FS Bancorp, Inc.

Institutional Equity Research

FSBW - NASDAQ

February 1, 2021

Growth Takes No Days Off; 2021 EPS To Take A Breather

FS Bancorp produced EPS upside in a manner we are accustomed to: mortgage gain on sale revenue. The revenue source in 2020 was nearly 4x 2019's contribution, helping to more than offset increased credit costs and lift TBV growth by 20%+. Loan growth expectations for this year are lofty and NIM is anticipated to be equal or moderately rise from 4Q20 levels. The reserve building burden is mostly in the rear view with additional provisioning more tilted towards growth in our estimation. We expect EPS to decelerate ahead as mortgage ebbs lower and loan losses could lift from 2020's meager base. We view FSBW as fairly valued with a ***NEUTRAL*** *rating.*

- **FSBW reported 4Q20 EPS of $2.60,** significantly outpacing our estimate of $1.06 and the Street at $1.53. Strong revenue production (predominantly mortgage fees) out of the bank drove the bulk of the beat, and strong organic growth delivered in impressive fashion. Expenses capped the beat, and credit was stable.

- **Organic growth opportunities not to be overlooked.** Loans and deposits posted double-digit organic growth at an annualized rate of 14.4% and 15.1%, respectively. PPP forgiveness was modest in the quarter adding less of a headwind than peers, but shouldn't take away from the growth engine on display in 4Q20. Construction, single family, and consumer were areas of growth in the quarter, and the 2021 outlook is for a 7%-9% increase ex. PPP.

- **Mortgage held up well; has an offset as it fades.** Fee income declined 15.7%, or $2.8M, over the prior quarter from a reduction in mortgage coming off a peak 3Q20 that wasn't expected to be repeated. As mortgage likely fades, the bank expects to pick up some slack on service charges guiding towards a run rate of $7M-$9M annually, up from $2.4M recorded in 2020. Expenses were up 8.3%, or $1.4M, in the quarter but included $0.6M of impairment charges that are not likely to repeat at that level. Our projected 2021 expense growth rate of 10% indicates the bank is in growth mode and looking to take advantages of scale.

- **Margin to receive support from yields and costs.** Spread income rose higher by 5.0% over the prior quarter adding nearly $1.0M off strong growth. The bank's reported NIM lifted from 3.92% to 3.99%, and further, yet more moderate, expansion is expected in the next quarter as the bank is finding solid yield in niche lending segments and managing liability costs. The bulk of PPP fees have yet to be recognized offering additional support to the 1Q21 figure.

- **Credit and reserves in "wait and see" mode.** NPAs remain at 37bp of assets and NCOs were just $228k, or 5bp annualized of average loans. Despite a non-event quarter on credit, FSBW added $1.6M to the reserve in part allocated for the growth booked. Reserves sit at 1.73% of non-PPP loans and management iterated a cautious approach that is unlikely to see near-term reserve release, but rather a preference to grow into the figure.

- **Increasing EPS outlook, maintaining NEUTRAL rating & $60 target.** We are increasing our 2021 and 2022 EPS estimates from $4.45 and $5.20 to $5.60 and $6.00, respectively. Changes to our model include an improved NIM outlook, increased fee income projections and reduced credit costs. Our price target of $60 equals 10.0x our 2022 EPS estimate and 1.1x current TBV. These trading multiples place FSBW in line with small cap peers, which we deem appropriate given the bank's above average growth profile yet lower multiple and volatile mortgage gain on sale business. Accordingly, we rate the shares **NEUTRAL**.

FY (Dec)		2020A	2021E	Previous	Cons.	2022E	Previous	Cons.
EPS	Q1 (Mar)	$1.14	**$1.35E**	$1.05	*$1.17*	**$1.32E**	$1.17	*$1.43*
	Q2 (Jun)	$2.34	**$1.57E**	$1.19	*$1.30*	**$1.54E**	$1.23	*$1.49*
	Q3 (Sep)	$2.94	**$1.41E**	$1.21	*$1.35*	**$1.66E**	$1.36	*$1.63*
	Q4 (Dec)	$2.60	**$1.27E**	$1.00	*$1.10*	**$1.49E**	$1.44	*$1.58*
		$9.03	**$5.60E**	$4.45	*$4.93*	**$6.00E**	$5.20	*$5.76*
Price/EPS		*5.9x*	*9.6x*			*8.9x*		
Revenue ($M)	Q1 (Mar)	$26.4	**$27.3E**	$24.5	*$25.7*	**$27.5E**	$26.0	*$26.0*
	Q2 (Jun)	$32.0	**$28.7E**	$25.5	*$25.9*	**$28.8E**	$26.2	*$26.2*
	Q3 (Sep)	$36.5	**$27.9E**	$25.9	*$26.4*	**$29.2E**	$26.5	*$26.5*
	Q4 (Dec)	$34.7	**$27.2E**	$25.3	*$26.0*	**$28.5E**	$26.8	*$26.8*
		$129.5	**$111.2E**	$101.2	*$104.1*	**$113.9E**	$105.5	*$109.3*

Neutral

Price Target	**$60.00**
Price (1/29/21)	$53.62
Industry	FINANCIAL INSTITUTIONS

Valuation & Performance

Return on Assets (MRQ)	2.18%
ROTCE (MRQ)	20.8%
Net Interest Margin (MRQ)	3.99%
Efficiency Ratio (MRQ)	53.7%
TBV per Share (12/31/20)	$53.63
TCE/TA (12/31/20)	10.6%
Dividend	$0.84 (1.6%)

Trading Data

Shares Outstanding (M)	4.3
Market Capitalization ($M)	$230.5
52-week range	$27.50 - $60.65
Avg. Volume (3-mth.) (K)	11.0

Jeff Rulis
MD, Senior Research Analyst
503-603-3025
jrulis@dadco.com

Levi Posen
Research Associate
503-603-3054
lposen@dadco.com

Company Description

Mountlake Terrace, WA - FS Bancorp, Inc., a Washington corporation, is the holding company for 1st Security Bank of Washington. The company provides loan and deposit services to customers who are predominantly small and middle-market businesses and individuals in western Washington.

Price Performance

NASDAQ: FSBW

Please refer to pages 3 - 4 of this report for detailed disclosure and certification information.

FS Bancorp, Inc.
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Financial Data (in 000's, except PS)

FYE Dec	4Q19	2019	1Q20	2Q20	3Q20	4Q20	2020	1Q21E	2Q21E	3Q21E	4Q21E	2021E	1Q22E	2Q22E	3Q22E	4Q22E	2022E
INCOME STATEMENT																	
Net Interest Income	17,350	70,308	17,473	17,860	18,918	19,869	74,120	18,662	18,577	18,365	18,208	73,812	18,309	18,616	18,876	19,094	74,895
Loan Loss Provision	647	2,880	3,686	4,649	3,100	1,601	13,036	1,750	1,800	1,800	1,800	7,150	1,500	1,500	1,000	1,000	5,000
Net Interest Income After Provision	16,703	67,428	13,787	13,211	15,818	18,268	61,084	16,912	16,777	16,565	16,408	66,662	16,809	17,116	17,876	18,094	69,895
Service Charges	1,423	6,554	924	96	546	807	2,373	1,000	1,400	1,800	2,200	6,400	2,250	2,250	2,250	2,250	9,000
Gain on Sale of Loans	3,692	14,248	5,899	13,365	16,228	13,350	48,842	7,000	8,000	7,000	6,000	28,000	6,000	7,000	7,000	6,000	26,000
BOLI Revenue	221	872	216	215	219	220	870	223	225	228	231	907	234	236	239	242	951
Other	317	1,361	1,852	455	553	414	3,274	455	501	551	606	2,114	667	733	807	887	3,094
Total Noninterest Income	5,653	23,035	8,891	14,131	17,546	14,791	55,359	8,678	10,126	9,579	9,037	37,420	9,150	10,220	10,296	9,379	39,045
Salaries and Benefits	9,059	33,816	9,547	7,420	10,225	10,903	38,095	10,458	10,562	10,668	10,721	42,408	10,850	10,980	11,112	11,245	44,186
Operations	2,660	9,722	2,403	2,573	2,809	2,686	10,471	2,699	2,713	2,726	2,740	10,879	2,768	2,795	2,823	2,851	11,237
Occupancy	1,194	4,640	1,109	1,216	1,167	1,244	4,736	1,250	1,263	1,275	1,288	5,076	1,301	1,314	1,327	1,340	5,283
Data Processing	1,202	4,972	980	1,051	1,127	1,230	4,388	1,236	1,242	1,249	1,255	4,982	1,267	1,280	1,293	1,306	5,146
Other	1,628	9,183	2,145	2,362	1,851	2,545	8,903	2,548	2,550	2,553	2,555	10,205	2,594	2,632	2,672	2,712	10,610
Total Noninterest Expense	15,743	62,333	16,184	14,622	17,179	18,608	66,593	18,191	18,330	18,471	18,559	73,551	18,779	19,002	19,227	19,455	76,462
Net Income Before Taxes	6,613	28,130	6,494	12,720	16,185	14,451	49,850	7,399	8,573	7,673	6,886	30,531	7,180	8,334	8,946	8,019	32,479
Applicable Taxes	695	5,413	1,327	2,700	3,472	3,087	10,586	1,628	1,886	1,688	1,515	6,717	1,651	1,917	2,057	1,844	7,470
Effective Tax Rate (%)	*10.5*	*19.2*	*20.4*	*21.2*	*21.5*	*21.4*	*21.2*	*22.0*	*22.0*	*22.0*	*22.0*	*22.0*	*23.0*	*23.0*	*23.0*	*23.0*	*23.0*
Net Income	5,918	22,717	5,167	10,020	12,713	11,364	39,264	5,771	6,687	5,985	5,371	23,814	5,528	6,417	6,888	6,175	25,009
Reported EPS ($)	**1.30**	**5.03**	**1.14**	**2.34**	**2.94**	**2.60**	**9.03**	**1.35**	**1.57**	**1.41**	**1.27**	**5.60**	**1.32**	**1.54**	**1.66**	**1.49**	**6.00**
Reported EPS Growth (year-over-year) (%)	*-54.1*	*-20.2*	*-0.8*	*138.8*	*86.1*	*100.0*	*79.5*	*18.2*	*-33.0*	*-52.0*	*-51.0*	*-38.0*	*-2.3*	*-2.1*	*17.4*	*17.3*	*7.1*
Core Net Income (Less extraordinary items)	5,829	24,088	3,973	9,074	12,713	11,364	37,124	5,771	6,687	5,985	5,371	23,814	5,528	6,417	6,888	6,175	25,009
Core EPS ($)	**1.30**	**5.34**	**0.89**	**2.11**	**2.94**	**2.60**	**8.53**	**1.35**	**1.57**	**1.41**	**1.27**	**5.60**	**1.32**	**1.54**	**1.66**	**1.49**	**6.00**
Core EPS Growth (year-over-year) (%)	*-10.4*	*9.2*	*-26.9*	*75.8*	*80.1*	*100.0*	*59.7*	*51.9*	*-25.6*	*-52.0*	*-51.0*	*-34.4*	*-2.3*	*-2.1*	*17.4*	*17.3*	*7.2*
Avg Diluted Shares	4,505	4,513	4,479	4,305	4,295	4,305	4,346	4,284	4,262	4,241	4,220	4,252	4,199	4,178	4,157	4,136	4,167
Shares Outstanding (Actual)	4,367	4,367	4,247	4,166	4,176	4,157	4,157	4,136	4,115	4,095	4,074	4,074	4,054	4,034	4,014	3,994	3,994
Book Value Per Share ($)	45.85	45.85	47.29	50.08	52.82	55.33	55.33	56.44	57.79	58.97	60.02	60.02	61.12	62.45	63.90	65.20	65.20
Tangible BV Per Share ($)	44.07	44.07	45.50	48.30	51.08	53.63	53.63	54.82	56.20	57.42	58.50	58.50	59.63	60.99	62.48	63.80	63.80
Dividend Per Share ($)	0.20	0.65	0.21	0.21	0.21	0.21	0.84	0.26	0.26	0.26	0.26	1.04	0.26	0.26	0.26	0.26	1.04
Dividend Payout (%)	*15.4*	*12.9*	*18.4*	*9.0*	*7.1*	*8.1*	*9.3*	*19.3*	*16.6*	*18.4*	*20.4*	*18.6*	*19.7*	*16.9*	*15.7*	*17.4*	*17.3*
BALANCE SHEET																	
Total Loans	1,351,892	1,351,892	1,411,874	1,468,908	1,519,418	1,574,227	1,574,227	1,593,198	1,604,584	1,601,139	1,597,642	1,597,642	1,621,043	1,644,816	1,668,965	1,693,498	1,693,498
Earning Assets	1,609,198	1,609,198	1,633,180	1,777,112	1,738,059	1,851,984	1,851,984	1,852,555	1,844,349	1,819,476	1,795,103	1,795,103	1,821,397	1,837,783	1,854,406	1,871,269	1,871,269
Total Assets	1,713,056	1,713,056	1,847,168	2,008,756	2,054,626	2,113,241	2,113,241	2,105,176	2,095,851	2,067,586	2,039,890	2,039,890	2,069,769	2,088,390	2,107,279	2,126,442	2,126,442
Deposits	1,392,408	1,392,408	1,446,269	1,606,872	1,613,219	1,674,071	1,674,071	1,660,812	1,694,028	1,727,909	1,762,467	1,762,467	1,797,716	1,833,670	1,870,344	1,907,751	1,907,751
Equity	200,242	200,242	200,829	208,641	220,550	230,007	230,007	233,453	237,820	241,490	244,552	244,552	247,776	251,895	256,489	260,376	260,376
Tangible Equity	192,473	192,473	193,236	201,225	213,310	222,944	222,944	226,741	231,283	235,128	238,365	238,365	241,739	246,008	250,752	254,789	254,789
AVERAGE BALANCE SHEET																	
Average Loans	1,390,135	1,361,482	1,420,227	1,542,581	1,648,070	1,694,942	1,576,455	1,583,712	1,598,891	1,602,861	1,599,390	1,596,214	1,609,342	1,632,930	1,656,890	1,681,232	1,645,099
Average Earning Assets	1,602,731	1,552,204	1,634,509	1,839,162	1,920,319	1,980,005	1,843,499	1,852,270	1,848,452	1,831,912	1,807,289	1,834,981	1,808,250	1,829,590	1,846,094	1,862,837	1,836,693
Average Assets	1,704,697	1,650,115	1,734,035	1,937,786	2,014,509	2,071,600	1,939,483	2,109,209	2,100,514	2,081,719	2,053,738	2,086,295	2,054,829	2,079,079	2,097,835	2,116,861	2,087,151
Average Deposits	1,378,702	1,267,980	1,233,617	1,383,064	1,613,526	1,634,523	1,466,183	1,667,441	1,677,420	1,710,968	1,745,188	1,700,254	1,780,091	1,815,693	1,852,007	1,889,047	1,834,210
Average Equity	197,472	190,534	203,170	203,882	210,343	220,707	209,526	231,730	235,636	239,655	243,021	237,510	246,164	249,835	254,192	258,433	252,156
ASSET QUALITY																	
Nonperforming Loans	3,000	3,000	3,200	7,900	7,600	7,800	7,800	9,000	10,000	11,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000
OREO & Other	168	168	90	90	90	90	90	0	0	0	0	0	0	0	0	0	0
NPAs	3,168	3,168	3,290	7,990	7,690	7,890	7,890	9,000	10,000	11,000	12,000	12,000	12,000	12,000	12,000	12,000	12,000
NPAs/ Assets (%)	0.18	0.18	0.18	0.40	0.37	0.37	0.37	0.43	0.48	0.53	0.59	0.59	0.58	0.57	0.57	0.56	0.56
Loan Loss Reserves	13,229	13,229	16,872	21,524	24,799	26,172	26,172	27,000	27,500	27,500	27,000	27,000	26,000	25,000	24,000	23,000	23,000
Reserves/ Loans (%)	0.98	0.98	1.20	1.47	1.63	1.66	1.66	1.69	1.71	1.72	1.69	1.69	1.60	1.52	1.44	1.36	1.36
Reserves/ NPLs (%)	441	441	527	272	326	336	336	300	275	250	225	225	217	208	200	192	192
Net Chargeoffs	183	2,000	43	(3)	(175)	228	93	922	1,300	1,800	2,300	6,322	2,500	2,500	2,000	2,000	9,000
NCOs/ Avg Loans (%)	0.05	0.15	0.01	(0.00)	(0.04)	0.05	0.01	0.23	0.33	0.45	0.58	0.40	0.62	0.61	0.48	0.48	0.55
KEY RATIOS																	
TCE/TA (%)	11.29	11.29	10.50	10.05	10.42	10.59	10.59	10.81	11.07	11.41	11.72	11.72	11.71	11.81	11.93	12.01	12.01
Return on Average Assets (%)	1.38	1.38	1.20	2.08	2.51	2.18	2.02	1.09	1.27	1.15	1.05	1.14	1.08	1.23	1.31	1.17	1.20
Return on Average Equity (%)	11.89	11.92	10.23	19.77	24.04	20.48	18.74	9.96	11.35	9.99	8.84	10.03	8.98	10.27	10.84	9.56	9.92
Return on Average Tangible Equity (%)	12.50	12.50	10.72	20.32	24.53	20.84	19.26	10.27	11.68	10.27	9.07	10.31	9.21	10.53	11.09	9.77	10.15
Net Interest Margin (%)	4.29	4.53	4.30	3.91	3.92	3.99	4.03	4.03	4.02	4.01	4.03	4.02	4.05	4.07	4.09	4.10	4.08
Efficiency Ratio (%)	68.4	66.8	61.4	45.7	47.1	53.7	51.4	66.5	63.9	66.1	68.1	66.1	68.4	65.9	65.9	68.3	67.1
Loan/ Deposit (%)	97	97	98	91	94	94	94	96	95	93	91	91	90	90	89	89	89
LOAN COMPOSITION																	
Commercial real estate	210,749	210,749	220,509	222,265	227,354	222,719	222,719	224,946	227,196	229,468	231,762	231,762	234,080	236,421	238,785	241,173	241,173
	15.6%	15.6%	15.6%	15.1%	15.0%	14.1%	14.1%	14.1%	14.2%	14.3%	14.5%	14.5%	14.4%	14.4%	14.3%	14.2%	14.2%
Construction and development	179,654	179,654	168,658	183,029	191,933	216,975	216,975	219,579	222,214	224,880	227,579	227,579	230,310	233,073	235,870	238,701	238,701
	13.3%	13.3%	11.9%	12.5%	12.6%	13.8%	13.8%	13.8%	13.8%	14.0%	14.2%	14.2%	14.2%	14.2%	14.1%	14.1%	14.1%
Home equity	38,167	38,167	37,503	35,082	40,459	43,093	43,093	43,308	43,525	43,743	43,961	43,961	44,181	44,402	44,624	44,847	44,847
	2.8%	2.8%	2.7%	2.4%	2.7%	2.7%	2.7%	2.7%	2.7%	2.7%	2.8%	2.8%	2.7%	2.7%	2.7%	2.6%	2.6%
One-to-four family	261,539	261,539	305,436	295,220	300,863	311,093	311,093	315,759	320,496	325,303	330,183	330,183	335,136	340,163	345,265	350,444	350,444
	19.3%	19.3%	21.6%	20.1%	19.8%	19.8%	19.8%	19.8%	20.0%	20.3%	20.7%	20.7%	20.7%	20.7%	20.7%	20.7%	20.7%
Multi-family	133,930	133,930	130,570	132,329	130,243	131,601	131,601	134,891	138,263	141,720	145,263	145,263	148,894	152,617	156,432	160,343	160,343
	9.9%	9.9%	9.2%	9.0%	8.6%	8.4%	8.4%	8.5%	8.6%	8.9%	9.1%	9.1%	9.2%	9.3%	9.4%	9.5%	9.5%
Consumer	326,210	326,210	335,095	345,321	364,808	375,178	375,178	378,930	382,719	386,546	390,412	390,412	396,268	402,212	408,245	414,369	414,369
	24.1%	24.1%	23.7%	23.5%	24.0%	23.8%	23.8%	23.8%	23.9%	24.1%	24.4%	24.4%	24.4%	24.5%	24.5%	24.5%	24.5%
Commercial and industrial	140,531	140,531	149,086	213,961	224,276	224,476	224,476	225,710	219,096	197,382	175,343	175,343	177,973	180,643	183,352	186,103	186,103
	10.4%	10.4%	10.6%	14.6%	14.8%	14.3%	14.3%	14.2%	13.7%	12.3%	11.0%	11.0%	11.0%	11.0%	11.0%	11.0%	11.0%
Warehouse lending	61,112	61,112	65,017	41,701	39,482	49,092	49,092	50,074	51,075	52,097	53,139	53,139	54,202	55,286	56,391	57,519	57,519
	4.5%	4.5%	4.6%	2.8%	2.6%	3.1%	3.1%	3.1%	3.2%	3.3%	3.3%	3.3%	3.3%	3.4%	3.4%	3.4%	3.4%
Total Loans	1,351,892	1,351,892	1,411,874	1,468,908	1,519,418	1,574,227	1,574,227	1,593,198	1,604,584	1,601,139	1,597,642	1,597,642	1,621,043	1,644,816	1,668,965	1,693,498	1,693,498

Source: Company data, Davidson estimates

Jeff Rulis, MD-Senior Research Analyst, 503-603-3025, Jrulis@dadco.com

Potential Risks

- Significant economic deterioration (i.e. home price deterioration, worsening employment situation, etc.).
- Severe deterioration in credit quality.

Required Disclosures

D.A. Davidson & Co. makes a market in FS Bancorp, Inc..

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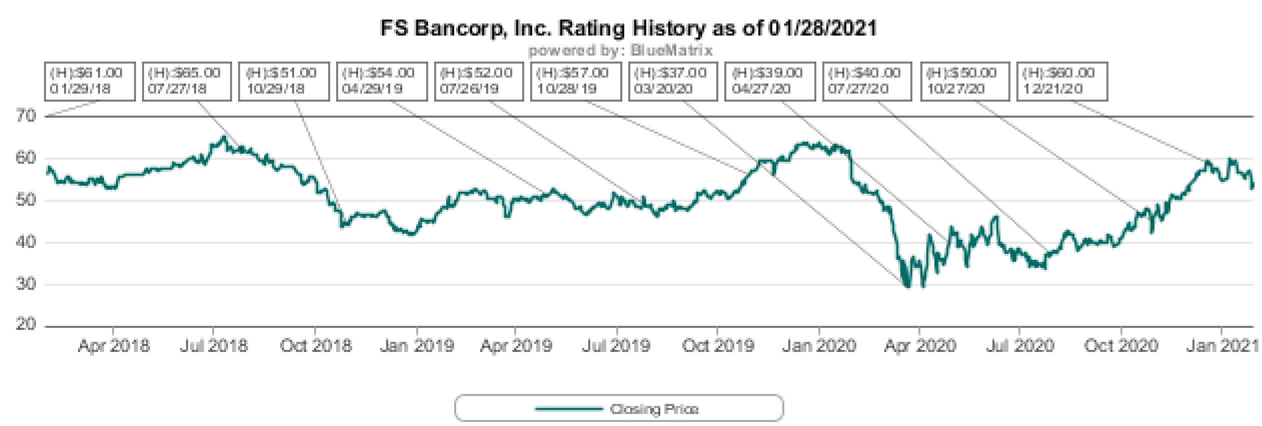
Rating Information
D.A. Davidson & Co.'s Institutional Research Rating Scale Definitions (maintained since October 10, 2017); information regarding our previous definitions is available upon request:
BUY: Expected to produce a total return of over 15% on a risk adjusted basis over the next 12-18 months
NEUTRAL: Expected to produce a total return of -15% to +15% on a risk adjusted basis over the next 12-18 months
UNDERPERFORM: Expected to lose value of over 15% on a risk adjusted basis over the next 12-18 months

Rating Distribution (as of 12/31/20)	Coverage Universe Distribution			Investment Banking Distribution		
	IR	WMR	Combined	IR	WMR	Combined
BUY (Buy)	58%	92%	62%	11%	0%	10%
NEUTRAL (Hold)	41%	8%	38%	4%	0%	3%
UNDERPERFORM (Sell)	1%	0%	1%	0%	0%	0%

IR denotes Institutional Research; WMR denotes Wealth Management Research whose rating scale is Buy/Add, Neutral, Sell/Reduce. Investment Banking Distribution denotes companies from whom D.A. Davidson & Co. has received compensation in the last 12 months.



Target prices are our Institutional Research Department's evaluation of price potential over the next 12 months, based upon our assessment of future earnings and cash flow, comparable company valuations, growth prospects and other financial criteria. Certain risks may impede achievement of these price targets including, but not limited to, broader market and macroeconomic fluctuations and unforeseen changes in the subject company's fundamentals or business trends.

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Other Companies Mentioned in this Report

Company Name	Ticker	Rating	Price
FS Bancorp, Inc.	FSBW	NEUTRAL	$53.62