

FSBW-FS Bancorp
Initiating At “Outperform” With Price Target of \$44.00

- **Initiating with “Outperform” Rating, Price Target of \$44.00, or 13.5x 2018 EPS and 156% 2018 TBV**
- **Our EPS Estimates Are \$0.75 for 1Q-17, \$3.25 for 2017 and \$3.48 for 2018**
- **Undervalued, Growing Franchise in Highly Fragmented Puget Sound Marketplace**

We are initiating coverage on FSBW-FS Bancorp at “Outperform” with a Price Target of \$44.00, as well as initial EPS estimates of \$0.75 for 1Q-17, \$3.25 for 2017 and \$3.48 for 2018. Our Price Target is equivalent to 13.5x forward EPS (\$3.25) and 156% of forward tangible book value (\$28.14). Our Price Target represents a 15% appreciation to the current stock price.

FSBW is the Washington State-based holding company for 1st Security Bank of Washington. The bank opened in 1936 as Washington’s Credit Union and converted to a mutual savings bank in 2004. The holding company was created in 2011 upon the bank’s conversion from a mutual to a stock institution in July 2012. As of 4Q-2016, FSBW had Total Assets of \$828 Million, Total Deposits of \$713 Mil and gross Loans of \$656 Mil.

The current iteration of FSBW took form shortly after the conversion in 2012. Among other moves, the company reintroduced in-house mortgage originations primarily for sale in the secondary market following the addition of several top-level bankers from Golf Savings Bank, a mortgage banking subsidiary of the former Sterling Financial Corp. Since 2012, gross Loans have increased 22% per year on average (compared to no growth the previous three years) and total real estate Loans grew by 49% per year on average (compared to 2% the previous three years).

Our forward EPS estimates at FSBW reflect our belief management will shift focus to growing commercial banking operations from origination and sale of residential mortgages. We anticipate a modest 2% growth in operating revenues in 2017 as the transition takes hold during which the environment for mortgage banking could also slow. The decline in year-over-year EPS that we forecast is likely to coincide with gain on Loan sales declining to 25% of operating revenue this year, compared to 33% in 2014 and 2015. We anticipate the transition to be largely complete by year-end 2017. The following year, FSBW could grow earnings by more than 7% with operating revenue increasing 10% and gain on Loan sales declining to near 20% of operating revenue.

In our opinion, FSBW’s forward stock price is more likely to be a function of elevated earnings through 2018 than where the stock trades in relation to peers or on a takeout.

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: \$37.70
“Outperform” // Price Target: \$44.00

Summary Statistics	
Exchange	NASDAQ
Market Cap (\$M)	\$115.6
Avg. Volume	3,134
Annual Dividend	\$0.40
Dividend Yield	1.06%
Tangible Book/Share	\$25.17
Price/Tangible Book	150%
Price/2017 EPS	11.6x
Price/2018 EPS	10.8x
Total Assets (\$000)	\$827,926
TCE/TA	9.35%
ROTCE (2017)	11.53%
ROA (2017)	1.10%

EPS Estimates (Core in Blue)				
	2015	2016	2017	2018
Q1	\$0.70	\$0.55	\$0.75	\$0.77
Q2	\$0.93	\$0.96	\$0.82	\$0.84
Q3	\$0.66	\$1.18	\$0.85	\$0.91
Q4	\$0.66	\$0.86	\$0.83	\$0.96
FY	\$2.93	\$3.51	\$3.25	\$3.48

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



Company Description and Background

FSBW-FS Bancorp is the Washington State-based holding company for 1st Security Bank of Washington. The bank opened in 1936 as Washington's Credit Union and converted to a mutual savings bank in 2004. The holding company was created in 2011 upon the bank's conversion from a mutual to a stock savings bank in July 2012. As of 4Q-16, FSBW had total Assets of \$828 Million, total Deposits of \$713 Mil and gross Loans of \$656 Mil.

The company operates 11 branches and seven Loan production offices in the greater Puget Sound region. FSBW also operates a Loan production office in the Tri-Cities area of Central Washington. The company's headquarters are located in Mountlake Terrace, a northern suburb of Seattle, WA

FSBW's operations are focused on the Puget Sound region with services targeted to the local retail bank customer and regional businesses. The bank focuses lending activities on a number of areas with strong emphasis on residential mortgages, consumer lending and commercial business Loans. The company's consumer lending includes an indirect home improvement lending business through a network of home improvement contractors and dealers in Washington, Oregon, Idaho and California.

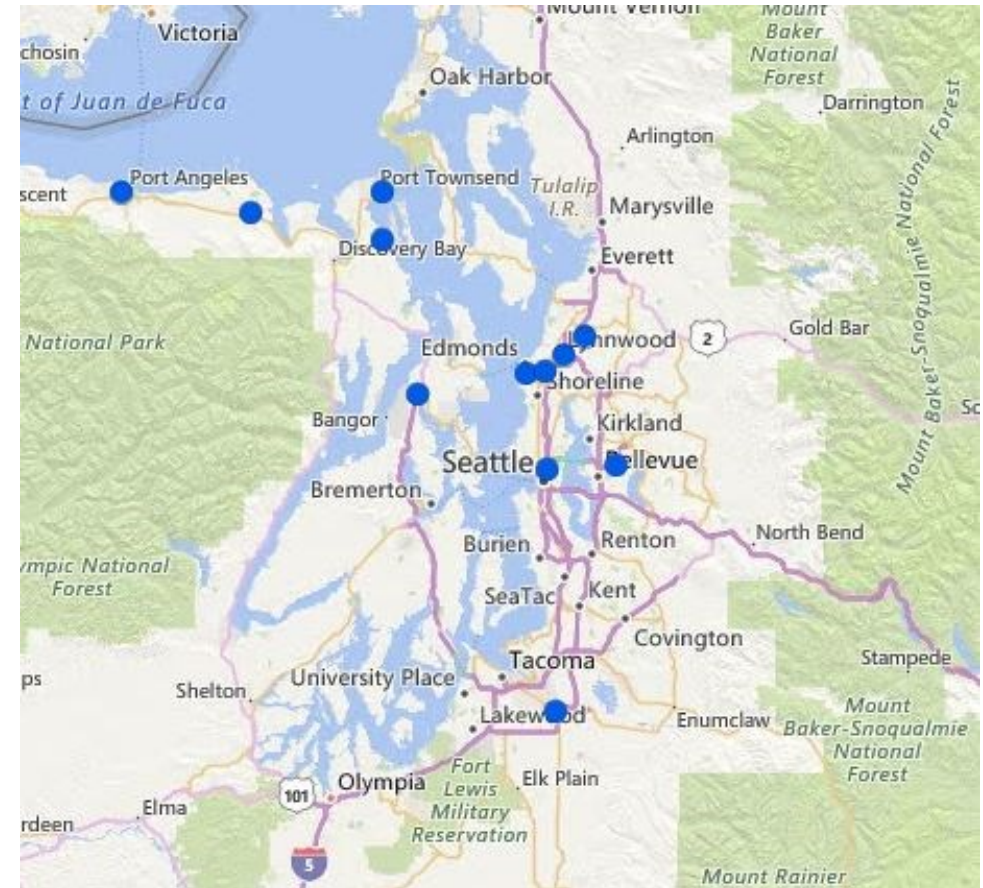
The current iteration of FSBW took form shortly after the conversion in 2012. Among other moves the company reintroduced in-house mortgage originations primarily for sale in the secondary market following the addition of several top-level bankers from Golf Savings Bank, a mortgage banking subsidiary of the former Sterling Financial Corp. Since 2012, gross Loans have increased 22% per year on average (compared to no growth the previous three years) and total real estate Loans grew by 49% per year on average (compared to 2% the previous three years).

Additions from Golf Savings Bank, include:

- Executive Vice Presidents of Home Lending Donn Costa and Debbie Steck
- Chief Financial Officer Matt Mullett
- Chief Credit Officer Rob Fuller
- Chief Lending Officer Dennis O'Leary
- Senior Vice President of Services and Operations Kathrine Shairrick

Chief Executive Joe Adams, 57, has held the position since formation of the holding company and was CEO of the bank since 2004. He joined 1st Security Bank in 2003 as CFO and previously served as Supervisory Committee Chairperson from 1993 to 1999 when the company was a credit union. Chairman of the Board Ted Leech, 68, is a retired finance executive with chemical servicer Univar Corp. He has served on the board since 2005. Leech's professional experience qualifies him as a financial expert and he is chairman of the Audit Committee.

FS Bancorp Branch Map



Source: SNL Financial LC



Earnings Outlook

- Estimated EPS of \$0.75 for 1Q-17, \$3.25 for 2017 and \$3.48 for 2018
- ROA +1% and ROE +10% in 1Q-17, 2017 and 2018
- Forecasting Double Digit Loan Growth in 2017 and 2018

Our forward EPS estimates at FSBW reflect our belief management will shift focus to growing commercial banking operations from origination and sale of residential mortgages. We anticipate a modest 2% growth in operating revenues in 2017 as the transition takes hold during which the environment for mortgage banking could also slow. The decline in year-over-year EPS that we forecast is likely to coincide with gain on Loan sales declining to 25% of operating revenue this year, compared to 33% in 2014 and 2015. We anticipate the transition to be largely complete by year-end 2017. The following year, FSBW could grow earnings by more than 7% with operating revenue increasing 10% and gain on Loan sales declining to near 20% of operating revenue.

Part of the transition to a business model less dependent on mortgage banking revenues requires more out reach to local businesses. The company hired two commercial-oriented lenders in 2016 and expects to higher three to four more in 2017. We believe it could take some time for the new lenders to reach full speed. As a result, we estimate gross Loan growth of 11% in 2017, compared to 18% in 2016. Part of our estimate for Loan growth includes a reduction in Loans held for sale due to slower mortgage banking volume. By 2018, we anticipate the Loan growth trend reverses and Loans increase by 17%.

We do not anticipate FSBW will need to provision as much going forward. Management provisioned \$600,000 per quarter in 2016, which was based on a model of potential credit costs set at the beginning of the year. When those credit costs did not materialize (net recoveries were \$26,000) the company had an outsized reserves (1.56% of Loans) relative to credit issues (1287% of non-performing Assets). We model for provision expense of \$200,000 to \$250,000 over the next six quarters.

We model for fee-based income to decline with the slowdown in mortgage banking operations. Specific to mortgage banking, we anticipate gain on Loan sales of \$14.7 Mil in 2017 and \$14.9 Mil in 2018. That represents declines of more than 20% in both years relative to 2016. Our EPS estimate could increase if those estimates are too conservative. The balance of fee income should increase as Deposits grow. Service charges account for more than 75% of non-mortgage banking fee income.

Expenses could remain elevated despite the drops in mortgage banking activity and associated commission-based compensation. FSBW continues to build out the commercial banking unit that includes modernization of treasury management and business-oriented products, in addition to new hires. We anticipate the efficiency ratio to trend in the low-70% range through 2018.

FS Bancorp, Inc. (FSBW)

Updated on 4/17/2017

FIG Research Rating: "Outperform"

	2017Q1	2017Y	2018Y
	FIG Estimate	FIG Estimate	FIG Estimate
Income Statement			
Net Interest Income (000)	\$9,374	\$38,710	\$43,580
Net Interest Margin	4.68%	4.69%	4.72%
Loan Loss Provision (000)	\$200	\$900	\$1,400
Non-Interest Income (000)	\$4,504	\$19,490	\$20,277
Non-Interest Expense (000)	\$10,110	\$41,901	\$45,974
Pre-Tax Income (000)	\$3,569	\$15,398	\$16,483
Net Income (000)	\$2,300	\$9,953	\$10,685
Diluted Shares Outstanding (M)	3.1	3.1	3.1
Earnings Per Share	\$0.75	\$3.25	\$3.48
Per Share			
	FIG Est.	FIG Est.	FIG Est.
Tangible Book Value	\$25.85	\$28.14	\$31.33
Book Value	\$27.12	\$29.27	\$32.28
Dividends Per Share	\$0.10	\$0.40	\$0.40
Ratios			
	FIG Est.	FIG Est.	FIG Est.
Return on Assets	1.09%	1.10%	1.05%
Return on Equity	11.21%	11.23%	10.91%
Efficiency Ratio	71.84%	71.03%	71.12%
NPAs/Assets	0.10%	0.10%	0.09%
NCO/Avg. Loans	0.10%	0.04%	0.04%
Balance Sheet			
	FIG Est.	FIG Est.	FIG Est.
Average Earning Assets (000)	\$801,975	\$850,493	\$977,209
Total Assets (000)	\$841,527	\$892,438	\$1,025,403
Net Loans (000)	\$652,029	\$717,797	\$837,975
Average Deposits (000)	\$722,042	\$770,825	\$867,687
Non-Performing Assets (000)	\$809	\$864	\$972

Source: FIG Partners Research



Operating Strategy

FSBW focuses on being a relationship-based lender to Puget Sound area families, businesses and industry niches.

The company's business plan calls for:

- Growing and diversifying the Loan portfolio;
- Maintaining strong Asset quality;
- Emphasizing lower cost core Deposits to fund Loan growth;
- Improving share of total customer relationships by leveraging service and reputation in the community; and
- Expanding the company's footprint.

Management's current preference is for organic growth. While the company did purchase four retail branches and \$186 Mil-

lion in Deposits from BAC-Bank of America Corp in early 2016, that was a special situation and not part of the business plan. FSBW plans to support the organic growth with the addition of new lenders. The company hired two lenders in 2016 and plans to hire an additional three to four lenders in 2017 to support the bank's transition to a more commercial-focused lending strategy.

Historically, FSBW has focused lending activities on consumer Loans (both indirect home Loans and auto lending), residential first mortgages and second mortgages. Following the conversion, the company shifted to balance the consumer lending with Loans to traditional commercial lending, as well as CRE-Commercial Real Estate and C&D-Construction & Development Loans. FSBW also restarted an in-house mortgage business to originate for sale certain residential mortgages.

The company's core market of the Puget Sound region has an estimated population of 4.2 million, which represents more than half of the population in Washington. The region's top employers include some of the most well-known companies in the country, such as Amazon, Boeing Corp, Costco, Microsoft Corp and Starbucks. The region is also home to significant Assets for the US Navy, which is the largest employer in Kitsap County, which encompasses the peninsula west of Seattle.

As shown in [Figure 1](#) above, nearly 45% of FSBW's Deposits are based in Snohomish County, which is north of Seattle. The population in the region, which is home to Boeing, is expected to grow twice as fast as the nation through 2022 (7.12% versus 3.77%) and the median household income of \$76,000 is 130% of the national median household income and 116 of Washington's median HHI. On the whole, FSBW's footprint is growing faster and more affluent than the national medians.

Fig. 1: Market Demographics

County	Market Rank	Number of Branches	Company Deposits in Market (\$000)	Deposit Market Share (%)	Percent of State Franchise (%)	Total Population 2017 (Actual)	Population Change 2010-2017 (%)	Projected Population Change 2017-2022 (%)	Median HH Income 2017 (\$)	Projected HH Income Change 2017-2022 (%)
Snohomish	11	4	301,663	2.78	44.91	790,032	10.75	7.12	76,074	11.14
Clallam	4	2	118,501	7.65	17.64	74,425	4.23	4.40	50,144	9.10
King	25	2	108,888	0.14	16.21	2,158,004	11.74	7.47	81,089	11.69
Jefferson	3	2	65,909	13.15	9.81	31,110	4.14	4.37	50,676	7.96
Pierce	21	1	48,563	0.47	7.23	859,855	8.13	6.11	64,771	8.58
Kitsap	13	1	28,117	0.95	4.19	264,833	5.46	4.98	65,702	5.37
Totals		12	671,641		100.00	4,178,259				
Weighted Average: Washington Franchise							8.70	6.26	68,568	10.13
Aggregate: Entire State of Washington						7,311,903	8.73	6.31	65,558	8.90
Aggregate: National						325,139,271	5.31	3.77	57,462	7.27

Source: SNL Financial



Loan Portfolio

Historically, FSBW has focused lending activities on consumer Loans (both indirect home Loans and auto lending) and residential mortgages. Following the conversion, the company shifted to balancing the consumer lending with traditional commercial lending, such as CRE-Commercial Real Estate and C&D-Construction & Development Loans. FSBW also restarted an in-house mortgage business to originate for sale certain residential mortgages.

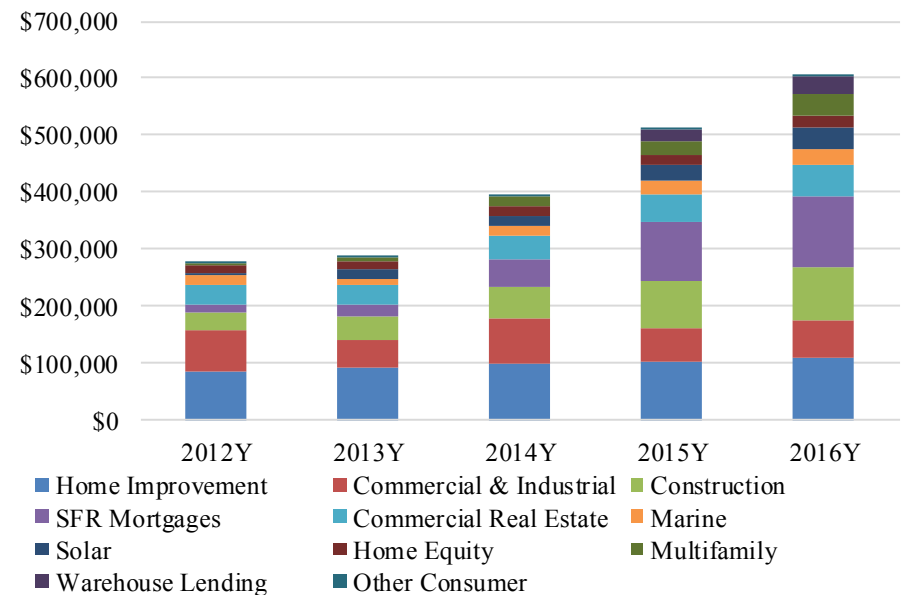
The current iteration of FSBW took form shortly after the conversion in 2012. The company hired several senior level bankers from Golf Savings Bank, a mortgage banking subsidiary of the former Sterling Financial Corp, to facilitate the transition to a more diversified Loan portfolio and stronger mortgage banking operation. Since 2012, gross Loans have increased 22% per year on average (compared to no growth the previous three years) and total real estate Loans grew by 49% per year on average (compared to 2% the previous three years).

FSBW is currently focused on expanding the commercial lending business. The company hired two new lenders in 2016 and plans to hire an additional three to four lenders in 2017. The near-term strategy is to expand small business credits on the lending side and attract corporate operating accounts on the Deposit side.

The indirect home lending operations are expected to remain a key part of FSBW's operations going forward. That business represents the largest portion of the consumer Loan portfolio at \$108 Million, or 62% of consumer Loans and 18% of total Loans. FSBW finances the end user purchase of mostly replacement windows and roofing, and to a lesser extent siding. The company originates these Loans through 115 home improvement contractors and dealers (although four dealers account for 50% of volume) in four Western States (Washington, Oregon, Idaho and California).

Fig. 2: Loans Held for Investment

Loans and Leases (000)	2012Y	2013Y	2014Y	2015Y	2016Y
Home Improvement	\$83,786	\$91,167	\$99,304	\$103,064	\$107,759
Commercial & Industrial	\$73,465	\$49,244	\$77,881	\$59,619	\$65,841
Construction	\$31,893	\$41,633	\$57,813	\$80,806	\$94,462
SFR Mortgages	\$13,976	\$20,809	\$46,801	\$102,921	\$124,009
Commercial Real Estate	\$33,250	\$32,970	\$42,970	\$50,034	\$55,871
Marine	\$17,226	\$11,203	\$16,713	\$23,851	\$28,549
Solar	\$2,463	\$16,838	\$18,162	\$29,226	\$36,503
Home Equity	\$15,474	\$15,172	\$15,737	\$16,540	\$20,081
Multifamily	\$3,202	\$4,682	\$16,201	\$22,223	\$37,527
Warehouse Lending	\$0	\$0	\$0	\$20,817	\$32,898
Other Consumer	\$5,195	\$3,498	\$2,628	\$2,181	\$1,915
Gross Loans HFI	\$279,930	\$287,216	\$394,210	\$511,282	\$605,415
Real Estate Loans (%)	35.0%	40.1%	45.6%	53.3%	54.8%
Consumer Loans (%)	38.8%	42.7%	34.7%	31.0%	28.9%
Commercial Loans (%)	26.2%	17.2%	19.7%	15.7%	16.3%



Source: FIG Partners, SNL Financial



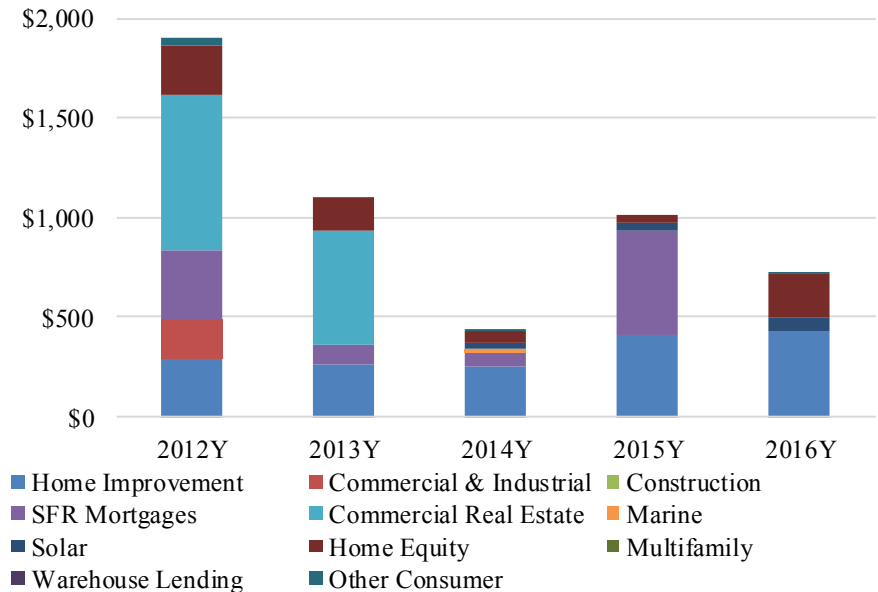
Credit Quality

As shown in **Figure 3**, FSBW's balances of year-end nonaccrual Loans has generally trended lower in the last five years and represented less than 1% of gross Loans in each year since 2012. The company's year-end balance of NPA-Non-Performing Assets were ~\$800,000, or 0.12% of Loans+OREO. Classified Assets totaled \$8 Million at year end, compared to \$3 Mil the previous year. FSBW also ended 2016 with net recoveries of \$26,000 and reserves of \$10.2 Mil, or 1.56% of Loans.

The majority of the company's modest nonaccrual balances have come from Consumer Loans, which includes indirect home improvement, solar lending and boat Loans. The combination of indirect home improvement and solar Loans totaled \$144.3 Million, or 24% of gross Loans. Given the inherently higher credit risk of these Loans, FSBW prefers to hold a granular portfolio of small Loans. As of 4Q-16, the portfolio had 13,000 Loans with an average balance of \$11,000.

Fig. 3: Credit Quality

Nonaccrual Loans (000)	2012Y	2013Y	2014Y	2015Y	2016Y
Home Improvement	\$295	\$258	\$250	\$408	\$435
Commercial & Industrial	\$194	\$0	\$0	\$0	\$0
Construction	\$0	\$0	\$0	\$0	\$0
SFR Mortgages	\$344	\$104	\$73	\$525	\$0
Commercial Real Estate	\$783	\$567	\$0	\$0	\$0
Marine	\$0	\$0	\$19	\$0	\$0
Solar	\$0	\$0	\$29	\$37	\$69
Home Equity	\$248	\$172	\$61	\$47	\$210
Multifamily	\$0	\$0	\$0	\$0	\$0
Warehouse Lending	\$0	\$0	\$0	\$0	\$0
Other Consumer	\$42	\$0	\$1	\$0	\$7
Total Nonaccruals	\$1,906	\$1,101	\$433	\$1,017	\$721
As % of Gross Loans	0.68%	0.38%	0.11%	0.20%	0.12%
Real Estate Loans (%)	72.1%	76.6%	30.9%	56.2%	29.1%
Consumer Loans (%)	17.7%	23.4%	69.1%	43.8%	70.9%
Commercial Loans (%)	10.2%	0.0%	0.0%	0.0%	0.0%



Source: FIG Partners, SNL Financial



Source of Non-Interest Income

The largest portion of the company’s Non-Interest Income comes from gains on the sale of mortgage Loans. As **Figure 4** shows, more than 81% of non-interest income in 2016 was from gain on sale of Loans followed by account service fees that were 14% of fee-based income.

Although FSBW restarted the in-house mortgage origination business in 2012, the unit really took off in the last couple of years. Gains on mortgages Loans were \$19.1 Mil on total originations of \$770.2 Mil and Loans sold volume of \$711.7 Mil in 2016. This compared to gains of \$14.7 Mil, total originations of \$624 Mil and sold volume of \$551.5 Mil in 2015.

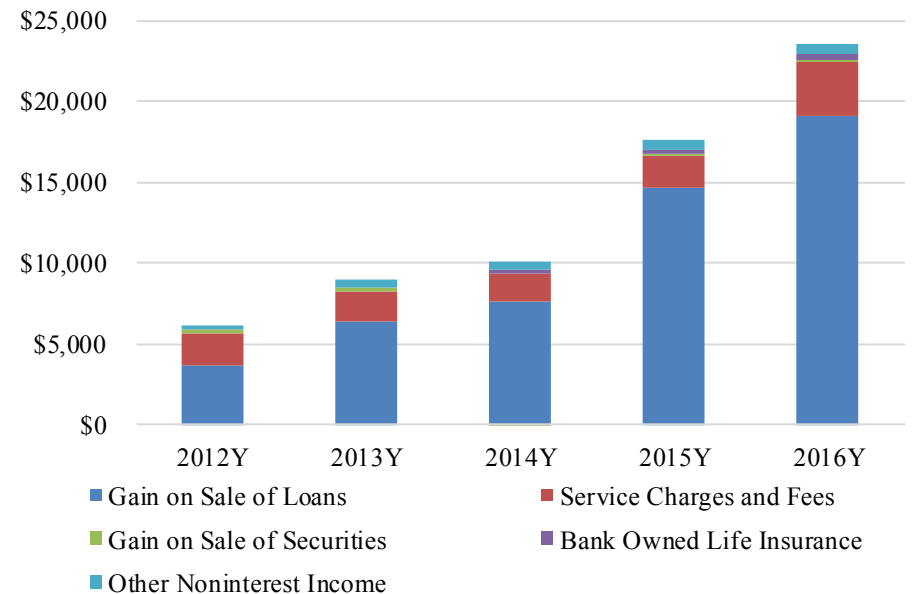
FSBW typically has a Loan sale margin higher than most banks, because the company forward sells its mortgage production. The bank’s Loan sale margin was 2.64% in 2016, compared to 2.58% in 2015. During that time, FSBW recorded gains of \$3.1 Mil in changes in the value of the hedging derivatives last year, compared to \$1.9 Mil the previous year. Gains on hedging is included in the Loan sale margin.

FSBW originates mortgage Loans through third party referrals (such as real estate agents, builders and existing clients) and walk-in customers. The Loans are generally underwritten to be sold, which means most of the company’s production are conforming Loans. As well, the majority of originations are often sold to Fannie Mae, Ginnie Mae, the Federal Home Loan Bank and/or Freddie Mac.

When Loans are sold, FSBW often retains servicing rights to maintain contact with the borrower. Servicing fees totaled \$2 Mil in 2016 (up from \$1.2 Mil the previous year) on servicing of \$973.5 Mil in Loans (up from \$631.9 Mil) that had a fair value on the company’s books of \$11.7 Mil (\$6.8 Mil).

Fig. 4: Noninterest Income

Noninterest Income (000)	2012Y	2013Y	2014Y	2015Y	2016Y
Gain on Sale of Loans	\$3,684	\$6,371	\$7,577	\$14,672	\$19,058
Service Charges and Fees	\$1,993	\$1,807	\$1,762	\$1,977	\$3,391
Gain on Sale of Securities	\$165	\$264	(\$41)	\$76	\$146
Bank Owned Life Insurance	\$0	\$0	\$187	\$216	\$282
Other Noninterest Income	\$322	\$473	\$557	\$652	\$692
Noninterest Income	\$6,164	\$8,915	\$10,042	\$17,593	\$23,569
Ex-Loan Sales	\$2,480	\$2,544	\$2,465	\$2,921	\$4,511



Source: FIG Partners, SNL Financial



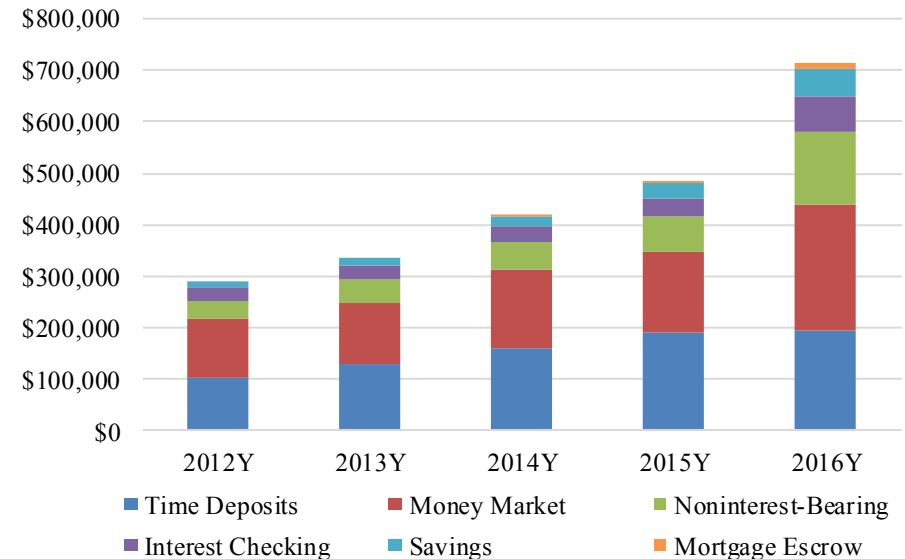
Deposit Base

Core Deposits accounted for 85.7% of total Deposits and Non-CD Deposits were 72.5% of Deposits as of 2016. Both ratios were significant improvements from prior years and reflect the acquisition of four branches from BAC-Bank of America Corp in 1Q-16. FSBW acquired total Deposits of \$186.4 Million in the transaction of which 43% were Non-Interest Bearing and 99% were Core Deposits. Approximately \$162.2 Mil of the acquired Deposits remain with the bank and new Deposits from those branches totaled \$195.5 Mil at year-end 2016. While time Deposits as a percentage of total Deposits remains elevated, management shift to emphasize commercial banking should result in an increase in Non-Interest Bearing Deposits in the form of operating accounts. That, in turn, could result in a lower cost of Deposits.

Nearly 45% of FSBW's Deposits are based in the north Seattle suburb of Snohomish County where the company operates four of its 11 branches. FSBW has the No. 11 market share in Snohomish with 2.78% of the market's Deposits. The next biggest market for Deposits at FSBW is in Clallam County on the peninsula west of Seattle. The company operates to two branches there with total Deposits of \$118.5 Mil and market share of 7.65%. Although FSBW currently has modest Deposit market share throughout its footprint, Deposits per average branch exceed \$55 Mil. That ratio typically implies most branches are profitable on a standalone basis.

Fig. 5: Total Deposits

Total Deposits (000)	2012Y	2013Y	2014Y	2015Y	2016Y
Time Deposits	\$104,378	\$129,861	\$159,954	\$189,102	\$195,717
Money Market	\$114,246	\$119,162	\$152,611	\$159,605	\$242,849
Noninterest-Bearing	\$34,165	\$45,783	\$53,743	\$66,676	\$143,236
Interest Checking	\$24,348	\$26,725	\$29,585	\$34,098	\$66,119
Savings	\$11,812	\$15,345	\$21,560	\$30,126	\$54,996
Mortgage Escrow	\$0	\$0	\$2,991	\$5,571	\$9,676
Total Deposits	\$288,949	\$336,876	\$420,444	\$485,178	\$712,593
Cost of Deposits	0.80%	0.65%	0.67%	0.69%	0.48%
Noninterest Bearing	11.8%	13.6%	13.5%	14.9%	21.5%
Core Deposits	77.8%	75.2%	74.4%	74.5%	85.7%
Non-CD Deposits	63.9%	61.5%	62.0%	61.0%	72.5%



Source: FIG Partners, SNL Financial



Valuation

We employ a three-piece valuation model to determine our Price Target of \$44.00, which is equivalent to 13.5x forward EPS (\$3.25) and 156% of forward tangible book value (\$28.14). We used DCF-Discounted Cash Flow Valuation (Figure 6), Implied Pricing based on peers (Figure 7) and estimated M&A Valuation (Figure 8). We applied an 80% weighting to the DCF Valuation of \$41.04, a 10% weighting to Implied Pricing of \$51.10 and 10% weighting to M&A Valuation of \$59.70 (which is the average of M&A Valuations based on comparable transactions nationwide and those in just the Western Region).

In our opinion, FSBW's forward stock price is more likely to be a function of elevated earnings through 2018 than where the stock trades in relation to peers or on a takeout. The low weighting on M&A Valuation is due to our belief valuation of Bank stocks should include the possibility of a sale, but our acknowledgement that FSBW is an unlikely seller given our estimates of the institution's forward profitability and the market's current discount to that profitability.

FIG. 6: DCF Valuation

Inputs	
Discount Rate	10.0%
Terminal P/E	12.0x
EPS Growth Beyond 2018	10.0%
Computation	
<i>Net Income</i>	
2016A	10.5
2017E	10.0
2018E	10.7
Terminal	11.8
DCF	
2016A	9.5
2017E	8.2
2018E	8.0
Terminal	96.3
Sum of DCF	122.1
Shares Outstanding (M)	3.0
DCF Per Share	\$41.04

Source: FIG Research

FIG. 7: Implied Pricing

Ticker	Price/ Total Assets	Price/ Core Deposits	Price/ Tangible Book Value	Price/ LTM Pre- Pre EPS
PROV	12.3%	22.9%	110%	1369%
BOCH	13.1%	18.9%	162%	1110%
FNWB	17.7%	29.8%	105%	2783%
FFNW	17.8%	64.8%	133%	1334%
RVSB	16.9%	22.8%	198%	1534%
TSBK	17.4%	24.9%	162%	1024%
PFLC	10.5%	14.4%	141%	953%
AMRB	14.9%	21.0%	146%	1194%
NBCT	11.5%	17.2%	125%	836%
IIBK	11.2%	NM	115%	1413%
SFBC	12.6%	24.1%	124%	869%
PUGB	15.7%	19.4%	167%	1174%
ANCB	14.0%	28.9%	96%	2698%
Average:	14.3%	25.8%	137.3%	1407.0%
	Total Assets	Core Deposits	Tangible Book	LTM Pre- Pre EPS
FSBW Per Share:	\$270.10	\$168.62	\$25.17	\$6.24
Implied Price:	\$38.56	\$43.44	\$34.56	\$87.83
Average Implied Price:	\$51.10			

Source: SNL Financial, FIG Partners Research

FIG. 8: Implied Pricing

	Total	Western Region
Median Deal Value/		
Assets (%)	16.3%	16.7%
Deposits (%)	19.7%	19.2%
Tangible Book (%)	178.6%	182.9%
Net Income (x)	21.4x	23.0x
FSBW (2018E)		
Assets (000)	\$1,025,403	\$1,025,403
Deposits (000)	\$873,466	\$873,466
Tangible Book (000)	\$96,307	\$96,307
Net Income (000)	\$9,953	\$9,953
Implied Price – FSBW		
Assets (000)	\$166,833	\$171,294
Total Deposits (000)	\$171,811	\$168,011
Tangible Book (000)	\$172,048	\$176,141
Net Income (000)	\$212,689	\$229,211
Avg. Implied Price (000)	\$180,845	\$186,164
Implied Price/Share	\$58.84	\$60.57
<i>Implied Price to TBV</i>	<i>188%</i>	<i>193%</i>
<i>Implied Price to EPS</i>	<i>18.2x</i>	<i>18.7x</i>

Source: FIG Partners Research, SNL Financial



FIG. 9: Comparative Analysis

Company Name	Ticker	Total Assets (\$000)	Closing Price (\$)	Price/This Year EPS (x)	Price/Next Year EPS (x)	Est. EPS Growth (%)	Price/Book (%)	Price/Tang. Book (%)	Market Cap (\$M)	TCE MRQ (%)	Core ROAA LTM (%)	Core ROAE LTM (%)	NIM LTM (%)	NPA/Assets LTM (%)	LLR/Loans LTM (%)
Provident Financial Holdings	PROV	1,192,155	18.43	21.4	18.2	17.4	110.0	110.0	146.6	11.12	0.61	5.37	3.00	1.09	0.81
Bank of Commerce Holdings	BOCH	1,140,992	11.10	13.7	12.1	13.6	158.5	162.4	149.2	8.07	0.69	8.10	3.71	1.68	1.43
First Northwest Bancorp	FNWB	1,043,815	15.23	NA	NA	NA	104.6	104.6	185.1	16.95	0.36	1.96	3.06	0.79	1.15
First Financial Northwest	FFNW	1,037,584	16.75	16.9	15.2	11.1	132.6	132.6	184.8	13.31	0.88	5.53	3.60	3.21	1.33
Riverview Bancorp	RVSB	985,669	7.39	22.4	14.2	57.6	152.1	198.4	166.4	8.73	0.76	6.52	3.72	1.29	1.54
Timberland Bancorp	TSBK	923,751	21.85	NA	NA	NA	152.6	161.7	160.5	10.24	1.23	11.36	3.86	1.50	1.45
Pacific Financial Corp	PFLC	891,383	9.00	NA	NA	NA	117.3	141.2	93.8	7.57	0.77	8.09	4.11	0.23	1.38
American River Bankshares	AMRB	651,450	14.84	17.5	15.9	9.8	117.9	146.4	97.1	10.63	0.97	7.36	3.62	1.43	1.47
Northwest BanCorp	NBCT	636,528	11.40	NA	NA	NA	110.8	124.9	73.2	9.31	0.89	8.71	4.41	0.79	1.25
Idaho Independent Bank	IIBK	666,591	9.81	NA	NA	NA	115.3	115.3	74.8	9.73	NA	NA	3.46	NA	1.90
Sound Financial Bancorp	SFBC	588,383	29.65	NA	NA	NA	122.9	123.6	74.1	10.19	0.99	9.55	4.26	1.24	0.96
Puget Sound Bancorp	PUGB	519,265	23.80	NA	NA	NA	160.1	167.0	81.3	9.35	0.84	8.45	3.64	NA	1.17
Anchor Bancorp	ANCB	440,911	24.67	29.0	24.7	17.6	96.4	96.4	61.8	14.53	0.33	2.24	4.11	NA	1.07
Average:		824,498	16.46	20.1	16.7	21.2	127.0	137.3	119.1	10.75	0.78	6.94	3.73	1.32	1.30
FS Bancorp	FSBW	827,926	37.70	13.5	12.6	7.1	142.3	149.8	115.6	9.35	1.38	14.41	4.43	0.10	1.56

Source: FIG Partners Research, SNL Financial

Comparative Valuation

As shown in [Figure 9](#), FS Bancorp's stock trades below Banks of comparable size on estimates for EPS in 2017 and 2018. In our opinion, the company's discount to peers on earnings reflects a liquidity discount. FSBW's average volume is 5,000 shares a day, compared to the mean for peers of nearly 18,000 shares a day.

Outside a possible liquidity discount, FSBW's fundamentals suggest the stock should trade in-line or better than peers. The company has a better NIM-Net Interest Margin, better credit quality and greater reserve coverage. FSBW also has better relative profitability in terms of ROAA-Return on Average Assets and ROAE-Return on Average Equity.



Further Comparison of FSBW to Peers

We examined a list of Banks in the Western Region with Total Assets between \$600 Million and \$1.5 Billion.

While FSBW trades in-line with this expanded peer group in terms of both Core Deposit Premium and Price-to-Tangible Book Value, the company has a stronger ROAA than the median.

Our Price Target of \$44.00 Implies a Core Deposit Premium of 8%. That multiple is in-line with more liquid, if not less profitable bank stocks in the Western Region.

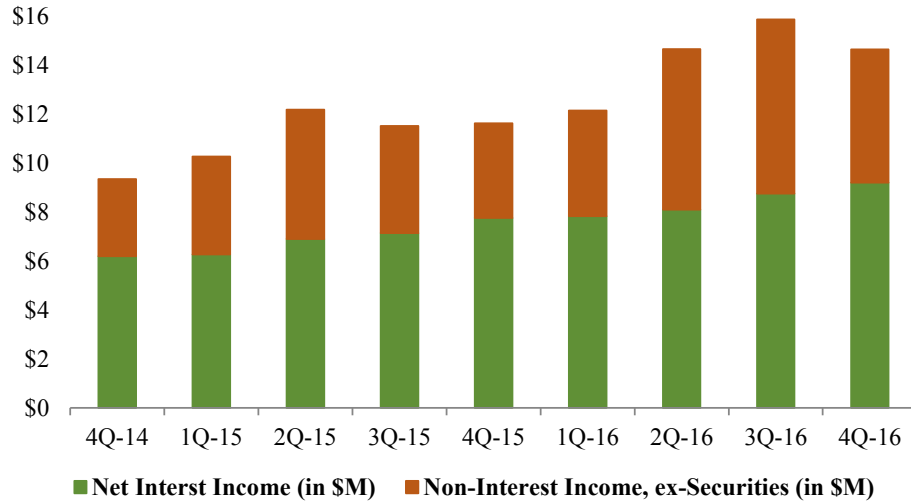
	Company Update	Market Cap (\$M)	Total Assets (\$000)	ROAA (%)	CDs % of Total	Cost of Deposits (%)	TCE Ratio (%)	Core Dep Premium (%)	Price/Tang Book (%)
AMRB	American River Bankshares	\$97	\$651,450	1.00	15.2	0.13	10.63	6.17	146.4
AVBH	Avidbank Holdings	\$90	\$646,655	1.14	16.1	0.21	9.82	5.50	141.5
BBBK	Baker Boyer Bncp	\$90	\$602,333	0.95	9.5	0.05	8.51	7.52	174.2
BOCH	Bank of Commerce Holdings	\$149	\$1,140,992	0.49	21.4	0.29	8.07	6.85	162.4
CABC	California Bank of Commerce	\$113	\$764,843	0.74	13.7	0.24	9.08	7.85	164.9
CFNB	California First National Bncp	\$164	\$880,344	1.06	84.0	1.20	21.70	NA	86.1
CSHX	Cashmere Valley Bank	\$207	\$1,454,239	1.25	18.8	0.35	10.99	4.17	130.0
CVCY	Central Valley Community Bncp	\$227	\$1,443,323	1.15	12.5	0.09	8.73	9.16	184.9
CWBB	Commonwealth Business Bank	\$137	\$913,194	1.38	52.3	0.75	11.17	NA	134.1
CWBC	Community West Bancshares	\$82	\$710,572	0.81	40.0	0.51	9.19	4.22	125.2
CWBK	CommerceWest Bank	\$70	\$616,672	1.03	12.4	0.24	9.46	2.38	121.3
CZBC	Citizens Bncp	\$79	\$723,262	0.73	4.8	0.08	9.15	2.15	119.1
EBMT	Eagle Bncp Montana	\$69	\$673,925	0.78	32.2	0.31	7.81	4.00	132.6
FCBK	First Choice Bank	\$145	\$863,455	1.01	21.0	0.78	11.75	NA	143.4
FFNW	First Financial Northwest	\$185	\$1,037,584	0.88	60.2	0.94	13.31	10.33	132.6
FNBG	FNB Bncp	\$207	\$1,219,394	0.90	11.2	0.25	8.66	10.88	197.2
FNRN	First Northern Community Bncp	\$126	\$1,166,763	0.74	7.1	0.12	7.91	3.34	141.9
FNWB	First Northwest Bncp	\$185	\$1,043,815	0.41	21.7	0.35	16.95	1.20	104.6
FSBW	FS Bncp	\$116	\$827,926	1.31	27.5	0.48	9.35	6.31	149.8
IIBK	Idaho Independent Bank	\$75	\$666,591	0.70	NA	NA	9.73	NA	115.3
MLGF	Malaga Financial Corp	\$153	\$993,000	1.16	NA	NA	NA	NA	130.3
NBCT	Northwest Bncp	\$73	\$636,528	0.82	22.4	0.30	9.31	3.12	124.9
NCAL	NCAL Bncp	\$29	\$810,892	NA	5.3	NA	NA	NA	NA
NRIM	Northrim Bncp	\$207	\$1,526,540	1.00	10.4	0.14	11.27	3.10	121.3
OPBK	OP Bncp	\$95	\$761,250	1.08	27.4	0.54	10.68	2.54	116.6
OVLY	Oak Valley Bncp	\$114	\$1,002,110	0.83	6.0	0.09	7.84	4.02	145.2
PDOB	Presidio Bank	\$104	\$747,503	0.66	7.0	0.15	9.01	5.91	154.3
PFCF	Pacific City Financial Corp	\$177	\$1,226,643	1.25	45.6	0.75	10.35	6.79	139.0
PFLC	Pacific Financial Corp	\$94	\$891,383	0.77	16.6	0.25	7.57	3.74	141.2
PLBC	Plumas Bncp	\$86	\$657,975	1.20	8.5	0.10	7.28	6.82	178.9
PLZZ	Plaza Bncp	\$181	\$1,217,273	1.00	23.9	0.52	9.08	8.97	164.3
PMBC	Pacific Mercantile Bncp	\$173	\$1,140,689	-3.13	25.8	0.54	8.74	9.41	171.9
PROV	Provident Financial Holdings	\$147	\$1,192,155	0.64	31.2	0.42	11.12	1.79	110.0
RVSB	Riverview Bncp	\$166	\$985,669	0.73	13.1	0.13	8.73	10.55	198.4
TSBK	Timberland Bncp	\$160	\$923,751	1.19	18.5	0.28	10.24	9.21	161.7
UBFO	United Security Bancshares	\$122	\$787,972	0.98	15.2	0.20	11.76	4.94	132.7
			Median:	0.95	17.5	0.28	9.33	5.71	141.17

Source: FIG Partners Research, SNL Financial LC



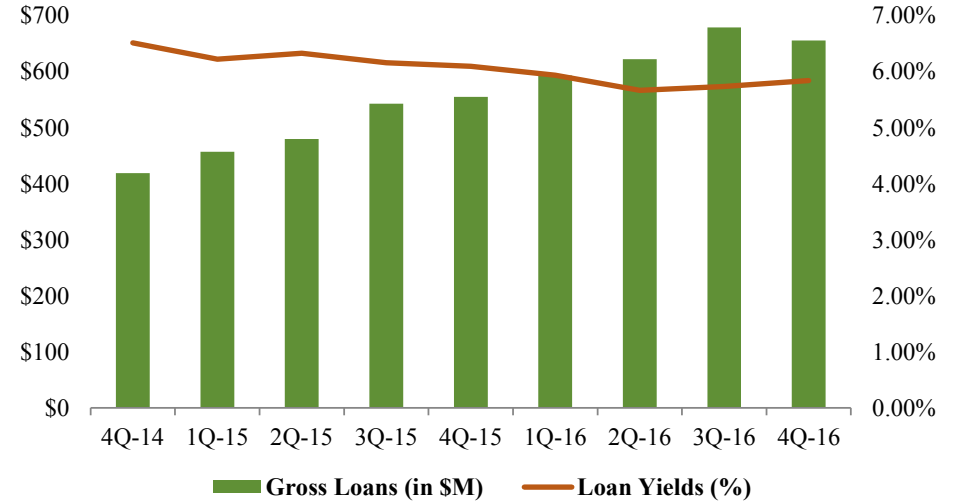
The charts on this page show important performance data for FSBW over the last two(2) years

Core Operating Revenue



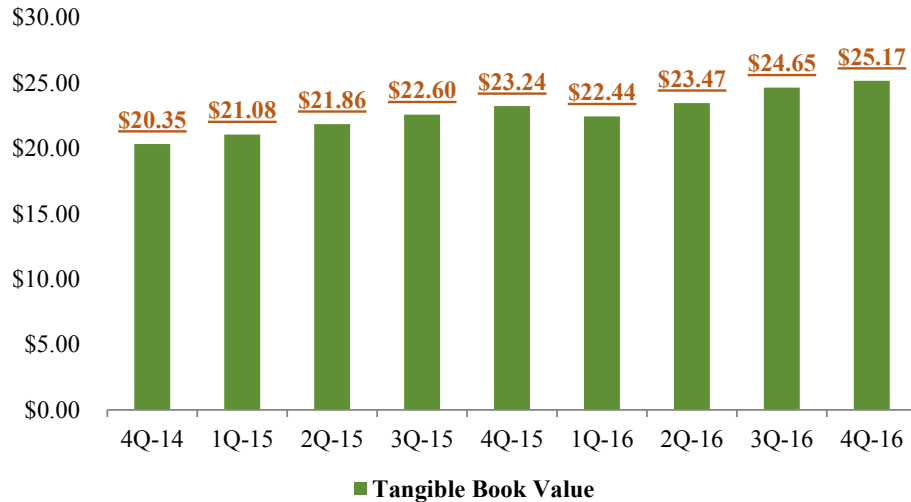
Source: FIG Partners Research, SNL Financial LC

Gross Loans and Loan Yields



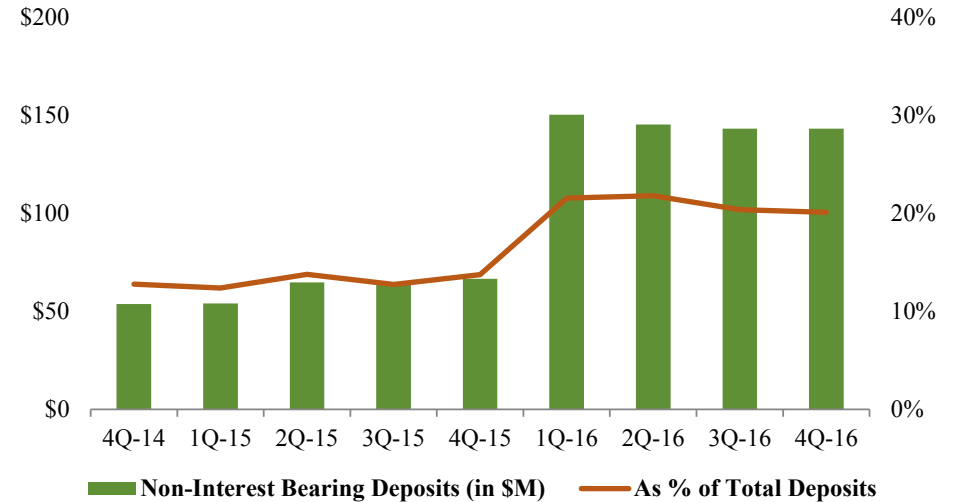
Source: FIG Partners Research, SNL Financial LC

Tangible Book Value Growth Since 4Q-14



Source: FIG Partners Research, SNL Financial LC

Deposit Trends



Source: FIG Partners Research, SNL Financial LC



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

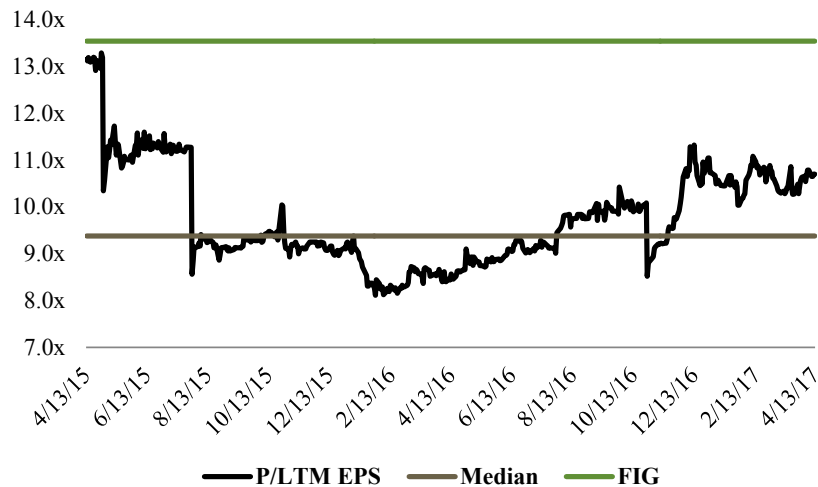
	1Q 2017	+	2Q 2017	+	3Q 2017	+	4Q 2017	= 1-Year Fwd Value	x Terminal Multiple	= 1-Year Price Target
Earnings per Share	\$0.75		\$0.82		\$0.85		\$0.83	\$3.25	13.5x	\$44.00
Pre-Pre EPS	\$1.23		\$1.34		\$1.39		\$1.35	\$5.32	8.3x	\$44.00
Core EPS	\$0.75		\$0.82		\$0.85		\$0.83	\$3.25	13.5x	\$44.00
Tangible Book							\$28.14	\$28.14	1.56x	\$44.00

Source: FIG Partners Research

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

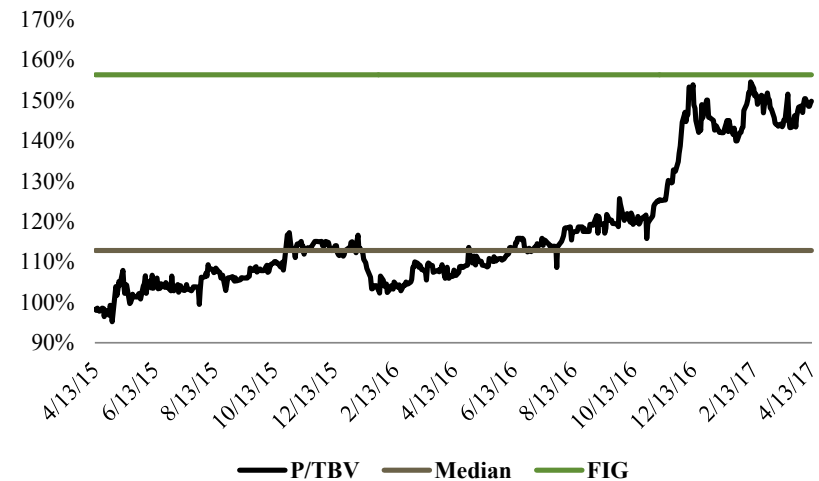
The horizontal lines show the two-year medians (grey line) and FIG estimated forward multiples (green).

FSBW: Price to Forward EPS



Source: FIG Partners Research, Company Filings

FSBW: Price to Tangible Book Value



Source: FIG Partners Research, Company Filings

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			2016 Quarterly				2017 Quarterly				2018 Quarterly			
	2016A	2017E	2018E	1Q16A	2Q16A	3Q16A	4Q16A	1Q17E	2Q17E	3Q17E	4Q17E	1Q18E	2Q18E	3Q18E	4Q18E
Income Data: (\$ in Millions)															
Net Interest Income (FTE)	\$33.9	\$38.7	\$43.6	\$7.8	\$8.1	\$8.8	\$9.2	\$9.4	\$9.5	\$9.8	\$10.0	\$10.2	\$10.6	\$11.2	\$11.6
Loan Loss Provision	\$2.4	\$0.9	\$1.4	\$0.6	\$0.6	\$0.6	\$0.6	\$0.2	\$0.2	\$0.3	\$0.3	\$0.3	\$0.4	\$0.4	\$0.4
Non-Interest Income	\$4.4	\$4.8	\$5.4	\$1.0	\$1.1	\$1.2	\$1.1	\$1.2	\$1.2	\$1.2	\$1.2	\$1.3	\$1.3	\$1.4	\$1.4
Gain/Loss on Loan Sales	\$19.1	\$14.7	\$14.9	\$3.4	\$5.4	\$5.9	\$4.3	\$3.4	\$3.7	\$3.9	\$3.8	\$3.4	\$3.8	\$3.9	\$3.8
Gain/Loss on Securities	\$0.1	\$0.0	\$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
One-Time Items	(\$0.4)	\$0.0	\$0.0	(\$0.4)	(\$0.0)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Non-Interest Expense	\$38.5	\$41.9	\$46.0	\$8.5	\$9.6	\$10.3	\$10.1	\$10.1	\$10.3	\$10.6	\$10.9	\$11.0	\$11.4	\$11.8	\$11.8
Pre-Tax Income	\$16.1	\$15.4	\$16.5	\$2.6	\$4.4	\$5.1	\$4.0	\$3.6	\$3.9	\$4.0	\$3.9	\$3.6	\$4.0	\$4.3	\$4.6
Taxes (w/ FTE adj.)	\$5.6	\$5.4	\$5.8	\$1.0	\$1.6	\$1.6	\$1.4	\$1.3	\$1.4	\$1.4	\$1.4	\$1.3	\$1.4	\$1.5	\$1.6
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	\$10.5	\$10.0	\$10.7	\$1.7	\$2.8	\$3.5	\$2.5	\$2.3	\$2.5	\$2.6	\$2.5	\$2.4	\$2.6	\$2.8	\$3.0
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	\$10.5	\$10.0	\$10.7	\$1.7	\$2.8	\$3.5	\$2.5	\$2.3	\$2.5	\$2.6	\$2.5	\$2.4	\$2.6	\$2.8	\$3.0
Avg. Shares O/S	3.0	3.1	3.1	3.0	3.0	2.9	3.0	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1
Earnings Per Share (EPS)	\$3.54	\$3.25	\$3.48	\$0.55	\$0.96	\$1.18	\$0.86	\$0.75	\$0.82	\$0.85	\$0.83	\$0.77	\$0.84	\$0.91	\$0.96
Per Share Data:															
Reported Book Value	\$26.49	\$29.27	\$32.28	\$23.85	\$24.88	\$26.02	\$26.49	\$27.12	\$27.83	\$28.56	\$29.27	\$29.92	\$30.64	\$31.44	\$32.28
Tangible Book Value	\$25.17	\$28.14	\$31.33	\$22.44	\$23.47	\$24.65	\$25.17	\$25.85	\$26.60	\$27.38	\$28.14	\$28.84	\$29.60	\$30.45	\$31.33
Dividends	\$0.37	\$0.40	\$0.40	\$0.07	\$0.10	\$0.10	\$0.10	\$0.10	\$0.10	\$0.10	\$0.10	\$0.10	\$0.10	\$0.10	\$0.10
Pre-Tax, Pre-Provision EPS	\$7.13	\$5.32	\$5.82	\$1.40	\$1.91	\$2.09	\$1.74	\$1.23	\$1.34	\$1.39	\$1.35	\$1.26	\$1.41	\$1.54	\$1.61
CORE GAAP EPS	\$3.58	\$3.25	\$3.48	\$0.63	\$0.96	\$1.14	\$0.86	\$0.75	\$0.82	\$0.85	\$0.83	\$0.77	\$0.84	\$0.91	\$0.96
KEY Ratios:															
Net Interest Margin	4.44%	4.69%	4.72%	4.19%	4.34%	4.55%	4.66%	4.68%	4.69%	4.69%	4.71%	4.69%	4.71%	4.73%	4.75%
Return on Avg Assets	1.27%	1.10%	1.05%	0.85%	1.44%	1.72%	1.23%	1.09%	1.17%	1.18%	1.13%	1.02%	1.08%	1.14%	1.16%
Return on Avg Equity	13.07%	11.23%	10.91%	8.95%	15.19%	18.18%	12.68%	11.21%	11.95%	12.06%	11.44%	10.39%	11.06%	11.77%	12.06%
Pre-Tax Pre-Provision ROA	2.56%	1.81%	1.76%	2.17%	2.88%	3.06%	2.50%	1.79%	1.91%	1.94%	1.84%	1.68%	1.82%	1.92%	1.95%
Return on Tang. Comm. Equity	13.63%	11.53%	11.09%	9.40%	15.81%	18.34%	13.22%	11.62%	12.34%	12.41%	11.75%	10.66%	11.31%	11.99%	12.26%
Efficiency Ratio	66.36%	71.03%	71.12%	69.46%	64.59%	64.17%	67.95%	71.84%	70.62%	70.32%	71.39%	73.00%	71.56%	70.48%	69.67%
TCE/TA	9.35%	9.71%	9.42%	8.82%	9.20%	9.16%	9.35%	9.45%	9.57%	9.65%	9.71%	9.77%	9.64%	9.45%	9.42%
Period-End Balances: (\$ in Millions)															
Total Assets	\$828	\$892	\$1,025	\$805	\$784	\$827	\$828	\$842	\$855	\$874	\$892	\$909	\$946	\$993	\$1,025
Net Loans	\$646	\$718	\$838	\$585	\$614	\$670	\$646	\$652	\$672	\$703	\$718	\$735	\$768	\$808	\$838
Total Deposits	\$713	\$776	\$873	\$697	\$666	\$703	\$713	\$727	\$741	\$758	\$776	\$793	\$816	\$849	\$873
Intangibles	\$4	\$3	\$3	\$4	\$4	\$4	\$4	\$4	\$4	\$4	\$3	\$3	\$3	\$3	\$3
Total Common Equity	\$81	\$90	\$99	\$75	\$76	\$80	\$81	\$83	\$85	\$88	\$90	\$92	\$94	\$97	\$99



FIG Partners LLC Distribution of Ratings

	Buy / Outperform	Hold / Market- Perform	Sell / Underperform
% Rated	32.0%	68.0%	0.0%
IB Client % in Category	29.3%	16.1%	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.
- Neither the analyst nor anyone at FIG serves as an officer, director, or advisory board member of the subject company.
- 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.
- All analysts are compensated based on a number of factors including the overall profits of FIG Partners LLC which includes investment Banking revenues, but no analyst receives any compensation which is based on a specific investment Banking service or transaction.
- 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.
- This research report reflects the analyst's actual opinion.
- No research analyst is subject to the supervision or control of any employee of the member's investment Banking department.
- No employee of the investment Banking department has reviewed or approved this report prior to publication
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