

FS Bancorp, Inc.
Form 10-Q
November 12, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013 OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 333-177125

FS BANCORP, INC.

(Exact name of registrant as specified in its charter)

Washington

(State or other jurisdiction of incorporation or organization)

45-4585178

(IRS Employer Identification No.)

6920 220th Street SW, Mountlake Terrace, Washington 98043

(Address of principal executive offices; Zip Code)

(425) 771-5299

(Registrant's telephone number, including area code)

None

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of November 8, 2013, there were 3,240,125 outstanding shares of the registrant's common stock.

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As used in this report, the terms "we," "our," and "us," and "Company" refer to FS Bancorp, Inc. and its consolidated subsidiary, unless the context indicates otherwise. When we refer to "Bank" in this report, we are referring to 1st Security Bank of Washington, the wholly owned subsidiary of FS Bancorp, Inc.

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Item 1. Financial Statements
 FS BANCORP, INC. AND SUBSIDIARY
 CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except share data) (Unaudited)

	September 30, 2013	December 31, 2012
ASSETS		
Cash and due from banks	\$2,017	\$4,003
Interest-bearing deposits at other financial institutions	25,323	5,410
Securities available-for-sale, at fair value	47,131	43,313
Federal Home Loan Bank stock, at cost	1,717	1,765
Loans held for sale, at fair value	8,389	8,870
Loans receivable, net	283,794	274,949
Accrued interest receivable	1,333	1,223
Premises and equipment, net	13,705	12,663
Other real estate owned ("OREO")	2,259	2,127
Deferred tax asset	752	1,927
Bank owned life insurance ("BOLI")	6,038	—
Other assets	3,608	2,780
TOTAL ASSETS	\$396,066	\$359,030
LIABILITIES		
Deposits		
Interest-bearing accounts	\$274,289	\$254,784
Noninterest-bearing accounts	42,579	34,165
Total deposits	316,868	288,949
Borrowings	13,664	6,840
Other liabilities	3,300	3,344
Total liabilities	333,832	299,133
COMMITMENTS AND CONTINGENCIES (NOTE 9)		
STOCKHOLDERS' EQUITY		
Preferred stock, \$.01 par value; 5,000,000 shares authorized; None issued or outstanding	—	—
Common stock, \$.01 par value; 45,000,000 shares authorized; 3,240,125 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively	32	32
Additional paid-in capital	30,029	29,894
Retained earnings	34,828	31,746
Accumulated other comprehensive income (loss)	(481	) 597
Unearned shares - Employee Stock Ownership Plan ("ESOP")	(2,174	) (2,372
Total stockholders' equity	62,234	59,897
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$396,066	\$359,030

See accompanying notes to these consolidated financial statements.

Table of ContentsFS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except earnings per share data) (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,		
	2013	2012	2013	2012	
INTEREST INCOME					
Loans receivable	\$5,365	\$4,647	\$15,536	\$13,121	
Interest and dividends on investment securities and cash and cash equivalents	232	193	672	521	
Total interest income	5,597	4,840	16,208	13,642	
INTEREST EXPENSE					
Deposits	502	543	1,438	1,715	
Borrowings	56	28	142	117	
Total interest expense	558	571	1,580	1,832	
NET INTEREST INCOME	5,039	4,269	14,628	11,810	
PROVISION FOR LOAN LOSSES	520	630	1,720	1,695	
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	4,519	3,639	12,908	10,115	
NONINTEREST INCOME					
Service charges and fee income	473	499	1,420	1,494	
Gain on sale of loans	1,537	915	5,316	1,466	
Gain on sale of investment securities	—	—	264	106	
Other noninterest income	153	65	357	258	
Total noninterest income	2,163	1,479	7,357	3,324	
NONINTEREST EXPENSE					
Salaries and benefits	2,578	2,162	8,190	5,723	
Operations	752	630	2,268	1,761	
Occupancy	372	286	1,074	889	
Data processing	285	254	817	762	
OREO fair value write-downs, net of loss on sales	151	82	347	728	
OREO expenses	41	57	79	155	
Loan costs	362	213	1,007	550	
Professional and board fees	331	178	894	481	
FDIC insurance	62	66	186	185	
Marketing and advertising	107	80	350	200	
Impairment (recovery) of loss on servicing rights	(2	) 108	(102	) 105
Total noninterest expense	5,039	4,116	15,110	11,539	
INCOME BEFORE PROVISION (BENEFIT) FOR INCOME TAX	1,643	1,002	5,155	1,900	
PROVISION (BENEFIT) FOR INCOME TAX	581	(2,323) 1,772	(2,323)
NET INCOME	\$1,062	\$3,325	\$3,383	\$4,223	
Basic earnings per share	\$0.35	\$1.03	\$1.12	n/a ⁽¹⁾	
Diluted earnings per share	\$0.35	\$1.03	\$1.12	n/a ⁽¹⁾	

(1): Earnings per share calculations are not available (n/a) as the Company completed its stock conversion and became a public company on July 9, 2012.

See accompanying notes to these consolidated financial statements.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands) (Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Net Income	\$ 1,062	\$ 3,325	\$ 3,383	\$ 4,223
Other comprehensive gain (loss), net of tax:				
Unrealized gain (loss) on securities available-for-sale:				
Unrealized holding gain (loss) arising during period	193	521	(1,063	) 864
Reclassification adjustment for realized gains included in net income	—	—	(264	) (106)
Income tax benefit (provision) related to realized and unrealized gain (loss)	(65	) 365	249	365
Other comprehensive gain (loss), net of tax	128	886	(1,078	) 1,123
COMPREHENSIVE INCOME	\$ 1,190	\$ 4,211	\$ 2,305	\$ 5,346

See accompanying notes to these consolidated financial statements.

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FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Dollars in thousands, except share data) (Unaudited)

	Common Stock		Additional	Retained Earnings	Accumulated Other	Unearned	Total Equity
	Shares	Amount	Paid-in Capital		Comprehensive Income (Loss)	ESOP Shares	
BALANCE, January 1, 2012	—	\$—	\$—	\$26,451	\$316	\$—	\$26,767
Net income	—	—	—	4,223	—	—	4,223
Other comprehensive income	—	—	—	—	1,123	—	1,123
Proceeds from public offering, net of expenses	3,240,125	32	29,863	—	—	—	29,895
Unearned employee stock ownership plan shares	—	—	—	—	—	(2,636)	(2,636)
BALANCE, September 30, 2012	3,240,125	\$32	\$29,863	\$30,674	\$1,439	\$(2,636)	\$59,372
BALANCE, January 1, 2013	3,240,125	\$32	\$29,894	\$31,746	\$597	\$(2,372)	\$59,897
Net income	—	—	—	3,383	—	—	3,383
Dividends paid (\$0.10 per share)	—	—	—	(301)	—	—	(301)
Other comprehensive loss, net of tax	—	—	—	—	(1,078)	—	(1,078)
ESOP shares allocated	—	—	135	—	—	198	333
BALANCE, September 30, 2013	3,240,125	\$32	\$30,029	\$34,828	\$(481)	\$(2,174)	\$62,234

See accompanying notes to these consolidated financial statements.

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FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands) (Unaudited)

	Nine Months Ended September 30,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$3,383	\$4,223
Adjustments to reconcile net income to net cash from operating activities		
Provision for loan losses	1,720	1,695
Depreciation, amortization and accretion	1,286	688
ESOP compensation expense for allocated shares	333	—
Provision for deferred income taxes	1,512	307
Valuation allowance on deferred income taxes	—	(2,630)
Increase in cash surrender value of BOLI	(38)	—
Gain on sale of loans held for sale	(4,933)	(1,466)
Gain on sale of portfolio loans	(383)	—
Origination of loans held for sale	(193,123)	(78,901)
Proceeds from sale of loans held for sale	197,396	71,260
Gain on sale of investment securities	(264)	(106)
Loss on sale of OREO	—	35
Impairment (recovery) of loss on servicing rights	(102)	105
Impairment loss on other real estate owned	347	693
Changes in operating assets and liabilities		
Accrued interest receivable	(110)	(263)
Other assets	213	216
Other liabilities	34	1,209
Net cash from (used by) operating activities	7,271	(2,935)
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in securities available-for-sale:		
Proceeds from sale of investment securities	8,786	—
Maturities, prepayments, and calls	3,971	11,572
Purchases	(18,223)	(22,587)
Loan originations and principal collections, net	(18,964)	(44,624)
Proceeds from sale of portfolio loans	8,195	—
Proceeds from sale of OREO	163	2,496
Purchase bank owned life insurance	(6,000)	—
Purchase of premises and equipment	(1,714)	(3,201)
Net cash used by investing activities	(23,786)	(56,344)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	27,919	28,406
Proceeds from borrowings	101,454	13,000
Repayments of borrowings	(94,630)	(17,800)
Dividends paid	(301)	—
Purchase ESOP shares	—	(2,636)
Proceeds from issuance of common stock, net	—	31,233
Net cash from financing activities	34,442	52,203

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NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	17,927	(7,076)
CASH AND CASH EQUIVALENTS, beginning of period	6,787	19,253
CASH AND CASH EQUIVALENTS, end of period	\$24,714	\$12,177
SUPPLEMENTARY DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest	\$1,574	\$1,839
Income taxes	\$260	\$—
SUPPLEMENTARY DISCLOSURES OF NONCASH OPERATING, INVESTING AND FINANCING ACTIVITIES		
Change in unrealized gain (loss) on investment securities	\$(1,634)	\$1,123
Property taken in settlement of loans	\$642	\$921
See accompanying notes to these consolidated financial statements.		

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FS BANCORP, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations – FS Bancorp, Inc. (the “Company”) was incorporated in September 2011 as the proposed holding company for 1st Security Bank of Washington (the “Bank”) in connection with the Bank's conversion from the mutual to stock form of ownership which was completed on July 9, 2012. The Bank is a community-based stock owned savings bank with seven branches in suburban communities in the greater Puget Sound area. The Bank provides loan and deposit services to customers who are predominantly small and middle-market businesses and individuals.

Financial Statement Presentation – The accompanying unaudited consolidated interim financial statements do not contain all necessary disclosures required by Generally Accepted Accounting Principles in the United States of America (“U.S. GAAP”) for complete financial statements and, therefore, should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 filed with the Securities and Exchange Commission (“SEC”) on April 1, 2013. These unaudited financial statements include all normal and recurring adjustments that management believes are necessary in order to conform to U.S. GAAP and have been reflected as required by Article 10 of Regulation S-X as promulgated by the SEC. The results for the three and nine months ended September 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013 or any other future period. Amounts presented in the financial statements and footnote tables are rounded and presented in thousands of dollars. In the narrative footnote discussion amounts are rounded and presented in millions of dollars to one decimal point if the amounts are above \$1.0 million. Amounts below \$1.0 million are rounded and presented in dollars to the nearest thousands. Certain prior year amounts have been reclassified to conform to the 2013 presentation with no change to net income or stockholders' equity previously reported.

Conversion and Change in Corporate Form – On July 9, 2012, in accordance with a Plan of Conversion (the “Plan”) adopted by its Board of Directors and as approved by its depositors and borrower members, the Bank (i) converted from a mutual savings bank to a stock savings bank, and (ii) became the wholly-owned subsidiary of FS Bancorp, Inc., a bank holding company registered with the Board of Governors of the Federal Reserve System (“FRB”). In connection with the conversion, FS Bancorp, Inc. issued an aggregate of 3,240,125 shares of common stock at an offering price of \$10.00 per share for gross proceeds of \$32.4 million. From the proceeds, FS Bancorp, Inc. made a capital contribution of \$15.5 million to the Bank. The Bank intends to use this additional capital for future lending and investment activities and for general and other corporate purposes subject to regulatory limitations. The cost of conversion and the issuance of capital stock was approximately \$2.5 million, which was deducted from the proceeds of the offering.

Pursuant to the Plan, the Company's Board of Directors adopted an ESOP plan which purchased 8% of the common stock in the open market or 259,210 shares. As provided for in the Plan, the Bank also established a liquidation account in the amount of retained earnings as of December 31, 2011. The liquidation account will be maintained for the benefits of eligible savings account holders as of June 30, 2007 and supplemental eligible account holders as of March 31, 2012 who maintain deposit accounts at the Bank after the conversion. The conversion was accounted for as a change in corporate form with the historic basis of the Company's assets, liabilities, and equity unchanged as a result.

Use of Estimates – The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect amounts reported in the financial statements. Actual results could differ from these estimates. Material estimates that are particularly susceptible to change in the near term are allowances for

loan losses, fair value of measurements, and the estimated realizability related to the deferred tax asset.

Principles of Consolidation – The consolidated financial statements include the accounts of FS Bancorp, Inc. and its wholly owned subsidiary, 1st Security Bank of Washington. All material intercompany accounts have been eliminated in consolidation.

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FS BANCORP, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(Continued)

Subsequent Events – The Company has evaluated events and transactions subsequent to September 30, 2013 for potential recognition or disclosure.

Cash and Cash Equivalents – Cash and cash equivalents include cash and due from banks, and interest-bearing balances due from other banks and the Federal Reserve Bank of San Francisco. Cash and cash equivalents have a maturity of 90 days or less at the time of purchase. As of September 30, 2013 and December 31, 2012, the Company had cash deposits at other financial institutions in excess of Federal Deposit Insurance Corporation ("FDIC") insured limits. However, as the Company places these deposits with major financial institutions and monitors the financial condition of these institutions, management believes the risk of loss to be minimal.

Deposits in Other Financial Institutions – The Company held interest-bearing deposits at other financial institutions with a cost basis of \$25.3 million and \$5.4 million as of September 30, 2013 and December 31, 2012, respectively. Certificates of deposits in the amount of \$2.6 million with original maturity dates greater than 90 days were excluded from cash and cash equivalents as of September 30, 2013 and December 31, 2012.

RECENT ACCOUNTING PRONOUNCEMENTS

In July 2013, the FASB issued Accounting Standards Update No. 2013-11, Presentation of Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (Topic 740). ASU No. 2013-11 requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except to the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. No new recurring disclosures are required. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2013 and are to be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. The adoption of ASU No. 2013-11 is not expected to have a material impact on the Company's consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 – SECURITIES AVAILABLE-FOR-SALE

The carrying amount of securities available-for-sale and their approximate fair values at September 30, 2013 and December 31, 2012 were as follows:

	September 30, 2013		Gross	Gross	Estimated
	Amortized	Gross	Unrealized	Unrealized	Fair
	Cost	Unrealized	Losses (less	Losses (more	Values
		Gains	than 1 year)	than 1 year)	
Securities available-for-sale					
Federal agency securities	\$9,796	\$33	\$(455	) \$—	\$9,374
Municipal bonds	10,428	176	(154	) —	10,450
Corporate securities	3,503	4	(44	) —	3,463
Mortgage-backed securities	24,133	107	(396	) —	23,844
Total securities available-for-sale	\$47,860	\$320	\$(1,049	) \$—	\$47,131
	December 31, 2012		Gross	Gross	Estimated
	Amortized	Gross	Unrealized	Unrealized	Fair
	Cost	Unrealized	Losses (less	Losses (more	Values
		Gains	than 1 year)	than 1 year)	
Securities available-for-sale					
Federal agency securities	\$12,287	\$281	\$(16	) \$—	\$12,552
Municipal bonds	8,863	202	(5	) —	9,060
Corporate securities	2,492	—	(4	) —	2,488
Mortgage-backed securities	18,766	447	—	—	19,213
Total securities available-for-sale	\$42,408	\$930	\$(25	) \$—	\$43,313

There were twenty-six investments with unrealized losses of less than one year as of September 30, 2013. There were nine investments with unrealized losses of less than one year as of December 31, 2012. The unrealized losses associated with these investments are believed to be caused by changing market conditions that are considered to be temporary and the Company has the intent and ability to hold these securities until recovery, and is not likely to be required to sell these securities. No other-than-temporary impairment write-downs were recorded for the nine months ended September 30, 2013 or the year ended December 31, 2012.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2 - SECURITIES AVAILABLE-FOR-SALE (Continued)

The contractual maturities of securities available-for-sale at September 30, 2013 were as follows:

	September 30, 2013	
	Amortized Cost	Fair Value
No contractual maturity	\$—	\$—
Due in one year or less	2,282	2,302
Due after one year through five years	3,597	3,643
Due after five years through ten years	15,758	15,290
Due after ten years	26,223	25,896
Total	\$47,860	\$47,131

The proceeds and resulting gains, computed using specific identification, from sales of securities available-for-sale were as follows for the periods ended:

	Three Months Ended September 30, 2013			Nine Months Ended September 30, 2013		
	Proceeds	Gross Gains	Gross Losses	Proceeds	Gross Gains	Gross Losses
Securities available-for-sale	\$—	\$—	\$—	\$8,786	\$264	\$—

	Three Months Ended September 30, 2012			Nine Months Ended September 30, 2012		
	Proceeds	Gross Gains	Gross Losses	Proceeds	Gross Gains	Gross Losses
Securities available-for-sale	\$—	\$—	\$—	\$2,432	\$106	\$—

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FS BANCORP, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3 – LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

The composition of the loan portfolio was as follows at September 30, 2013 and December 31, 2012:

September 30, 2013	December 31,
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