\$1.09		\$1.09		\$3.97		15.1x		\$60.00
Tangible Book							\$34.38		\$34.38		1.75x		\$60.00

The charts below show FSBW's stock price relative to forward EPS and tangible book value over the last 2 years.

The horizontal lines show the two-year medians (grey line) and FIG estimated forward multiples (green).

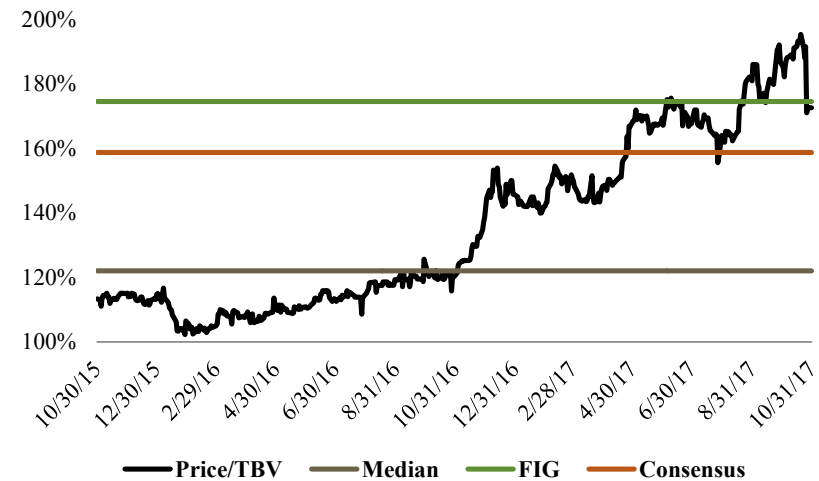
Source: FIG Partners Research

FSBW: Price to Forward EPS



Source: FIG Partners Research, S&P Global Market Intelligence

FSBW: Price to Tangible Book Value



Source: FIG Partners Research, S&P Global Market Intelligence

Key Risks

Risks to our analysis and recommendation of FS Bancorp include: (1) severe decline in residential real estate valuations, (2) overly competitive mortgage banking environment, (3) decline in economic activity in the Puget Sound region, and specifically in Snohomish County, WA, (4) weakened financial position of key contractors and dealers in the home improvement market and (5) substantial decline in credit quality.

Earnings Model

	Annual			2017 Quarterly				2018 Quarterly				2019 Quarterly			
	2017E	2018E	2019E	1Q17A	2Q17A	3Q17A	4Q17E	1Q18E	2Q18E	3Q18E	4Q18E	1Q19E	2Q19E	3Q19E	4Q19E
Income Data: (\$ in Millions)															
Net Interest Income (FTE)	\$41.3	\$50.4	\$59.1	\$9.0	\$10.0	\$11.0	\$11.4	\$11.9	\$12.3	\$12.8	\$13.4	\$14.0	\$14.5	\$15.1	\$15.6
Loan Loss Provision	\$0.7	\$1.6	\$1.8	\$0.0	\$0.0	\$0.5	\$0.3	\$0.4	\$0.3	\$0.4	\$0.4	\$0.5	\$0.4	\$0.4	\$0.4
Non-Interest Income	\$4.9	\$5.5	\$6.3	\$1.1	\$1.3	\$1.2	\$1.3	\$1.3	\$1.3	\$1.4	\$1.4	\$1.5	\$1.5	\$1.6	\$1.7
Gain/Loss on Loan Sales	\$18.1	\$17.4	\$16.6	\$4.4	\$4.5	\$5.0	\$4.2	\$3.4	\$4.3	\$5.1	\$4.6	\$3.6	\$4.4	\$5.0	\$3.6
Gain/Loss on Securities	\$0.4	\$0.0	\$0.0	\$0.0	\$0.2	\$0.1	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
One-Time Items	\$1.0	\$0.0	\$0.0	\$0.0	\$1.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Non-Interest Expense	\$44.1	\$49.0	\$55.8	\$10.4	\$10.9	\$11.6	\$11.2	\$11.4	\$12.1	\$12.7	\$12.8	\$13.3	\$13.7	\$14.2	\$14.6
Pre-Tax Income	\$20.8	\$22.6	\$24.5	\$4.0	\$6.0	\$5.4	\$5.4	\$4.8	\$5.4	\$6.2	\$6.2	\$5.3	\$6.3	\$7.1	\$5.8
Taxes (w/ FTE adj.)	\$6.9	\$7.4	\$7.9	\$1.4	\$1.6	\$2.0	\$1.9	\$1.7	\$1.4	\$2.2	\$2.2	\$1.9	\$1.6	\$2.5	\$2.0
Extraordinary Items	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Net Income	\$13.9	\$15.2	\$16.6	\$2.6	\$4.4	\$3.5	\$3.5	\$3.1	\$4.1	\$4.0	\$4.0	\$3.5	\$4.7	\$4.6	\$3.8
Preferred Dividend	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Net Income Avail. To Common	\$13.9	\$15.2	\$16.6	\$2.6	\$4.4	\$3.5	\$3.5	\$3.1	\$4.1	\$4.0	\$4.0	\$3.5	\$4.7	\$4.6	\$3.8
Avg. Shares O/S	3.3	3.7	3.8	3.1	3.1	3.2	3.7	3.7	3.7	3.7	3.7	3.7	3.8	3.8	3.8
Earnings Per Share (EPS)	\$4.27	\$4.10	\$4.41	\$0.85	\$1.41	\$1.07	\$0.95	\$0.84	\$1.09	\$1.09	\$1.08	\$0.92	\$1.26	\$1.22	\$1.00
Per Share Data:															
Reported Book Value	\$32.91	\$36.13	\$39.60	\$27.39	\$28.88	\$32.17	\$32.91	\$33.53	\$34.41	\$35.27	\$36.13	\$36.82	\$37.85	\$38.84	\$39.60
Tangible Book Value	\$31.93	\$35.26	\$38.86	\$26.11	\$27.64	\$31.16	\$31.93	\$32.58	\$33.48	\$34.38	\$35.26	\$35.99	\$37.05	\$38.07	\$38.86
Dividends	\$0.43	\$0.44	\$0.44	\$0.10	\$0.11	\$0.11	\$0.11	\$0.11	\$0.11	\$0.11	\$0.11	\$0.11	\$0.11	\$0.11	\$0.11
Pre-Tax, Pre-Provision EPS	\$6.98	\$6.51	\$6.99	\$1.53	\$1.76	\$1.96	\$1.72	\$1.41	\$1.55	\$1.77	\$1.78	\$1.54	\$1.80	\$2.00	\$1.65
CORE GAAP EPS	\$3.96	\$4.10	\$4.41	\$0.85	\$1.13	\$1.03	\$0.95	\$0.84	\$1.09	\$1.09	\$1.08	\$0.92	\$1.26	\$1.22	\$1.00
KEY Ratios:															
Net Interest Margin	4.64%	4.71%	4.75%	4.54%	4.63%	4.70%	4.70%	4.69%	4.70%	4.71%	4.74%	4.75%	4.76%	4.74%	4.75%
Return on Avg Assets	1.41%	1.32%	1.25%	1.22%	1.93%	1.44%	1.42%	1.19%	1.52%	1.46%	1.40%	1.16%	1.54%	1.44%	1.14%
Return on Avg Equity	11.62%	11.43%	11.18%	12.57%	20.56%	13.34%	11.72%	10.07%	12.88%	12.48%	12.13%	10.12%	13.51%	12.75%	10.18%
Pre-Tax Pre-Provision ROA	2.31%	2.10%	1.98%	2.20%	2.42%	2.64%	2.56%	2.01%	2.16%	2.37%	2.31%	1.93%	2.20%	2.35%	1.89%
Return on Tang. Comm. Equity	11.82%	11.56%	11.27%	12.96%	20.51%	12.07%	11.93%	10.25%	13.05%	12.62%	12.26%	10.25%	13.60%	12.82%	10.26%
Efficiency Ratio	68.06%	66.43%	67.47%	71.39%	68.95%	66.53%	65.95%	68.03%	67.24%	65.34%	65.40%	69.23%	66.45%	64.86%	69.59%
TCE/TA	11.52%	11.03%	10.58%	9.16%	9.19%	11.56%	11.52%	11.25%	11.26%	11.15%	11.03%	10.85%	10.78%	10.68%	10.58%
Period-End Balances: (\$ in Millions)															
Total Assets	\$1,026	\$1,198	\$1,393	\$878	\$929	\$994	\$1,026	\$1,075	\$1,107	\$1,151	\$1,198	\$1,245	\$1,295	\$1,347	\$1,393
Net Loans	\$845	\$1,016	\$1,207	\$658	\$766	\$819	\$845	\$893	\$930	\$970	\$1,016	\$1,065	\$1,112	\$1,159	\$1,207
Total Deposits	\$866	\$1,005	\$1,158	\$758	\$786	\$841	\$866	\$905	\$932	\$970	\$1,005	\$1,043	\$1,075	\$1,118	\$1,158
Intangibles	\$4	\$3	\$3	\$4	\$4	\$4	\$4	\$4	\$3	\$3	\$3	\$3	\$3	\$3	\$3
Total Common Equity	\$121	\$135	\$150	\$84	\$89	\$118	\$121	\$124	\$128	\$131	\$135	\$138	\$142	\$146	\$150



FIG Partners LLC Distribution of Ratings

	Buy / Outperform	Hold / Market- Perform	Sell / Underperform
% Rated	37.3%	62.7%	0.0%
IB Client % in Category	27.7%	13.9%	0.0%

Equity Rating System as of July 1, 2003

Buy/Outperform “O” FIG expects that total return of the subject stock will outperform the industry benchmark (BIX) over the next 12 months

Hold/Market-Perform “M-P” FIG expects that total return of the subject stock will perform inline with the industry benchmark (BIX) over the next 12 months

Sell/Underperform “U” FIG expects that total return of the subject stock will under perform the industry benchmark (BIX) over the next 12 months

For purposes of FINRA rule 2711, outperform is classified as a buy, market perform is a hold and underperform is a sell. The industry benchmark that we use is the S&P Bank Index referred to as the BIX.

Ratings Changes for FS Bancorp (FSBW)



Additional Risks to Our Earnings Model Assumptions & Ratings:

Unexpected and/or rapid changes in interest rates may have significant negative impact on the company’s balance sheet. Likewise, persistently low interest rates, and/or a flat yield curve may add downward pressure to revenues and the absolute level of NIM-Net Interest Margin.

Declines in Asset quality beyond our estimates due to an economic slowdown in the company’s operating footprint may require increased expenses for Loan losses which could decrease profitability. Further, this may cause an increase in Net Charge-offs, Nonperforming Loans, and Classified Assets.

New rules set forth by regulatory agencies could reduce future profitability by eliminating certain revenue items, adding additional expenses, or requiring this institution to hold more capital. A similar effect is possible if new legislation (local, state, or federal) is passed.

Any regulatory action or litigation against the company could impact future earnings and also affect the public market perception towards this stock.



Compliance

- Neither the research analyst nor any member of the analyst's household has any financial interest in the subject company.
- At the prior month end, neither FIG Partners LLC nor any of its partners or officers owned more than 1% of the outstanding equity securities of the subject company.
- There are no material conflicts of interest of the analyst or FIG Partners LLC at the time of this report.
- FIG has not been a manager or co-manager of a public offering of any securities of the recommended issuer within the last 12 months.
- FIG has not received investment Banking compensation from the subject company in the last 12 months.
- FIG intends to seek investment Banking compensation from the subject in the next three months.
- The subject company is a client of FIG.
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- FIG will usually make a market in the subject security and was making a market in this security at the time of this report's publication.
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- To determine price target, our analysts utilize a variety of valuation techniques including but not limited to: peer analysis, absolute P/E, relative P/E, projected P/E, absolute P/B, relative P/B, projected P/B, Deposit premium, and a discounted cash flow model.
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