FS Bancorp, Inc.
Form 10-Q
May 13, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 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	45-4585178
(State or other jurisdiction of incorporation or organization)	(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 [X] 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 [X] 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 [ ]

Non-accelerated filer [ ] (Do not check if a smaller reporting company) Smaller reporting company [X]

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

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 May 10, 2013, there were 3,240,125 outstanding shares of the registrant's common stock.

Table of Contents

FS Bancorp, Inc.
Form 10-Q
Table of Contents

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.

Table of Contents

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

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

	March 31, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$1,354	$4,003
Interest-bearing deposits at other financial institutions	7,552	5,410
Securities available-for-sale, at fair value	43,158	43,313
Federal Home Loan Bank stock, at cost	1,749	1,765
Loans held for sale	20,160	8,870
Loans receivable, net	276,501	274,949
Accrued interest receivable	1,328	1,223
Premises and equipment, net	13,024	12,663
Other real estate owned ("OREO")	1,956	2,127
Deferred tax asset	1,472	1,927
Other assets	3,317	2,780
TOTAL ASSETS	$371,571	$359,030
LIABILITIES		
Deposits		
Interest-bearing accounts	$257,281	$254,784
Noninterest-bearing accounts	36,500	34,165
Total deposits	293,781	288,949
Borrowings	13,659	6,840
Other liabilities	3,190	3,344
Total liabilities	310,630	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 March 31, 2013 and December 31, 2012, respectively	32	32
Additional paid-in capital	29,923	29,894
Retained earnings	32,981	31,746
Accumulated other comprehensive income	311	597
Unearned shares - Employee Stock Ownership Plan ("ESOP")	(2,306)	(2,372)
Total stockholders' equity	60,941	59,897
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$371,571	$359,030

See accompanying notes to these consolidated financial statements.

2

Table of Contents

FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands, except per share data) (Unaudited)

	Three Months Ended March 31, 2013	2012
INTEREST INCOME		
Loans receivable	$4,938	$4,134
Interest and dividends on investment securities, and cash and cash equivalents	237	165
Total interest income	5,175	4,299
INTEREST EXPENSE		
Deposits	472	603
Borrowings	38	46
Total interest expense	510	649
NET INTEREST INCOME	4,665	3,650
PROVISION FOR LOAN LOSSES	600	515
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	4,065	3,135
NONINTEREST INCOME		
Service charges and fee income	453	490
Gain on sale of loans	1,552	106
Gain on sale of investment securities	168	12
Other noninterest income	90	115
Total noninterest income	2,263	723
NONINTEREST EXPENSE		
Salaries and benefits	2,477	1,697
Operations	758	507
Occupancy	317	289
Data processing	266	233
OREO fair value write-downs, net of loss on sales	78	430
OREO expenses	22	34
Loan costs	300	139
Professional and board fees	230	137
FDIC insurance	57	63
Marketing and advertising	85	53
Recovery of loss on mortgage servicing rights	(122)	(1)
Total noninterest expense	4,468	3,581
INCOME BEFORE PROVISION FOR INCOME TAX	1,860	277
PROVISION FOR INCOME TAX	625	—
NET INCOME	$1,235	$277
Basic earnings per share	$0.41	n/a (1)
Diluted earnings per share	$0.41	n/a (1)

(1): Earnings per share and 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.

3

Table of Contents

FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands) (Unaudited)

	Three Months Ended March 31,	
	2013	2012
Net Income	$ 1,235	$ 277
Other comprehensive income, net of tax:		
Unrealized loss on securities available-for-sale:		
Unrealized holding gain arising during period	42	6
Reclassification adjustment for realized gains included in net income	(168)	(12)
Income tax benefit related to unrealized gain	(160)	—
Other comprehensive loss, net of tax	(286)	(6)
COMPREHENSIVE INCOME	$ 949	$ 271

See accompanying notes to these consolidated financial statements.

Table of Contents

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

	Common Stock		Additional		Accumulated Other	Unearned	
	Shares	Amount	Paid-in Capital	Retained Earnings	Comprehensive Income	ESOP Shares	Total Equity
BALANCE, January 1, 2012	—	$—	$—	$26,451	$ 316	$—	$26,767
Net income	—	—	—	277	—	—	277
Other comprehensive loss	—	—	—	—	(6)	—	(6)
BALANCE, March 31, 2012	—	$—	$—	$26,728	$ 310	$—	$27,038
BALANCE, January 1, 2013	3,240,125	$32	$29,894	$31,746	$ 597	$(2,372)	$59,897
Net income	—	—	—	1,235	—	—	1,235
Other comprehensive loss, net of tax	—	—	—	—	(286)	—	(286)
ESOP shares allocated	—	—	29	—	—	66	95
BALANCE, March 31, 2013	3,240,125	$32	$29,923	$32,981	$ 311	$(2,306)	$60,941

See accompanying notes to these consolidated financial statements.

Table of Contents

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

	Three Months Ended March 31, 2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$1,235	$277
Adjustments to reconcile net income to net cash from operating activities		
Provision for loan losses	600	515
Depreciation, amortization and accretion	496	404
ESOP compensation expense for allocated shares	95	—
Provision for deferred income taxes	525	92
Valuation allowance on deferred income taxes	—	(92)
Gain on sale of loans and loans held for sale	(1,552)	(106)
Origination of loans held for sale	(52,508)	(8,479)
Proceeds from sale of loans held for sale	42,474	7,120
Gain on sale of investment securities	(168)	(12)
Loss on sale of other real estate owned	—	51
Recovery of loss on mortgage servicing rights	(122)	(1)
Impairment loss on other real estate owned	78	379
Changes in operating assets and liabilities		
Accrued interest receivable	(105)	(115)
Other assets	(168)	307
Other liabilities	(77)	(180)
Net cash from (used by) operating activities	(9,197)	160
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in securities available-for-sale:		
Proceeds from sale of investment securities	4,068	785
Maturities, prepayments, and calls	844	3,430
Purchases	(5,095)	(9,357)
Loan originations and principal collections, net	(2,301)	(15,925)
Proceeds from sale of other real estate owned	93	1,370
Purchase of premises and equipment	(570)	(307)
Net cash used by investing activities	(2,961)	(20,004)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	4,832	18,050
Proceeds from borrowings	31,819	8,900
Repayments of borrowings	(25,000)	(10,000)
Net cash from financing activities	11,651	16,950
NET DECREASE IN CASH AND CASH EQUIVALENTS	(507)	(2,894)
CASH AND CASH EQUIVALENTS, beginning of period	6,787	19,253
CASH AND CASH EQUIVALENTS, end of period	$6,280	$16,359
SUPPLEMENTARY DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest	$508	$649
Income taxes	$100	$—

SUPPLEMENTARY DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Change in unrealized gain on investment securities	$(433)	$(6)

See accompanying notes to these consolidated financial statements.

Table of Contents

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 six 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 months ended March 31, 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 thousandths. Certain prior year amounts have been reclassified to conform to the 2013 presentation with no change to net income or equity previously reported. Earnings per share and share calculations prior to December 31, 2012 are not available as the Company completed its stock conversion and became a public company on July 9, 2012.

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 OREO, and the estimated realizability related to the deferred tax asset.

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

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

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.

Subsequent Events – The Company has evaluated events and transactions subsequent to March 31, 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 March 31, 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 $7.6 million and $5.4 million as of March 31, 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 March 31, 2013 and December 31, 2012.

RECENT ACCOUNTING PRONOUNCEMENTS

In January 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2013 - 01, Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. The objective of this ASU is to address implementation issues about the scope of ASU 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities which enhances disclosures and provides converged disclosures under U.S. GAAP and IFRS about financial instruments and derivative instruments that are either offset on the statement of financial position or subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset on the statement of financial position. This ASU requires disclosure of both net and gross information for these assets and liabilities. The scope of ASU 2013-01 clarifies that ordinary trade receivables and receivables are not in the scope of ASU 2011-11. The new guidance is effective for annual and interim periods beginning on or after January 1, 2013. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In February 2013, the FASB issued ASU No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income, to improve the transparency of reporting reclassifications out of accumulated other comprehensive income. The amendments in the ASU do not change the current requirements for reporting net income or other comprehensive income in financial statements. The amendments are effective prospectively for fiscal years, and interim periods within those years beginning after December 15, 2012 and did not have a material impact on the Company's consolidated financial statements.

Table of Contents

FS BANCORP, INC. AND SUBSIDIARY
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 March 31, 2013 and December 31, 2012 were as follows:

	March 31, 2013				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (less than 1 year)	Gross Unrealized Losses (more than 1 year)	Estimated Fair Values
Securities available-for-sale					
Federal agency securities	$11,351	$60	$(60)	$—	$11,351
Corporate securities	2,493	5	(4)	—	2,494
Municipal bonds	9,385	215	(42)	—	9,558
Mortgage-backed securities	19,457	306	(8)	—	19,755
Total securities available-for-sale	$42,686	$586	$(114)	$—	$43,158

	December 31, 2012				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (less than 1 year)	Gross Unrealized Losses (more than 1 year)	Estimated Fair Values
Securities available-for-sale					
Federal agency securities	$12,287	$281	$(16)	$—	$12,552
Corporate securities	2,492	—	(4)	—	2,488
Municipal bonds	8,863	202	(5)	—	9,060
Mortgage-backed securities	18,766	447	—	—	19,213
Total securities available-for-sale	$42,408	$930	$(25)	$—	$43,313

Table of Contents

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

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

There were fifteen investments with unrealized losses of less than one year as of March 31, 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 three months ended March 31, 2013 or December 31, 2012.

The contractual maturities of securities available-for-sale at March 31, 2013 were as follows:

	March 31, 2013	
	Amortized Cost	Fair Value
No contractual maturity	$—	$—
Due in one year or less	1,008	1,014
Due after one year through five years	6,442	6,522
Due after five years through ten years	15,697	15,796
Due after ten years	19,539	19,826
Total	$42,686	$43,158

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

	Three Months Ended March 31, 2013		
	Proceeds	Gross Gains	Gross Losses
Securities available-for-sale	$4,068	$168	$—

	Three Months Ended March 31, 2012		
	Proceeds	Gross Gains	Gross Losses
Securities available-for-sale	$785	$12	$—

Table of Contents

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 March 31, 2013 and December 31, 2012:

	March 31, 2013	December 31, 2012
REAL ESTATE LOANS		
Commercial	$36,282	$33,250
Construction and development	39,074	31,893
Home equity	15,627	15,474
One-to-four-family	13,465	13,976
Multi-family	2,247	3,202
Total real estate loans	106,695	97,795
CONSUMER LOANS		
Indirect home improvement	91,369	86,249
Recreational	18,750	17,968
Automobile	1,910	2,416
Home improvement	585	651
Other	1,338	1,386
Total consumer loans	113,952	108,670
COMMERCIAL BUSINESS LOANS	61,061	73,465
Total loans	281,708	279,930
Allowance for loan losses	(5,044)	(4,698)
Deferred costs, fees, and discounts, net	(163)	(283)
Total loans receivable, net	$276,501	$274,949

The Company has defined its loan portfolio into three segments that reflect the structure of the lending function, the Company's strategic plan and the manner in which management monitors performance and credit quality. The three loan portfolio segments are: (a) Real Estate Loans, (b) Consumer Loans and (c) Commercial Business Loans. Each of these segments is disaggregated into classes based on the risk characteristics of the borrower and/or the collateral type securing the loan. The following is a summary of each of the Company's loan portfolio segments and classes:

Real Estate Loans

Commercial Lending. Loans originated by the Company primarily secured by income producing properties, including retail centers, warehouses and office buildings located in our market areas.

Construction and Development Lending. Loans originated by the Company for the construction of and secured by commercial real estate and one-to-four-family residences and tracts of land for development, primarily in our market area.

Home Equity Lending. Loans originated by the Company secured by second mortgages on one-to-four-family residences, primarily in our market area.

One-to-Four-Family Real Estate Lending. Loans originated by the Company secured by first mortgages on one-to-four-family residences, primarily in our market area.

Table of Contents

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

NOTE 3 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

Multi-family Lending. Apartment lending (more than four units) to current banking customers and community reinvestment loans for low to moderate income individuals in the Company's primary market area.

Consumer Lending

Indirect Home Improvement. Fixture secured loans are originated by the Company for home improvement and are secured by the personal property installed in, on or at the borrower’s real property, and may be perfected with a UCC-2 financing statement filed in the county of the borrower’s residence.

Automobile and Recreational. Loans originated by the Company secured by boats and automobiles.

Other Consumer and Home Improvement Loans. Loans originated by the Company, including direct home improvement loans, loans on deposits and other consumer loans.

Commercial Business Loans

Commercial Business Lending. Commercial business loans originated by the Company to local small and mid-sized businesses in our Puget Sound market area are secured by accounts receivable, inventory or property, plant and equipment. Commercial business loans are made on the basis of the borrower’s ability to make repayment from the cash flow of the borrower’s business.

Table of Contents

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

NOTE 3 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following table details activity in the allowance for loan losses by loan categories:

	At or For the Three Months Ended March 31, 2013				
ALLOWANCE FOR LOAN LOSSES	Real Estate	Consumer	Commercial Business	Unallocated	Total
Beginning balance	$1,690	$2,158	$815	$35	$4,698
Provision for loan losses	654	(151)	(138)	235	600
Charge-offs	(115)	(399)	—	—	(514)
Recoveries	35	223	2	—	260
Net charge-offs	(80)	(176)	2	—	(254)
Ending balance	$2,264	$1,831	$679	$270	$5,044
Period end amount allocated to:					
Loans individually evaluated for impairment	$116	$—	$6	$—	$122
Loans collectively evaluated for impairment	2,148	1,831	673	270	4,922
Ending balance	$2,264	$1,831	$679	$270	$5,044
LOANS RECEIVABLES					
Loans individually evaluated for impairment	$3,590	$—	$227	$—	$3,817
Loans collectively evaluated for impairment	103,105	113,952	60,834	—	277,891
Ending balance	$106,695	$113,952	$61,061	$—	$281,708

	At or For the Three Months Ended March 31, 2012				
ALLOWANCE FOR LOAN LOSSES	Real Estate	Consumer	Commercial Business	Unallocated	Total
Beginning balance	$803	$2,846	$511	$185	$4,345
Provision for loan losses	134	204	205	(28)	515
Charge-offs	—	(825)	(98)	—	(923)
Recoveries	1	262	—	—	263
Net charge-offs	1	(563)	(98)	—	(660)
Ending balance	$938	$2,487	$618	$157	$4,200
Year-end amount allocated to:					
Loans individually evaluated for impairment	$140	$—	$10	$—	$150
Loans collectively evaluated for impairment	798	2,487	608	157	4,050
Ending balance	$938	$2,487	$618	$157	$4,200
LOANS RECEIVABLES					
Loans individually evaluated for impairment	$4,395	$—	$329	$—	$4,724
Loans collectively evaluated for impairment	67,490	112,660	51,498	—	231,648
Ending balance	$71,885	$112,660	$51,827	$—	$236,372

Table of Contents

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

NOTE 3 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

Information pertaining to aging analysis of past due loans are summarized as follows:

	March 31, 2013 Loans Past Due and Still Accruing						
	30-59 Days	60-89 Days	Greater Than 90 Days	Total Past Due	Non-Accrual	Current	Total Loans Receivable
REAL ESTATE LOANS							
Commercial	$—	$—	$—	$—	$ 783	$35,499	$36,282
Construction and development	—	—	—	—	—	39,074	39,074
Home equity	329	119	—	448	203	14,976	15,627
One-to-four-family	—	—	—	—	344	13,121	13,465
Multi-family	—	—	—	—	—	2,247	2,247
Total real estate loans	329	119	—	448	1,330	104,917	106,695
CONSUMER							
Indirect home improvement	435	318	—	753	276	90,340	91,369
Recreational	63	22	—	85	—	18,665	18,750
Automobile	39	16	—	55	1	1,854	1,910
Home improvement	—	—	—	—	31	554	585
Other	10	3	—	13	5	1,320	1,338
Total consumer loans	547	359	—	906	313	112,733	113,952
COMMERCIAL BUSINESS LOANS	—	—	—	—	130	60,931	61,061
Total	$876	$478	$—	$1,354	$ 1,773	$278,581	$281,708

Table of Contents

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

NOTE 3 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

	December 31, 2012						
	Loans Past Due and Still Accruing						
	30-59 Days	60-89 Days	Greater Than 90 Days	Total Past Due	Non-Accrual	Current	Total Loans Receivable
REAL ESTATE LOANS							
Commercial	$—	$—	$—	$—	$ 783	$32,467	$33,250
Construction and development	—	—	—	—	—	31,893	31,893
Home equity	192	484	—	676	248	14,550	15,474
One-to-four-family	—	—	—	—	344	13,632	13,976
Multi-family	—	—	—	—	—	3,202	3,202
Total real estate loans	192	484	—	676	1,375	95,744	97,795
CONSUMER							
Indirect home improvement	653	300	—	953	295	85,001	86,249
Recreational	128	2	—	130	—	17,838	17,968
Automobile	68	1	—	69	10	2,337	2,416
Home improvement	—	—	—	—	32	619	651
Other	8	11	—	19	—	1,367	1,386
Total consumer loans	857	314	—	1,171	337	107,162	108,670
COMMERCIAL BUSINESS LOANS	—	—	—	—	194	73,271	73,465
Total	$1,049	$798	$—	$1,847	$ 1,906	$276,177	$279,930

Table of Contents

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

NOTE 3 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following tables provide additional information about our impaired loans that have been segregated to reflect loans for which an allowance for credit losses has been provided and loans for which no allowance has been provided:

	At or For the Three Months Ended March 31, 2013						
	Unpaid Principal Balance	Write-downs	Recorded Investment	Specific Reserve	Adjusted Recorded Investment	YTD Average Recorded Investment	YTD Interest Income Recognized
WITH NO RELATED ALLOWANCE RECORDED							
Commercial	$—	$—	$—	$—	$—	$—	$—
Construction and development	—	—	—	—	—	—	—
Home equity	157	—	157	—	157	157	—
One-to-four-family	1,290	(169)	1,121	—	1,121	1,122	10
Multi-family	—	—	—	—	—	—	—
Indirect home improvement	—	—	—	—	—	—	—
Recreational	—	—	—	—	—	—	—
Automobile	—	—	—	—	—	—	—
Home improvement	—	—	—	—	—	—	—
Other	—	—	—	—	—	—	—
Commercial business loans	276	(112)	164	—	164	165	—
Subtotal loans	1,723	(281)	1,442	—	1,442	1,444	10
WITH AN ALLOWANCE RECORDED							
Commercial	950	(167)	783	(39)	744	783	—
Construction and development	1,567	(38)	1,529	(77)	1,452	1,529	16
Home equity	—	—	—	—	—	—	—
One-to-four-family	—	—	—	—	—	—	—
Multi-family	—	—	—	—	—	—	—
Indirect home improvement	—	—	—	—	—	—	—
Recreational	—	—	—	—	—	—	—
Automobile	—	—	—	—	—	—	—
Home improvement	—	—	—	—	—	—	—
Other	—	—	—	—	—	—	—
Commercial business	65	(2)	63	(6)	57	63	—

loans									
Subtotal loans	2,582	(207)		2,375		(122)	2,253	2,375	16
Total	$4,305	$(488)	—	$3,817	—	$(122)	$3,695	$3,819	$26

Table of Contents

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

NOTE 3 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

	At or For the Year Ended December 31, 2012						
	Unpaid Principal Balance	Write-downs	Recorded Investment	Specific Reserve	Adjusted Recorded Investment	YTD Average Recorded Investment	YTD Interest Income Recognized
WITH NO RELATED ALLOWANCE RECORDED							
Commercial	$—	$—	$—	$—	$—	$—	$—
Construction and development	—	—	—	—	—	—	—
Home equity	111	—	111	—	111	112	3
One-to-four-family	1,295	(170)	1,125	—	1,125	1,172	30
Multi-family	—	—	—	—	—	—	—
Indirect home improvement	—	—	—	—	—	—	—
Recreational	—	—	—	—	—	—	—
Automobile	—	—	—	—	—	—	—
Home improvement	—	—	—	—	—	—	—
Other	—	—	—	—	—	—	—
Commercial business loans	241	(111)	130	—	130	172	—
Subtotal loans	1,647	(281)	1,366	—	1,366	1,456	33
WITH AN ALLOWANCE RECORDED							
Commercial	950	(167)	783	(39)	744	893	7
Construction and development	—	—	—	—	—	—	—
Home equity	1,625	(38)	1,587	(79)	1,508	1,616	68
One-to-four-family	—	—	—	—	—	—	—
Multi-family	—	—	—	—	—	—	—
Indirect home improvement	—	—	—	—	—	—	—
Recreational	—	—	—	—	—	—	—
Automobile	—	—	—	—	—	—	—
Home improvement	—	—	—	—	—	—	—

Other	—	—	—	—	—	—	—
Commercial business loans	67	(3)	64	(7)	57	68	5
Subtotal loans	2,642	(208)	2,434	(125)	2,309	2,577	80
Total	$4,289	$(489)	$3,800	$(125)	$3,675	$4,033	$113

Table of Contents

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

NOTE 3 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Quality Indicators

As part of the Company’s on-going monitoring of credit quality of the loan portfolio, management tracks certain credit quality indicators including trends related to (i) the risk grading of loans, (ii) the level of classified loans, (iii) net charge-offs, (iv) non-performing loans and (v) the general economic conditions in the Company’s market.

The Company utilizes a risk grading matrix to assign a risk grade to its real estate and commercial business loans. Loans are graded on a scale of 1 to 10, with loans in risk grades 1 to 6 considered “Pass” and loans in risk grades 7 to 10 are reported as classified loans in the Company's allowance for loan loss analysis.

A description of the 10 risk grades is as follows:

- Grades 1 and 2 – These grades include loans to very high quality borrowers with excellent or desirable business credit.
- Grade 3 – This grade includes loans to borrowers of good business credit with moderate risk.
- Grades 4 and 5 – These grades include “Pass” grade loans to borrowers of average credit quality and risk.
- Grade 6 – This grade includes loans on management’s “Watch” list and is intended to be utilized on a temporary basis for “Pass” grade borrowers where frequent and thorough monitoring is required due to credit weaknesses and where significant risk-modifying action is anticipated in the near term.
- Grade 7 – This grade is for “Other Assets Especially Mentioned (OAEM)” in accordance with regulatory guidelines and includes borrowers where performance is poor or significantly less than expected.
- Grade 8 – This grade includes “Substandard” loans in accordance with regulatory guidelines which represent an unacceptable business credit where a loss is possible if loan weakness is not corrected.
- Grade 9 – This grade includes “Doubtful” loans in accordance with regulatory guidelines where a loss is highly probable.
- Grade 10 – This grade includes “Loss” loans in accordance with regulatory guidelines for which total loss is expected and when identified are charged-off.

Consumer, Home Equity and One-to-Four-Family Real Estate Loans

Homogeneous loans are risk rated based upon the Uniform Retail Credit Classification Policy. Loans classified under this policy at the Company are consumer loans which include indirect home improvement, recreational, automobile, direct home improvement and other, and one-to-four-family first and second liens. Under the Uniform Retail Credit Classification Policy, loans that are current or less than 90 days past due are graded “Pass” and risk graded "4" internally. Loans that are past due more than 90 days are classified “Substandard” risk graded "8" internally. At 120 days past due, homogeneous loans are charged off based on the value of the collateral less cost to sell.

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

NOTE 3 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following tables summarize risk rated loan balances by category:

	March 31, 2013					
	Pass (1 - 5)	Watch (6)	Special Mention (7)	Substandard (8)	Doubtful(9)	Total
REAL ESTATE LOANS						
Commercial	$32,189	$3,310	$—	$783	$—	$36,282
Construction and development	37,545	—	—	1,529	—	39,074
Home equity	15,424	—	—	203	—	15,627
One-to-four-family	12,344	—	—	1,121	—	13,465
Multi-family	2,247	—	—	—	—	2,247
Total real estate loans	99,749	3,310	—	3,636	—	106,695
CONSUMER						
Indirect home improvement	91,093	—	—	276	—	91,369
Recreational	18,750	—	—	—	—	18,750
Automobile	1,909	—	—	1	—	1,910
Home improvement	554	—	—	31	—	585
Other	1,333	—	—	5	—	1,338
Total consumer loans	113,639	—	—	313	—	113,952
COMMERCIAL BUSINESS LOANS	60,114	49	671	227	—	61,061
Total	$273,502	$3,359	$671	$4,176	$—	$281,708

	December 31, 2012					
	Pass (1 - 5)	Watch (6)	Special Mention (7)	Substandard (8)	Doubtful(9)	Total
REAL ESTATE LOANS						
Commercial	$29,145	$3,322	$—	$783	$—	$33,250
Construction and development	30,306	—	—	1,587	—	31,893
Home equity	15,226	—	—	248	—	15,474
One-to-four-family	12,851	—	—	1,125	—	13,976
Multi-family	3,202	—	—	—	—	3,202
Total real estate loans	90,730	3,322	—	3,743	—	97,795
CONSUMER						
Indirect home improvement	85,954	—	—	295	—	86,249
Recreational	17,968	—	—	—	—	17,968
Automobile	2,406	—	—	10	—	2,416
Home improvement	619	—	—	32	—	651
Other	1,386	—	—	—	—	1,386
Total consumer loans	108,333	—	—	337	—	108,670
COMMERCIAL BUSINESS LOANS	72,596	—	675	194	—	73,465
Total	$271,659	$3,322	$675	$4,274	$—	$279,930

Table of Contents

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

NOTE 3 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

Troubled Debt Restructured Loans

The Company had six and three troubled debt restructured ("TDR") loans still on accrual and included in impaired loans at March 31, 2013 and at December 31, 2012, respectively. In addition, at March 31, 2013 and December 31, 2012 the Company had two and three loans on non-accrual of $827,000 and $892,000, respectively. The two non-accrual loans at March 31, 2013 consist of one commercial real estate loan and one home equity loan.
The Company had no commitments to lend additional funds on these restructured loans.

A summary of TDR loans at dates indicated is as follows:

	March 31, 2013	December 31, 2012
Troubled debt restructured loans still on accrual	$2,404	$2,368
Troubled debt restructured loans on non-accural	827	892
Total troubled debt restructured loans	$3,231	$3,260

The following table presents loans that became TDRs during the three months ended March 31, 2013:

	At or For the Three Months Ended March 31, 2013			
	Number of Contracts	Recorded Investment	Increase in the Allowance	Charge-offs to the Allowance
Commercial Business Loans	1	$35	$—	$—
Total	1	$35	$—	$—

During the three month period ended March 31, 2012, the Company did not restructure any loans considered to be troubled debt restructuring.

The recorded investments in the table above are period end balances that are inclusive of all partial pay-downs and charge-offs since the modification date. Loans modified in a TDR that were fully paid down, charged-off, or foreclosed upon by the period end are not included.

TDRs in the tables above were the result of interest rate modifications and extended payment terms. The Company has not forgiven any principal on the above loans. For the three months ended March 31, 2013 and March 31, 2012 there were no reported TDRs that were modified in the previous 12 months that subsequently defaulted in the reporting period.

NOTE 4 – MORTGAGE SERVICING RIGHTS

Mortgage loans serviced for others are not included on the consolidated balance sheets. The unpaid principal balances of mortgage loans serviced for others were $159.6 million and $130.5 million at March 31, 2013 and December 31, 2012, respectively. The fair market value of the mortgage servicing rights' asset at March 31, 2013 and December 31,

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

NOTE 4 – MORTGAGE SERVICING RIGHTS (Continued)

2012 was $1.5 million and $1.1 million, respectively. Fair value adjustments to the mortgage servicing rights were mainly due to market based assumptions associated with mortgage prepayment speeds.

The following table summarizes mortgage servicing rights activity for the three months ended March 31, 2013 and 2012:

	At or For the Three Months Ended March 31,	
	2013	2012
Beginning balance	$1,064	$200
Additions	296	66
Mortgage servicing rights amortized	(78)	(21)
Recovery of loss on mortgage servicing rights	122	1
Ending balance	$1,404	$246

NOTE 5 - DERIVATIVES AND HEDGING

The Company regularly enters into commitments to originate and sell loans held for sale. Such commitments are considered derivatives but have not been designated as hedging instruments. Rather, they are accounted for as free-standing derivatives, or economic hedges, with changes in the fair value of the derivatives reported in income. The Company recognizes all derivative instruments as either assets or liabilities in the consolidated balance sheet and measures those instruments at fair value. As of March 31, 2013, the Company had fallout adjusted interest rate lock commitments with customers of $18.0 million with a fair value of $416,000. The Company also had mandatory and best effort forward commitments with investors with notional balances of $25.6 million and $14.0 million, respectively. The fair value of mandatory and best effort commitments with investors are aggregated in the fair value of customer interest rate locks disclosed above and the fair value of loans held for sale of $413,000 at March 31, 2013.

The Company has established a hedging strategy to protect itself against the risk of loss associated with interest rate movements on loan commitments. The Company enters into contracts to sell forward To-Be-Announced ("TBA") mortgage backed securities. These contracts are considered derivatives but have not been designated as hedging instruments. Rather, they are accounted for as free-standing derivatives, or economic hedges, with changes in the fair value of the derivatives reported in income. These instruments are measured at fair value and are recognized as either an asset or liability on the consolidated balance sheet and changes in fair value are reported in current period income. The Company had forward TBA mortgage backed-securities of $15.5 million at March 31, 2013, with a fair value of ($59,000) for the three months ended March 31, 2013.

Hedging activity was considered to be immaterial for the year ended December 31, 2012.

Table of Contents

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

NOTE 6 – OTHER REAL ESTATE OWNED

The following table presents the activity related to OREO for the three months ended March 31, 2013 and 2012:

	For the Three Months Ended March 31,	
	2013	2012
Beginning balance	$2,127	$4,589
Additions	—	—
Fair value write-downs	(78)	(379)
Disposition of assets	(93)	(1,421)
Ending balance	$1,956	$2,789

At March 31, 2013, OREO consisted of three properties located in Washington, with balances ranging from $270,000 to $1.0 million. For the three months ended March 31, 2013 and 2012, the Company recorded none and $51,000 net loss, respectively, on disposals of OREO and holding costs associated with OREO in the amount of $22,000 and $34,000, respectively.

NOTE 7 – DEPOSITS

Deposits are summarized as follows as of March 31, 2013 and December 31, 2012:

	March 31, 2013	December 31, 2012
Interest-bearing checking	$22,579	$24,348
Noninterest-bearing checking	36,500	34,165
Savings	12,254	11,812
Money market	117,482	114,246
Certificates of deposits of less than $100,000	39,358	40,119
Certificates of deposits of $100,000 through $250,000	43,683	43,810
Certificates of deposits of more than $250,000	21,925	20,449
Total	$293,781	$288,949

Scheduled maturities of time deposits for future periods ending were as follows:

	As of March 31, 2013
2013	$27,445
2014	31,866
2015	33,280
2016	7,443
2017	4,848
Thereafter	84
Total	$104,966

Table of Contents

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

NOTE 7 – DEPOSITS (Continued)

The Bank pledged two securities held at the Federal Home Loan Bank ("FHLB") of Seattle with a fair value of $1.3 million to secure Washington State public deposits of $1.9 million of which $1.2 million was uninsured, at March 31, 2013.

Federal Reserve regulations require that the Bank maintain reserves in the form of cash on hand and deposit balances with the FRB, based on a percentage of deposits. The amounts of such balances at March 31, 2013 and December 31, 2012 were $1.2 million and $1.3 million, respectively and were in compliance with FRB regulations.

Interest expense by deposit category for the three months ended March 31, 2013 and 2012 was as follows:

	For Three Months Ended March 31,	
	2013	2012
Interest-bearing checking	$9	$17
Savings and money market	134	165
Certificates of deposit	329	421