



FS Bancorp, Inc.

FSBW * - NASDAQ

October 27, 2017

Rating: **Neutral**
 Price: (10/26/17) \$53.31
 Price Targets: 12-18 month: ↑ \$56.00
 5-year: \$70.00

Industry:
 Financial Institutions

Jeff Rulis
 503-603-3025
 jrulis@dadco.com

Riley Stormont
 Research Associate
 503-603-3054
 rstormont@dadco.com

**Robust Growth Drives Beat Following Capital Raise.
 Raising Estimates and Price Target, Maintaining NEUTRAL Rating.**

- **FS Bancorp reported 3Q17 EPS of \$1.07**, ahead of our \$1.02 estimate and the Street mean of \$1.01. Both margin expansion and loan growth impressed, pushing spread income ahead of our estimate. Fee income also beat expectations, while higher expenses and the return of a LLP worked against these positive variances.
- **Loan growth takes off with new capital runway.** Period-end loan balances grew 25% annualized, driven largely by increases in the construction and multifamily portfolios. The secondary offering completed in the quarter has expanded the growth platform, which the company took full advantage of. Going forward management anticipates more normalized growth in the 10%-15% range for 4Q17, and provided preliminary guidance near 15% for the full year 2018. Deposit growth was also strong at nearly 28% annualized; expectations are for a high-single digit pace of growth in 2018.
- **A positive asset mix shift helped boost NIM 7bp to 4.70%**, with management noting the use of some investment sale proceeds to fund loan balances in the quarter. Average earning asset yields increased 9bp to 5.27%, while average funding costs were 4bp higher to 0.61%. Management expects a bit of a pullback in margin in 4Q17 given the relatively transitory nature of the mix shift in 3Q.
- **Expenses should more or less hold the line while fees see some pullback.** Non-interest expenses of \$11.6M came in \$0.4M above our estimate. 4Q17 expectations call for a modest pullback in operating expenses, with slightly lower compensation costs the most notable delta. Elevated loan sale gains boosted fee income \$0.5M above our model; we anticipate that line item to normalize somewhat in 4Q17, driving our expectations for lower sequential non-interest income.
- **Credit remains a non-issue.** Nonperforming asset levels trended higher but remain remarkably low at just 13bp of total assets. The increase in nonperforming loan balances from \$0.8M to \$1.3M was attributed to one C&I credit. FSBW recorded a \$450k provision given the strong loan production in 3Q and expects positive provisions going forward (versus zero in 1H17). Reserves current stand at a healthy 1.38% of loans.
- **We are increasing our 2017, 2018, and 2019 EPS estimates** from \$4.05, \$3.75, and \$4.05 to \$4.15, \$3.85, and \$4.15, respectively. Our 2017E EPS is reflective of this quarter's beat and higher loan balances going forward. Our 2018 and 2019 estimates also reflect higher asset levels, as well as modestly improved margin expectations and slightly lower expenses.
- **We are reiterating our NEUTRAL rating and raising our price target from \$52 to \$56**, which represents 14.5x our 2018E EPS and 1.5x 2018E TBV. Our thesis for FSBW remains largely unchanged, with above-average growth and credit quality netting against a somewhat lower-quality deposit mix. Thus, we are maintaining our **NEUTRAL** rating with ~6% total upside to current share levels.

Valuation Data

Long-Term Growth Rate (E)	10%
Equity/Assets (9/30/17)	11.6%
Book Value per Share (9/30/17)	\$33.52
Tangible BV per Share (9/30/17)	\$32.46
Price/Tangible Book Value	164.2%
Dividend	\$0.44 (0.8%)
Return on Equity (T-T-M)	15.2%

Trading Data

Shares Outstanding (M)	3.5
Market Capitalization (\$M)	\$191.8
52-week range	\$28.96-\$54.00
Avg. Daily Volume (3 mos.) (K)	8.9
Float (%)	71.4%

FY (Dec)		FY16A	FY17E	Previous	FY18E	Previous
EPS	Q1 (Mar)	\$0.55	\$0.85 A	-	\$0.87	\$0.84
	Q2 (Jun)	\$0.96	\$1.41 A	-	\$0.96	\$0.94
	Q3 (Sep)	\$1.18	\$1.07 A	\$1.02	\$1.04	\$1.01
	Q4 (Dec)	\$0.86 E	\$0.86 E	<u>\$0.82</u>	\$0.98	<u>\$0.97</u>
	Dividend	\$3.51	\$4.15 E	\$4.05	\$3.85	\$3.75
Price/EPS		15.2x	12.8x		13.8x	
Revenue (\$M)	Q1 (Mar)	\$12.1	\$14.4 A	-	\$17.0	\$16.3
	Q2 (Jun)	\$14.6	\$16.9 A	-	\$17.7	\$17.1
	Q3 (Sep)	\$16.0	\$17.4 A	\$16.4	\$18.4	\$17.6
	Q4 (Dec)	\$14.6 E	\$16.8 E	<u>\$16.0</u>	\$18.2	<u>\$17.6</u>
	Dividend	\$57.4	\$65.6 E	\$63.7	\$71.3	\$68.6
Price/Revenue		3.3x	2.8x		2.6x	

Please refer to pages 4 - 5 of this report for detailed disclosure and certification information.

* D. A. Davidson & Co. makes a market in this security.

D.A. Davidson & Co. Member SIPC

Price Chart



Source: Bloomberg

powered by: BlueMatrix

Company Description:

Mountlake Terrace, WA - FS Bancorp, Inc., a Washington corporation, is the holding company for 1st Security Bank of Washington. The company provides loan and deposit services to customers who are predominantly small and middle-market businesses and individuals in western Washington.

Potential Risks:

- Significant economic deterioration (i.e. home price deterioration, worsening employment situation, etc.).
- Severe deterioration in credit quality.

FS Bancorp, Inc.
FSBW

Financial Data (in 000's, except PS)
FYE Dec

	3Q16	4Q16	2016	1Q17	2Q17	3Q17E	4Q17E	2017E	1Q18E	2Q18E	3Q18E	4Q18E	2018E	2019E
INCOME STATEMENT														
Net Interest Income	8,750	9,192	33,857	8,975	9,966	11,022	11,268	41,231	11,476	11,784	12,161	12,501	47,921	53,591
Loan Loss Provision	600	600	2,400	0	0	450	350	800	350	375	400	400	1,525	1,600
Net Interest Income After Provision	8,150	8,592	31,457	8,975	9,966	10,572	10,918	40,431	11,126	11,409	11,761	12,101	46,396	51,991
Service Charges	899	903	3,392	861	1,003	879	888	3,631	897	906	915	924	3,641	3,732
Gain on Sale of Loans	5,922	4,335	19,058	4,355	4,460	5,025	4,271	18,111	4,229	4,651	4,884	4,396	18,159	17,758
BOLI Revenue	71	71	281	69	71	68	69	277	69	70	71	71	282	289
Other	356	135	838	135	1,423	455	317	2,330	320	323	326	329	1,298	1,331
Total Noninterest Income	7,248	5,444	23,569	5,420	6,957	6,427	5,544	24,348	5,514	5,950	6,196	5,720	23,380	23,110
Salaries and Benefits	6,287	5,472	21,983	6,118	6,916	7,140	6,997	27,171	7,137	7,244	7,317	7,463	29,161	31,494
Operations	1,450	1,779	5,999	1,486	1,443	1,577	1,593	6,099	1,625	1,641	1,657	1,674	6,597	6,896
Occupancy	597	629	2,403	643	645	650	657	2,595	670	676	683	690	2,719	2,787
Data Processing	537	558	2,133	568	593	651	658	2,470	671	684	698	712	2,764	2,904
Other	1,441	1,647	6,406	1,562	1,347	1,571	1,587	6,067	1,618	1,651	1,684	1,718	6,671	7,007
Total Noninterest Expense	10,312	10,085	38,924	10,377	10,944	11,589	11,491	44,401	11,721	11,896	12,039	12,256	47,911	51,089
Net Income Before Taxes	5,086	3,951	16,102	4,018	5,979	5,410	4,972	20,379	4,919	5,462	5,918	5,565	21,865	24,013
Applicable Taxes	1,629	1,405	5,603	1,425	1,620	1,956	1,740	6,741	1,648	1,830	1,983	1,864	7,325	8,164
Effective Tax Rate (%)	32.0	35.6	34.8	35.5	27.1	36.2	35.0	33.1	33.5	33.5	33.5	33.5	33.5	34.0
Net Income	3,457	2,546	10,499	2,593	4,359	3,454	3,232	13,638	3,271	3,632	3,936	3,701	14,540	15,848
EPS (\$) Avail. To Common SH														
	1.18	0.86	3.51	0.85	1.41	1.07	0.86	4.15	0.87	0.96	1.04	0.98	3.85	4.15
EPS Growth (year-over-year) (%)	79.3	30.5	20.0	54.6	47.2	-9.4	0.7	18.2	2.8	-31.4	23.2	-30.4	-7.3	7.9
Average Metrics														
Avg Diluted Shares	2,938	2,976	2,990	3,062	3,098	3,239	3,751	3,287	3,758	3,766	3,773	3,781	3,781	3,818
Shares Outstanding (Actual)	2,853	2,861	2,861	2,875	2,922	3,528	3,546	3,546	3,553	3,560	3,567	3,574	3,574	3,610
Book Value Per Share (\$)	27.89	28.32	28.32	29.21	30.40	33.52	34.15	34.15	34.89	35.72	36.64	37.48	37.48	40.99
Tangible BV Per Share (\$)	26.42	26.91	26.32	27.84	29.09	32.46	33.13	33.13	33.90	34.76	35.70	36.57	36.57	40.21
Dividend Per Share (\$)	0.10	0.10	0.37	0.10	0.11	0.11	0.11	0.43	0.11	0.12	0.12	0.12	0.47	0.51
Dividend Payout (%)	8.5	11.7	10.5	11.8	7.8	10.3	12.8	10.4	12.6	12.4	11.5	12.3	12.2	12.3
BALANCE SHEET														
Total Loans	604,218	605,415	605,415	629,915	720,302	765,571	787,666	787,666	820,142	854,011	889,335	926,181	926,181	1,065,108
Earning Assets	791,190	790,676	790,676	840,054	892,335	957,880	972,427	972,427	1,000,173	1,038,942	1,071,488	1,102,596	1,102,596	1,253,068
Total Assets	827,486	827,926	827,926	877,884	928,582	993,891	1,012,945	1,012,945	1,041,846	1,082,232	1,116,134	1,148,538	1,148,538	1,305,279
Deposits	703,164	712,593	712,593	758,014	785,697	840,578	857,390	857,390	878,824	900,795	923,315	946,398	946,398	1,059,965
Equity	79,557	81,033	81,033	83,964	88,824	118,239	121,081	121,081	123,961	127,166	130,674	133,946	133,946	147,954
Tangible Equity	75,388	77,004	77,004	80,035	84,995	114,510	117,452	117,452	120,432	123,737	127,345	130,717	130,717	130,214
AVERAGE BALANCE SHEET														
Average Loans	643,989	667,796	617,087	662,040	720,569	742,937	776,619	725,541	803,904	837,076	871,673	907,758	855,103	995,644
Average Earning Assets	764,376	789,013	763,927	790,749	862,807	925,108	965,154	885,954	986,300	1,019,557	1,055,215	1,087,042	1,037,029	1,177,832
Average Assets	803,457	827,706	799,506	852,905	902,483	961,237	1,003,418	930,011	1,027,396	1,062,039	1,099,183	1,132,336	1,100,238	1,226,908
Average Deposits	685,278	707,879	676,020	735,304	757,990	813,138	848,984	788,854	868,107	889,810	912,055	934,856	901,207	1,003,182
Average Equity	76,075	80,295	76,312	82,499	84,795	103,532	119,660	97,621	122,521	125,564	129,920	132,310	127,329	140,950
Average Tangible Equity	73,565	76,196	73,519	78,520	82,515	99,753	115,981	94,192	118,942	122,085	125,541	129,031	123,900	130,465
ASSET QUALITY														
Nonperforming Loans	594	721	721	790	754	1,300	1,250	1,250	1,250	1,250	1,500	1,500	1,500	2,000
OREO & Other	0	15	15	0	0	0	0	0	0	0	0	0	0	0
NPAs	594	736	736	790	754	1,300	1,250	1,250	1,250	1,250	1,500	1,500	1,500	2,000
NPAs/ Assets (%)	0.07	0.09	0.09	0.09	0.08	0.13	0.12	0.12	0.12	0.12	0.13	0.13	0.13	0.15
Loan Loss Reserves	9,586	10,211	10,211	10,147	10,143	10,598	10,800	10,800	11,000	11,200	11,400	11,600	11,600	13,000
Reserves/ Loans (%)	1.59	1.69	1.69	1.61	1.41	1.38	1.37	1.37	1.34	1.31	1.28	1.25	1.25	1.22
Reserves/ NPLs (%)	1,614	1,416	1,416	1,284	1,345	815	864	864	880	896	760	773	773	650
Net Chargeoffs	(35)	(25)	(26)	64	4	(5)	148	211	150	175	200	200	725	200
NCOs/ Avg Loans (%)	(0.02)	(0.01)	(0.01)	0.04	0.00	(0.00)	0.08	0.03	0.07	0.08	0.09	0.09	0.08	0.02
KEY RATIOS														
TCE/TA (%)	9.16	9.35	9.35	9.16	9.19	11.56	11.64	11.64	11.60	11.47	11.44	11.41	11.41	10.11
Return on Average Assets (%)	1.71	1.23	1.31	1.25	1.94	1.42	1.29	1.47	1.27	1.37	1.43	1.31	1.35	1.29
Return on Average Equity (%)	18.08	12.92	13.84	12.98	20.62	15.17	10.80	13.97	10.68	11.57	12.21	11.19	11.42	11.24
Return on Average Tangible Equity (%)	18.80	13.37	14.28	13.21	21.13	13.85	11.15	14.48	11.00	11.90	12.54	11.47	11.74	12.15
Net Interest Margin (%) - Reported	4.55	4.66	4.43	4.54	4.63	4.70	4.67	4.64	4.65	4.62	4.61	4.60	4.62	4.55
Efficiency Ratio (%)	64.5	68.9	67.8	72.1	64.7	66.4	68.3	67.7	69.0	67.1	65.6	67.3	67.2	66.6
Loan/ Deposit (%)	86	85	85	83	92	91	92	92	93	95	96	98	98	100
LOAN COMPOSITION														
Commercial real estate	55,794	55,871	55,871	55,483	57,997	63,180	64,444	64,444	67,021	69,702	72,490	75,390	75,390	86,698
	9.2%	9.2%	9.2%	8.8%	8.1%	8.3%	8.2%	8.2%	8.2%	8.2%	8.2%	8.1%	8.1%	8.1%
Construction and development	90,201	94,462	94,462	104,276	119,455	129,407	133,289	133,289	140,620	148,354	156,514	165,122	165,122	189,890
	14.9%	15.6%	15.6%	16.6%	16.6%	16.9%	16.9%	16.9%	17.1%	17.4%	17.6%	17.8%	17.8%	17.8%
Home equity	19,649	20,081	20,081	19,903	22,450	24,026	24,507	24,507	25,242	25,999	26,779	27,582	27,582	31,720
	3.3%	3.3%	3.3%	3.2%	3.1%	3.1%	3.1%	3.1%	3.1%	3.0%	3.0%	3.0%	3.0%	3.0%
One-to-four family	116,886	124,009	124,009	141,301	154,826	170,187	175,293	175,293	182,304	189,596	197,180	205,068	205,068	235,828
	19.3%	20.5%	20.5%	22.4%	21.5%	22.2%	22.3%	22.3%	22.2%	22.2%	22.2%	22.1%	22.1%	22.1%
Multi-family	33,988	37,527	37,527	37,006	42,967	43,408	44,710	44,710	46,052	47,433	48,856	50,322	50,322	57,870
	5.6%	6.2%	6.2%	5.9%	6.0%	5.7%	5.7%	5.7%	5.6%	5.6%	5.5%	5.4%	5.4%	5.4%
Consumer	170,576	174,726	174,726	178,311	190,729	201,674	207,724	207,724	217,072	226,840	237,048	247,715	247,715	284,872
	28.2%	28.9%	28.9%	28.3%	26.5%	26.3%	26.4%	26.4%	26.5%	26.6%	26.7%	26.7%	26.7%	26.7%
Commercial and industrial	68,526	65,841	65,841	67,152	92,713	83,221	85,718	85,718	88,289	90,938	93,666	96,476	96,476	110,947
	11.3%	10.9%	10.9%	10.7%	12.9%	10.9%	10.9%	10.9%	10.8%	10.6%	10.5%	10.4%	10.4%	10.4%
Warehouse lending	48,598	32,898	32,898	26,483	39,165	50,468	51,982	51,982	53,542	55,148	56,802	58,506	58,506	67,282
	8.0%	5.4%	5.4%	4.2%	5.4%	6.6%	6.6%	6.6%	6.5%	6.5%	6.4%	6.3%	6.3%	6.3%

Required Disclosures

D.A. Davidson & Co. or an affiliate has managed, co-managed or acted as an underwriter in a public offering of securities for FS Bancorp, Inc. in the past 12 months.

D.A. Davidson & Co. expects to receive, or intends to seek, compensation for investment banking services from this company in the next three months.

D.A. Davidson & Co. is a full service investment firm that provides both brokerage and investment banking services. Jeff Rulis and Riley Stormont, the research analysts principally responsible for the preparation of this report, will receive compensation that is based upon (among other factors) D.A. Davidson & Co.'s investment banking revenue. D.A. Davidson & Co.'s analysts, however, are not directly compensated for involvement in specific investment banking transactions.

We, Jeff Rulis and Riley Stormont, attest that (i) all the views expressed in this research report accurately reflect our personal views about the common stock of the subject company, and (ii) no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

Rating Information

D.A. Davidson & Co.'s Institutional Research Rating Scale Definitions (maintained since October 10, 2017); information regarding our previous definitions is available upon request:

BUY: Expected to produce a total return of over 15% on a risk adjusted basis over the next 12-18 months

NEUTRAL: Expected to produce a total return of -15% to +15% on a risk adjusted basis over the next 12-18 months

UNDERPERFORM: Expected to lose value of over 15% on a risk adjusted basis over the next 12-18 months

Rating Distribution (as of 9/30/17)	Coverage Universe Distribution			Investment Banking Distribution		
	IR	IIG	Combined	IR	IIG	Combined
BUY (Buy)	53 %	77 %	55 %	12 %	3 %	11 %
NEUTRAL (Hold)	46 %	23 %	44 %	8 %	0 %	8 %
UNDERPERFORM (Sell)	1 %	0 %	1 %	0 %	0 %	0 %

IR denotes Institutional Research; IIG denotes Individual Investor Group Research whose rating scale is Buy/Add, Neutral, Sell/Reduce. Investment Banking Distribution denotes companies from whom D.A. Davidson & Co. has received compensation in the last 12 months.

FS Bancorp, Inc. Rating History as of 10/26/2017

powered by: BlueMatrix



Target prices are our Institutional Research Department's evaluation of price potential over the next 12-18 months and 5 years, based upon our assessment of future earnings and cash flow, comparable company valuations, growth prospects and other financial criteria. Certain risks may impede achievement of these price targets including, but not limited to, broader market and macroeconomic fluctuations and unforeseen changes in the subject company's fundamentals or business trends.

Other Disclosures

Information contained herein has been obtained by sources we consider reliable, but is not guaranteed and we are not soliciting any action based upon it. Any opinions expressed are based on our interpretation of data available to us at the time of the original publication of the report. These opinions are subject to change at any time without notice. Investors must bear in mind that inherent in investments are the risks of fluctuating prices and the uncertainties of dividends, rates of return and yield. Investors should also remember that past performance is not necessarily an indicator of future performance and D.A. Davidson & Co. makes no guarantee, express or implied, as

to future performance. Investors should note this report was prepared by D.A. Davidson & Co.'s Institutional Research Department for distribution to D.A. Davidson & Co.'s institutional investor clients and assumes a certain level of investment sophistication on the part of the recipient. Readers, who are not institutional investors or other market professionals, should seek the advice of their individual investment advisor for an explanation of this report's contents, and should always seek such advisor's advice before making any investment decisions. Further information and elaboration will be furnished upon request.