First Business Financial Services, Inc.
Form 10-Q
July 29, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.**
For the quarterly period ended June 30, 2011
OR

o **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission file number 001-34095
FIRST BUSINESS FINANCIAL SERVICES, INC.
(Exact name of registrant as specified in its charter)

Wisconsin	**39-1576570**
(State or jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
401 Charmany Drive Madison, WI	**53719**
(Address of Principal Executive Offices)	(Zip Code)

(608) 238-8008
Telephone number

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 and 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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data Field 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 þ No o

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

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

The number of shares outstanding of the registrant s sole class of common stock, par value $0.01 per share, on July 20, 2011 was 2,597,190 shares.

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PART I. Financial Information

Item 1. Financial Statements
First Business Financial Services, Inc.
Consolidated Balance Sheets

	(Unaudited) June 30, 2011	December 31, 2010
	(In Thousands, Except Share Data)	
Assets		
Cash and due from banks	$ 12,552	$ 9,450
Short-term investments	30,323	41,369
Cash and cash equivalents	42,875	50,819
Securities available-for-sale, at fair value	168,318	153,379
Loans and leases receivable, net of allowance for loan and lease losses of $15,937 and $16,271, respectively	844,757	860,935
Leasehold improvements and equipment, net	1,041	974
Foreclosed properties	1,400	1,750
Cash surrender value of bank-owned life insurance	17,293	16,950
Investment in Federal Home Loan Bank stock, at cost	2,367	2,367
Accrued interest receivable and other assets	18,326	19,883
Total assets	$ 1,096,377	$ 1,107,057
Liabilities and Stockholders Equity		
Deposits	$ 977,488	$ 988,298
Federal Home Loan Bank and other borrowings	39,498	41,504
Junior subordinated notes	10,315	10,315
Accrued interest payable and other liabilities	9,229	11,605
Total liabilities	1,036,530	1,051,722
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.01 par value, 2,500,000 shares authorized, none issued or outstanding		
Common stock, $0.01 par value, 25,000,000 shares authorized, 2,680,360 shares issued, 2,597,190 and 2,597,820 shares outstanding at 2011 and 2010, respectively	27	27
Additional paid-in capital	25,560	25,253
Retained earnings	33,306	29,808
Accumulated other comprehensive income	2,507	1,792
Treasury stock (83,170 and 82,540 shares at 2011 and 2010, respectively), at cost	(1,553)	(1,545)

Total stockholders equity	59,847	55,335
Total liabilities and stockholders equity	$ 1,096,377	$ 1,107,057

See accompanying Notes to Unaudited Consolidated Financial Statements.

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First Business Financial Services, Inc.
Consolidated Statements of Income (Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2011	2010	2011	2010
	(In Thousands, Except Share Data)			
Interest income:				
Loans and leases	$ 13,049	$ 12,742	$ 25,969	$ 25,933
Securities income, taxable	1,106	1,166	2,224	2,300
Short-term investments	19	32	52	73
Total interest income	14,174	13,940	28,245	28,306
Interest expense:				
Deposits	4,350	5,213	9,000	10,724
Notes payable and other borrowings	578	759	1,240	1,493
Junior subordinated notes	277	277	552	552
Total interest expense	5,205	6,249	10,792	12,769
Net interest income	8,969	7,691	17,453	15,537
Provision for loan and lease losses	1,474	1,069	2,878	2,413
Net interest income after provision for loan and lease losses	7,495	6,622	14,575	13,124
Non-interest income:				
Trust and investment services fee income	655	599	1,296	1,167
Service charges on deposits	417	414	790	812
Loan fees	368	285	699	576
Increase in cash surrender value of bank-owned life insurance	168	171	335	332
Credit, merchant and debit card fees	58	57	111	107
Other	78	159	187	321
Total non-interest income	1,744	1,685	3,418	3,315
Non-interest expense:				
Compensation	3,836	3,402	7,573	6,897
Occupancy	358	376	699	748
Professional fees	345	321	772	840
Data processing	324	297	634	595
Marketing	248	182	527	378
Equipment	105	115	219	260

FDIC insurance		571		756		1,330		1,538
Collateral liquidation costs		177		333		419		558
Goodwill Impairment				2,689				2,689
Loss (gain) on foreclosed properties		79		(95)		130		18
Other		595		845		1,096		1,245
Total non-interest expense		6,638		9,221		13,399		15,766
Income (loss) before income tax expense		2,601		(914)		4,594		673
Income tax expense		88		611		732		1,299
Net income (loss)	$	2,513	$	(1,525)	$	3,862	$	(626)
Earnings (losses) per common share:								
Basic	$	0.98	$	(0.60)	$	1.49	$	(0.25)
Diluted		0.98		(0.60)		1.49		(0.25)
Dividends declared per share		0.07		0.07		0.14		0.14

See accompanying Notes to Unaudited Consolidated Financial Statements.

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First Business Financial Services, Inc.
Consolidated Statements of Changes in Stockholders Equity and Comprehensive Income
(Unaudited)

	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Treasury stock	Total
			(In Thousands, Except Share Data)			
Balance at December 31, 2009	$ 26	$ 24,731	$ 29,582	$ 1,544	$ (1,490)	$ 54,393
Comprehensive income:						
Net loss			(626)			(626)
Unrealized securities gains arising during the period				1,093		1,093
Income tax effect				(437)		(437)
Comprehensive income						30
Share-based compensation restricted shares		261				261
Cash dividends ($0.14 per share)			(356)			(356)
Treasury stock purchased (1,582 shares)					(15)	(15)
Balance at June 30, 2010	$ 26	$ 24,992	$ 28,600	$ 2,200	$ (1,505)	$ 54,313

Consolidated Statements of Changes in Stockholders Equity and Comprehensive Income

	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Treasury stock	Total
			(In Thousands, Except Share Data)			
Balance at December 31, 2010	$ 27	$ 25,253	$ 29,808	$ 1,792	$ (1,545)	$ 55,335
Comprehensive income:						
Net income			3,862			3,862
Unrealized securities gains arising during the period				1,173		1,173
Income tax effect				(458)		(458)
Comprehensive income						4,577
Share-based compensation restricted shares		307				307
Cash dividends ($0.14 per share)			(364)			(364)
Treasury stock purchased (630 shares)					(8)	(8)

Balance at June 30, 2011	$	27	$	25,560	$	33,306	$	2,507	$	(1,553)	$	59,847

See accompanying Notes to Unaudited Consolidated Financial Statements.

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First Business Financial Services, Inc.
Consolidated Statements of Cash Flows (Unaudited)

	For the Six Months Ended June 30, 2011	2010
	(In Thousands)	
Operating activities		
Net income (loss)	$ 3,862	$ (626)
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income taxes, net	1,051	(1,717)
Provision for loan and lease losses	2,878	2,413
Depreciation, amortization and accretion, net	1,017	669
Share-based compensation	307	261
Increase in cash surrender value of bank-owned life insurance	(335)	(332)
Origination of loans for sale	(988)	(250)
Sale of loans originated for sale	993	250
Gain on sale of loans originated for sale	(5)	
Loss on foreclosed properties	130	18
Goodwill impairment		2,689
Decrease (increase) in accrued interest receivable and other assets	259	(565)
(Decrease) increase in accrued interest payable and other liabilities	(2,376)	2,336
Net cash provided by operating activities	6,793	5,146
Investing activities		
Proceeds from maturities of available-for-sale securities	20,572	17,422
Purchases of available-for-sale securities	(35,181)	(35,941)
Proceeds from sale of foreclosed properties	1,327	908
Net decrease in loans and leases	12,193	7,564
Investment in Aldine Capital Fund, L.P.	(210)	(150)
Purchases of leasehold improvements and equipment, net	(242)	(72)
Premium payment on bank owned life insurance policies	(8)	(8)
Net cash used in investing activities	(1,549)	(10,277)
Financing activities		
Net decrease in deposits	(10,810)	(45,748)
Repayment of FHLB advances	(2,006)	(5)
Cash dividends paid	(364)	(356)
Purchase of treasury stock	(8)	(15)
Net cash used in financing activities	(13,188)	(46,124)
Net decrease in cash and cash equivalents	(7,944)	(51,255)
Cash and cash equivalents at the beginning of the period	50,819	112,737

Cash and cash equivalents at the end of the period	$	42,875	$	61,482
Supplementary cash flow information				
Interest paid on deposits and borrowings	$	11,203	$	13,232
Income taxes paid		2,751		2,375
Transfer to foreclosed properties		1,107		577

See accompanying Notes to Unaudited Consolidated Financial Statements.

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Notes to Unaudited Consolidated Financial Statements

Note 1 Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations. The accounting and reporting practices of First Business Financial Services (FBFS or the Corporation), its wholly-owned subsidiaries, First Business Bank (FBB) and First Business Bank Milwaukee (FBB Milwaukee) have been prepared in accordance with U.S. generally accepted accounting principles. First Business Bank and First Business Bank Milwaukee are sometimes referred to together as the Banks . FBB operates as a commercial banking institution in the Dane County and surrounding areas market with loan production offices in Oshkosh, Appleton, and Green Bay, Wisconsin. FBB also offers trust and investment services through First Business Trust & Investments (FBTI), a division of FBB. FBB Milwaukee operates as a commercial banking institution in the Waukesha County and surrounding areas market. The Banks provide a full range of financial services to businesses, business owners, executives, professionals and high net worth individuals. The Banks are subject to competition from other financial institutions and service providers and are also subject to state and federal regulations. FBB has the following subsidiaries: First Business Capital Corp. (FBCC), First Madison Investment Corp. (FMIC), First Business Equipment Finance, LLC and FBB Real Estate, LLC (FBBRE). FBCC has a wholly-owned subsidiary, FMCC Nevada Corp. (FMCCNC). FMIC and FMCCNC are located in and were formed under the laws of the state of Nevada. FBB-Milwaukee has one subsidiary, FBB Milwaukee Real Estate, LLC (FBBMRE).

Principles of Consolidation. The unaudited consolidated financial statements include the accounts and results of First Business Financial Services, Inc. (FBFS or the Corporation), and its wholly-owned subsidiaries, First Business Bank and First Business Bank Milwaukee (Banks). In accordance with the provisions of Accounting Standards Codification (ASC) Topic 810, the Corporation s ownership interest in FBFS Statutory Trust II (Trust II) has not been consolidated into the financial statements. All significant intercompany balances and transactions were eliminated in consolidation.

Basis of Presentation. The accompanying unaudited consolidated financial statements were prepared in accordance with U.S. generally accepted accounting principles (GAAP) and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The Corporation has not changed its significant accounting and reporting policies from those disclosed in the Corporation s Form 10-K for the year ended December 31, 2010 except as described further below in Note 1.

In the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of the unaudited consolidated financial statements were included in the unaudited consolidated financial statements. The results of operations for the three and six month periods ended June 30, 2011 are not necessarily indicative of results that may be expected for any other interim period or the entire fiscal year ending December 31, 2011. Certain amounts in prior periods were reclassified to conform to the current presentation. Subsequent events were evaluated through the issuance of the unaudited consolidated financial statements.

Recent Accounting Pronouncements.

Troubled Debt Restructuring. In April 2011, the FASB issued Accounting Standard Update (ASU) 2011-02, A Creditor s Determination of Whether a Restructuring Is a Troubled Debt Restructuring . This accounting guidance provides for clarification and guidance for evaluating whether a restructuring constitutes a troubled debt restructuring. The guidance specifically states that a creditor must separately conclude that both of the following conditions exist for a restructuring to constitute a troubled debt restructuring: 1) the restructuring constitutes a concession and 2) the debtor is experiencing financial difficulties. The amendments in this ASU are effective for the first interim or annual period beginning on or after June 15, 2011 and should be applied retrospectively to restructurings occurring on or after the beginning of the fiscal year of adoption. The impact on the allowance for loan and lease losses as a result of the identification of additional troubled debt restructurings, if any, is to be applied prospectively for the first interim or annual period beginning on or after June 15, 2011. Additionally, pursuant to ASU No. 2011-01, Receivables: Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20 , the disclosures about the credit quality of financing receivables and the allowance for credit losses previously deferred for troubled debt restructurings, is also effective for reporting periods beginning on or after June 15, 2011. The Corporation does not expect the adoption of this standard to have a material impact on the consolidated financial condition and results of operations.

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Fair Value Measurement. In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requires in the U.S. GAAP and IFRSs . This update was issued primarily to provide largely identical guidance about fair value measurement and disclosure requirements for International Financial Reporting Standards (IFRS) and U.S. GAAP. The new standards do not extend the use of fair value but rather provide guidance about how fair value should be determined where it already is required or permitted under IFRS or U.S. GAAP. For U.S. GAAP, most of the changes are clarifications of existing guidance or wording changes to align with IFRS. Public companies are required to apply the standard prospectively for interim and annual periods beginning after December 15, 2011. Early adoption is not permitted. In the period of adoption, disclosure is required for changes in any valuation technique and related inputs that result from applying the standard. Quantification of the total effect should be made. The Corporation is currently evaluating the impact of this accounting guidance.

Comprehensive Income. In June 2011, the FASB issued ASU 2011-05, Comprehensive Income . This accounting guidance is intended to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. The amendments require that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The current practice of presenting the components of other comprehensive income as part of the statement of changes in stockholders equity is no longer permitted. This amendment does not change the items that must be reported in the other comprehensive income or when an item of other comprehensive income must be reclassified to net income. This amendment will be applied retrospectively and is effective for fiscal years and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. The Corporation is currently evaluating the impact of this statement and expects that a disclosure change is required to present comprehensive income within one of the two permitted formats.

Note 2 Earnings (Losses) Per Common Share

Earnings per common share are computed using the two-class method. Basic earnings per common share are computed by dividing net income allocated to common shares by the weighted average number of shares outstanding during the applicable period, excluding outstanding participating securities. Participating securities include unvested restricted shares. Unvested restricted shares are considered participating securities because holders of these securities receive non-forfeitable dividends at the same rate as holders of the Corporation s common stock. Diluted earnings per share are computed by dividing net income allocated to common shares adjusted for reallocation of undistributed earnings of unvested restricted shares by the weighted average number of shares determined for the basic earnings per common share computation plus the dilutive effect of common stock equivalents using the treasury stock method.

For the three month periods ended June 30, 2011 and 2010, average anti-dilutive employee share-based awards totaled 139,158 and 193,988, respectively. For the six month periods ended June 30, 2011 and 2010, average anti-dilutive employee share-based awards totaled 138,766 and 196,135, respectively.