

FSBW-FS Bancorp Inc.

Reiterating at “Outperform” And Price Target at \$60.00

- **Adjusting Core EPS Estimates to \$1.32 (-\$0.02) in 2Q-19, \$5.40 (-\$0.02) in '19; Reported EPS of \$5.90 (Unchanged) in '20**
- **Price Target Equivalent to 10.8x Forward Core EPS (\$5.53) and 137% Forward Tangible Book Value (\$43.88)**
- **1Q-19 Results Were: Reported = \$1.15 / Core = \$1.21 / FIG (Core) = \$1.25 / Consensus = \$1.27**
- **Results Highlighted By Lower Than Expected Spread Income Offset By Better Than Expected Fee Income**
- **Betas: Deposits = 79% / Cost of Funds = 37% / Loans (Core) = -11% / Core NIM Change = -7bps**

Following our analysis of the company’s 1Q-19 results, we are reiterating our rating on FSBW-FS Bancorp Inc. at “Outperform” and our Price Target at \$60.00, as well as adjusting our forward Core EPS estimates to \$1.32 (from \$1.34) for 2Q-19 and \$5.40 (from \$5.42) for 2019, and our reported EPS estimate to \$5.90 (unchanged) for 2020. Our Price Target is equivalent to 10.8x our forward four quarter Core EPS estimate (\$5.53) and 137% of our forward tangible book value forecast (\$43.88).

FSBW reported 1Q-19 Core EPS of \$1.21, missing our Core EPS estimate of \$1.25 and the mean Consensus estimate of \$1.17. The company’s reported EPS of \$1.15 included \$374,000 in merger-related expenses. Results were highlighted by lower than expected spread income offset by better than expected fee income, including mortgage banking revenue of \$2.4 Million. We estimated Core Pre-Tax, Pre-Provision EPS of \$1.73 and Core Pre-Pre ROAA of 1.94%, compared to \$1.68 and 1.94% the previous quarter. Tangible book value increased 3.6% sequentially to \$39.57 and TCE-Tangible Common Equity ended the quarter at 10.98% of tangible assets.

While loan growth in 1Q-19 was softer than expected (down \$29.1 Mil, or 2.2% sequentially), we continue to forecast annual loan growth of ~\$100 Million, or ~7% for the year. The decline in loan balances in the most recent quarter was mostly the result of pay-offs and project completions in the construction book (C&D-Construction & Development loans declined \$28.1 Mil). We anticipate greater construction loan fundings and continued strength in SFR-Single Family Residential mortgages, consumer loans and CRE-Commercial Real Estate could result in loan growth meeting our estimates.

Additionally, we forecast lower operating expenses as FSBW continues to recognize cost saves from the acquisition of Anchor Bancorp in November. FSBW management expects to consolidate core operating systems during 2Q-19 (resulting in our estimates of nonrecurring expenses of \$1.6 Mil) and starting in 3Q-19 cost saves of \$100,000 per month. We forecast the efficiency ratio could improve to the low 60%-range from mid-60% in 2018

See the last page for disclosures on FIG Partners’ equity rating system, distribution, and other disclosures.

FSBW: \$52.00

“Outperform” // Price Target: \$60.00

Summary Statistics

Exchange	NASDAQ
Market Cap (\$M)	\$228.6
Avg. Volume	10,362
Annual Dividend	\$0.56
Dividend Yield	1.08%
Tangible Book/Share	\$39.57
Price/Tangible Book	131%
Price/2019 EPS	9.6x
Price/2020 EPS	8.8x
Total Assets (\$000)	\$1,626,116
TCE/TA	10.98%
ROTCE (2019)	11.77%
ROA (2019)	1.21%

EPS Estimates

	2017	2018	2019	2020
Q1	\$0.85	\$1.13	\$1.21	\$1.35
Q2	\$1.41	\$1.13	\$1.32	\$1.45
Q3	\$1.07	\$1.16	\$1.42	\$1.58
Q4	\$0.98	\$1.44	\$1.44	\$1.52
FY	\$4.28	\$4.86	\$5.40	\$5.90

Industry Type	Thrift
Headquarters	Mountlake Terrace, WA
Offices	23
Date Established	2012
CEO	Joseph C. Adams
CFO	Matthew D. Mullet

Core EPS in BLUE



Review of 1Q-19 Results:

Overview: FSBW-FS Bancorp reported 1Q-19 Core EPS of \$1.21, missing our Core EPS estimate of \$1.25 and beating the mean Consensus estimate of \$1.17. The company's reported EPS of \$1.15 included \$374,000 in merger-related expenses. Results were highlighted by lower than expected spread income offset by better than expected fee income, including mortgage banking revenue of \$2.4 Million. We estimated Core Pre-Tax, Pre-Provision EPS of \$1.73 and Core Pre-Pre ROAA of 1.94%, compared to \$1.68 and 1.94% the previous quarter. Tangible book value increased 3.6% sequentially to \$39.57 and TCE-Tangible Common Equity ended the quarter at 10.98% of tangible assets.

Spread Income and Margin: NII-Net Interest Income increased 11.8% sequentially to \$17.7 Mil and NIM-Net Interest Margin expanded 11bps to 4.70%. We had forecasted spread income of \$18.5 Mil and margin of 4.59%. We estimate Core NIM was 4.56%, down from 4.63% the previous quarter. Gross loans declined \$29.1 Mil, or down 2.2% sequentially, to \$1.30 Billion with growth in residential mortgages (up \$12.5 Mil) and consumer loans (up \$8.9 Mil) offset by declines in C&D-Construction & Development loans (down \$28.1 Mil) and mortgage warehouse lending (down \$23.8 Mil). Average loans ended the quarter at \$1.35 Bil, or 88.4% of average earning assets, up from 87.9% the previous quarter. Loan yields expanded 7bps to 6.26% (core yields compressed 2bps to 6.17%) and earning asset yields expanded 5bps to 5.73%.

Mortgage Banking: Gain on sale of mortgage loans was \$2.4 Mil, unchanged from the previous quarter and down 39.7% from the year ago period. Loan closings were \$143.7 Mil, down 7.6% from the previous quarter and 15.6% from a year earlier. We estimated the loan sale margin was 1.83%, down 20bps from the previous quarter and 74bps from the same period a year earlier.

Funding Sources and Costs: Total deposits increased \$47.3 Mil, or 3.7% sequentially, to \$1.32 Bil. Non-interest bearing deposits increased 3.1% sequentially to \$228 Mil, or 17.3% of total deposits, and non-time deposits increased 3.3% sequentially to \$803 Mil, or 60.8% of total deposits. Average borrowings ended the quarter at \$120.3 Mil, or 10.2% of average interest-bearing liabilities, down from 14.4% the previous quarter. Cost of total deposits expanded 14bps to 1.15% and total cost of funds expanded 6bps to 1.31%.

Credit Quality: FSBW booked a provision expense of \$750,000, compared to \$290,000 the previous quarter. NPA-Non-Performing Assets declined 31% sequentially to \$3.2 Mil or 0.24% of Loans+OREO. The company booked NCO-Net Charge-Offs of \$1.3 Mil, or 0.37% of average loans annualized on a single commercial line of credit charge-off in the amount of \$1.2 Mil. Reserves ended the quarter at \$11.8 Mil, or 0.91% of loans and 1.26% of loans when the discount is included.

Fee-Based Income: Core non-interest income increased 34% sequentially to \$2.2 Mil, or 0.53% of average assets, up from the trailing four quarter average of 0.38%. The sequential increase was driven by a \$470,000 increase in service charges.

Non-Interest Expense and Efficiency Ratio: Core non-interest expenses increased 12% sequentially to \$14.4 Mil, or 3.57% of average assets, down from the trailing average of 4.09%. The increase was driven by a \$1.5 Mil increase in compensation expenses and \$360,000 increase in data processing costs. The company also booked merger-related expenses of \$374,000, compared to \$976,000 the previous quarter. We estimated the company's core efficiency ratio was 64.0%, compared to 64.3% the previous quarter.

FSBW (Mountlake Terrace, WA--\$229 Mil. Mkt. Cap, \$1.6 Bil. Assets, \$52.00, 1.1% Yld)

	4Q-2018	Δ	1Q-2019	Consensus	Variance Per Share
EPS	\$2.83	-	\$1.15	\$1.27	(\$0.12)
Operating/Core EPS*	\$1.23	-	\$1.21		
FIG Estimate	\$1.17	-	\$1.25		
Net Interest Income	15.8	11.8%	17.7	18.2	(\$0.12)
Loan Loss Provision	0.3	158.6%	0.8	0.7	(\$0.02)
Core Non-Interest Income (ex. sec.)	4.0	13.6%	4.6	4.2	\$0.08
Core Non-Interest Expense	12.9	12.0%	14.4	14.3	(\$0.02)
Net Charge-Offs	0.0	(9,057%)	1.3		
NCOs % of Avg Total Loans (bps)	0	37bps	37	5	(32)
Tangible Book Per Share	\$38.18	3.6%	\$39.57	\$39.37	\$0.20
Net Interest Margin	4.59%	11bps	4.70%	4.57%	0.13%
Gross Loans (\$Mil.)	1,324.9	(2.2%)	1,295.8	1,361.0	(65.2)
TCE Ratio (TCE/TA)	10.63%	35bps	10.98%		
NPAs to Loans/REO	0.35%	(2)bps	0.24%		

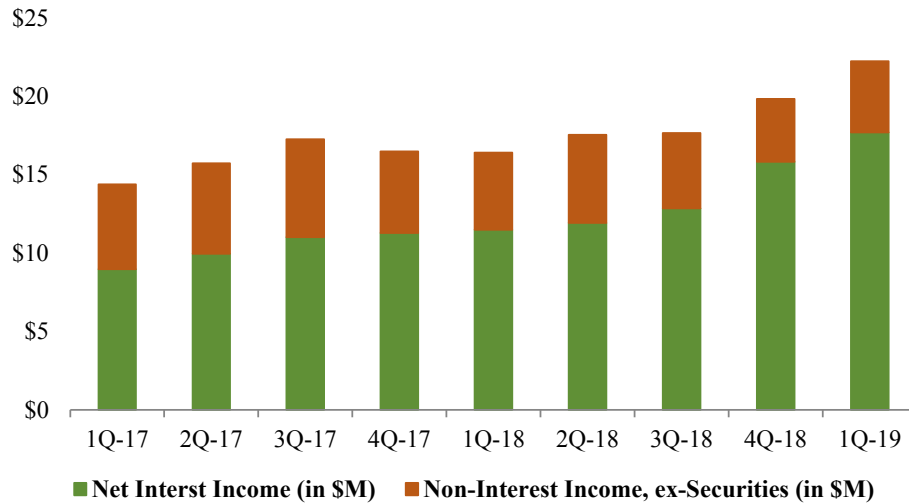
*Core EPS exclude various one-time items.

Source: FIG Partners, S&P Global Market Intelligence

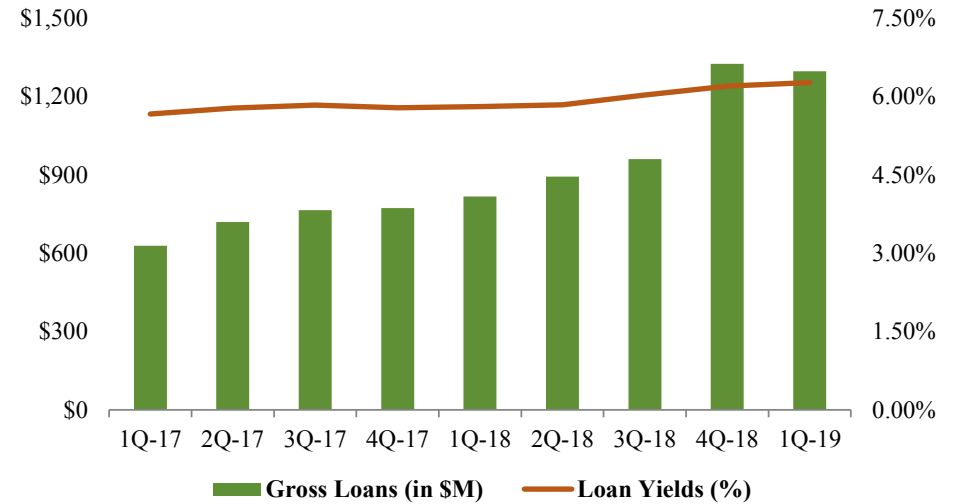


The charts on this page show important performance data for FSBW over the last two(2) years

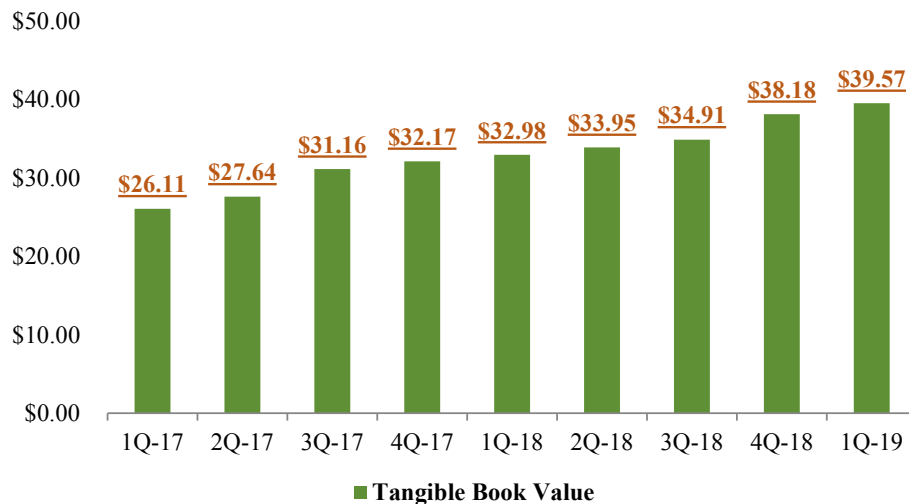
Core Operating Revenue



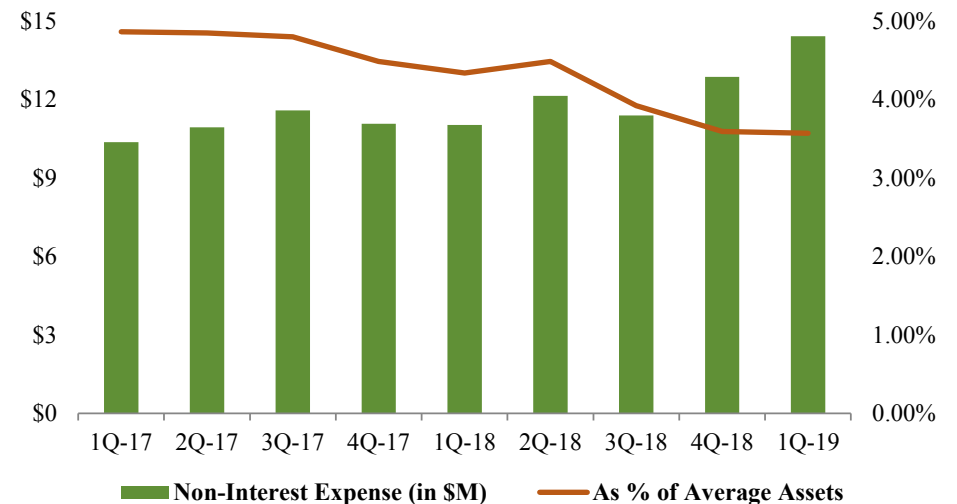
Gross Loans and Loan Yields



Tangible Book Value Growth Since 1Q-17



Non-Interest Expense Trends



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



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

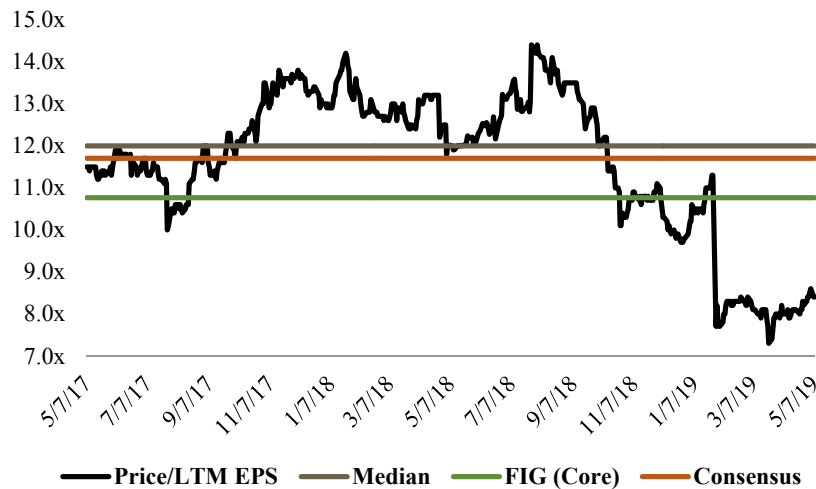
	2Q 2019	+	3Q 2019	+	4Q 2019	+	1Q 2020	=	1-Year Fwd Value	x	Terminal Multiple	=	1-Year Price Target
Earnings per Share	\$1.03		\$1.45		\$1.47		\$1.35		\$5.30		11.3x		\$60.00
Pre-Pre EPS	\$1.84		\$2.01		\$2.04		\$1.88		\$7.77		7.7x		\$60.00
Core EPS	\$1.31		\$1.45		\$1.47		\$1.35		\$5.57		10.8x		\$60.00
Tangible Book							\$43.93		\$43.93		1.37x		\$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).

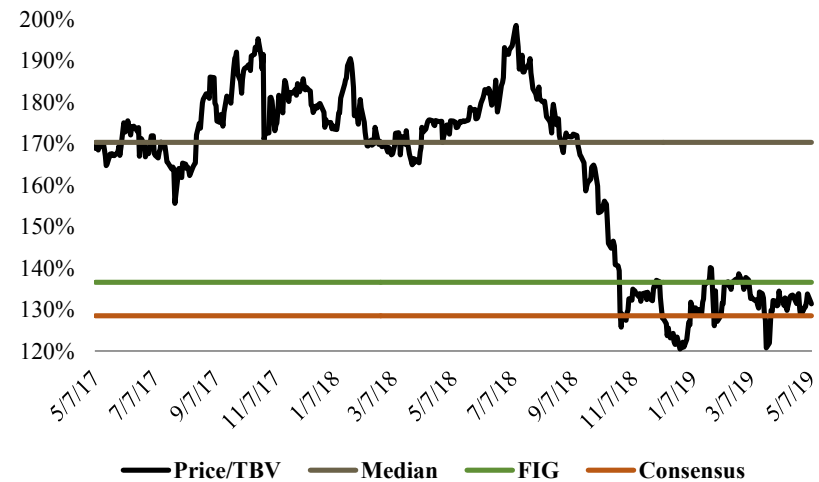
Source: FIG Partners Research

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			2018 Quarterly				2019 Quarterly				2020 Quarterly			
	2018A	2019E	2020E	1Q18A	2Q18A	3Q18A	4Q18A	1Q19E	2Q19E	3Q19E	4Q19E	1Q20E	2Q20E	3Q20E	4Q20E
Income Data: (\$ in Millions)															
Net Interest Income (FTE)	\$52.1	\$74.4	\$78.4	\$11.5	\$11.9	\$12.9	\$15.8	\$18.5	\$18.5	\$18.6	\$18.8	\$19.1	\$19.4	\$19.8	\$20.1
Loan Loss Provision	\$1.5	\$3.0	\$3.0	\$0.4	\$0.5	\$0.5	\$0.3	\$0.8	\$0.8	\$0.8	\$0.8	\$0.8	\$0.8	\$0.8	\$0.8
Non-Interest Income	\$4.5	\$6.6	\$7.2	\$0.9	\$0.9	\$1.0	\$1.6	\$1.5	\$1.6	\$1.7	\$1.7	\$1.8	\$1.8	\$1.8	\$1.9
Gain/Loss on Loan Sales	\$14.9	\$10.4	\$10.3	\$4.0	\$4.7	\$3.8	\$2.4	\$2.1	\$2.5	\$3.0	\$2.8	\$2.3	\$2.6	\$2.9	\$2.5
Gain/Loss on Securities	\$0.2	\$0.0	\$0.0	\$0.1	\$0.0	\$0.0	\$0.1	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
One-Time Items	\$6.0	(\$2.1)	\$0.0	\$0.0	\$0.0	(\$0.4)	\$6.5	(\$0.5)	(\$1.6)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Non-Interest Expense	\$47.5	\$57.6	\$59.1	\$11.0	\$12.1	\$11.4	\$12.9	\$14.3	\$14.4	\$14.5	\$14.4	\$14.7	\$14.7	\$14.8	\$14.9
Pre-Tax Income	\$28.6	\$28.7	\$33.8	\$5.1	\$4.9	\$5.4	\$13.2	\$6.6	\$6.0	\$8.0	\$8.1	\$7.7	\$8.4	\$9.0	\$8.8
Taxes (w/ FTE adj.)	\$4.2	\$6.2	\$7.3	\$0.8	\$0.7	\$1.3	\$1.4	\$1.4	\$1.3	\$1.7	\$1.7	\$1.7	\$1.8	\$1.9	\$1.9
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	\$24.4	\$22.5	\$26.6	\$4.3	\$4.3	\$4.1	\$11.8	\$5.2	\$4.7	\$6.3	\$6.4	\$6.1	\$6.6	\$7.0	\$6.9
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	\$24.3	\$22.5	\$26.6	\$4.3	\$4.3	\$4.1	\$11.7	\$5.2	\$4.7	\$6.3	\$6.4	\$6.1	\$6.6	\$7.0	\$6.9
Avg. Shares O/S	3.9	4.5	4.5	3.8	3.8	3.8	4.1	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5
Earnings Per Share (EPS)	\$6.18	\$5.05	\$5.90	\$1.15	\$1.13	\$1.07	\$2.83	\$1.16	\$1.05	\$1.41	\$1.42	\$1.35	\$1.46	\$1.56	\$1.53
Per Share Data:															
Reported Book Value	\$40.08	\$43.96	\$48.91	\$33.94	\$34.88	\$35.82	\$40.08	\$40.90	\$41.67	\$42.87	\$43.96	\$45.02	\$46.26	\$47.60	\$48.91
Tangible Book Value	\$38.18	\$42.17	\$47.24	\$32.98	\$33.95	\$34.91	\$38.18	\$39.01	\$39.81	\$41.04	\$42.17	\$43.26	\$44.53	\$45.90	\$47.24
Dividends	\$0.53	\$0.60	\$0.60	\$0.11	\$0.14	\$0.14	\$0.14	\$0.15	\$0.15	\$0.15	\$0.15	\$0.15	\$0.15	\$0.15	\$0.15
Pre-Tax, Pre-Provision EPS	\$6.20	\$7.57	\$8.18	\$1.43	\$1.43	\$1.66	\$1.68	\$1.76	\$1.87	\$1.97	\$1.98	\$1.88	\$2.02	\$2.16	\$2.11
CORE GAAP EPS	\$4.65	\$5.42	\$5.90	\$1.13	\$1.13	\$1.16	\$1.23	\$1.25	\$1.34	\$1.41	\$1.42	\$1.35	\$1.46	\$1.56	\$1.53
KEY Ratios:															
Net Interest Margin	4.62%	4.62%	4.61%	4.76%	4.58%	4.55%	4.59%	4.59%	4.61%	4.62%	4.64%	4.60%	4.62%	4.62%	4.61%
Return on Avg Assets	1.70%	1.31%	1.43%	1.70%	1.57%	1.39%	3.29%	1.40%	1.20%	1.51%	1.48%	1.38%	1.47%	1.55%	1.49%
Return on Avg Equity	15.66%	11.60%	12.19%	14.08%	13.53%	12.29%	30.24%	11.45%	10.21%	13.37%	13.09%	12.12%	12.76%	13.32%	12.67%
Pre-Tax Pre-Provision ROA	1.67%	1.97%	1.98%	2.11%	1.99%	2.16%	1.94%	2.13%	2.13%	2.10%	2.06%	1.93%	2.04%	2.14%	2.05%
Return on Tang. Comm. Equity	14.19%	11.92%	12.44%	14.18%	13.53%	12.49%	27.29%	11.95%	10.57%	13.76%	13.45%	12.44%	13.07%	13.61%	12.93%
Efficiency Ratio	65.93%	62.47%	61.09%	66.79%	68.80%	64.09%	64.32%	64.06%	62.76%	61.73%	61.41%	62.91%	61.27%	59.81%	60.50%
TCE/TA	10.63%	10.09%	10.52%	11.72%	11.15%	10.92%	10.63%	10.28%	9.96%	9.88%	10.09%	10.18%	10.29%	10.41%	10.52%
Period-End Balances: (\$ in Millions)															
Total Assets	\$1,622	\$1,881	\$2,037	\$1,044	\$1,133	\$1,191	\$1,622	\$1,695	\$1,791	\$1,863	\$1,881	\$1,919	\$1,958	\$1,997	\$2,037
Net Loans	\$1,364	\$1,591	\$1,738	\$857	\$936	\$1,002	\$1,364	\$1,449	\$1,532	\$1,575	\$1,591	\$1,627	\$1,663	\$1,700	\$1,738
Total Deposits	\$1,274	\$1,526	\$1,652	\$857	\$870	\$945	\$1,274	\$1,312	\$1,391	\$1,489	\$1,526	\$1,556	\$1,587	\$1,619	\$1,652
Intangibles	\$9	\$8	\$8	\$4	\$3	\$3	\$9	\$8	\$8	\$8	\$8	\$8	\$8	\$8	\$8
Total Common Equity	\$180	\$197	\$221	\$125	\$129	\$133	\$180	\$182	\$186	\$191	\$197	\$203	\$208	\$215	\$221



FIG Partners LLC Distribution of Ratings

	Buy / Outperform	Hold / Market- Perform	Sell / Underperform
% Rated	50.4%	49.6%	0.0%
IB Client % in Category	25.0%	17.9%	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.
- 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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