

FS Bancorp, Inc.
Form 10-K
March 28, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
(Mark one)

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

For the fiscal year ended December 31, 2013 OR

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

Commission File Number: 001-35589

FS BANCORP, INC.
(Exact name of registrant as specified in its charter)

Washington 45-4585178
(State or other jurisdiction of incorporation or (I.R.S. Employer Identification Number)
organization)

6920 220th Street SW, Mountlake Terrace, Washington 98043
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (425) 771-5299

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value \$0.01 per share
(Title of Each Class)

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES NO

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO

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 disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or other information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K.

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 definition 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

Indicate by check mark whether the Registrant is a shell company (as defined in Exchange Act Rule 12b-2). YES
NO

As of March 26, 2014, there were 3,240,125 shares of the Registrant's common stock outstanding. The Registrant's common stock is listed on the NASDAQ Capital Market under the symbol "FSBW." The aggregate market value of the common stock held by non affiliates of the Registrant, based on the closing sales price of the Registrant's common stock as quoted on the NASDAQ Capital Market on June 28, 2013, was \$56,724,984. For purposes of this calculation, common stock held only by executive officers and directors of the Registrant is considered to be held by affiliates.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Annual Report to Shareholders are incorporated by reference into Part II.
 2. Portions of the definitive Proxy Statement for the 2014 Annual Meeting of Shareholders ("Proxy Statement") are incorporated by reference into Part III.
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As used in this report, the terms “we,” “our,” “us,” and “FS Bancorp” refer to FS Bancorp, Inc. and its consolidated subsidiary, 1st Security Bank of Washington, unless the context indicates otherwise.

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Forward Looking Statements

This Form 10-K contains forward looking statements, which can be identified by the use of words such as “believes,” “expects,” “anticipates,” “estimates” or similar expressions. Forward looking statements include:

- statements of our goals, intentions and expectations;
- statements regarding our business plans, prospects, growth and operating strategies;
- statements regarding the quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward looking statements are subject to significant risks and uncertainties. Actual results may differ materially from those contemplated by the forward looking statements due to, among others, the following factors:

- general economic conditions, either nationally or in our market area, that are worse than expected;
- the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write offs and
- changes in our allowance for loan losses and provision for loan losses that may be impacted by deterioration in the housing and commercial real estate markets;
- secondary market conditions and our ability to sell loans in the secondary market;
- fluctuations in the demand for loans, the number of unsold homes, land and other properties and fluctuations in real estate values in our market area;
- increases in premiums for deposit insurance;
- the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation;
- changes in the interest rate environment that reduce our interest margins or reduce the fair value of financial instruments;
- increased competitive pressures among financial services companies;
- our ability to execute our plans to grow our residential construction lending, our mortgage banking operations and our warehouse lending and the geographic expansion of our indirect home improvement lending;
- our ability to attract and retain deposits;
- our ability to control operating costs and expenses;
- changes in consumer spending, borrowing and savings habits;
- our ability to successfully manage our growth;
- legislative or regulatory changes that adversely affect our business, including the effect of the Dodd-Frank Wall Street Reform and Consumer Protection Act, changes in regulation policies and principles, or the interpretation of regulatory capital or other rules, including as a result of Basel III;
- adverse changes in the securities markets;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Public Company Accounting Oversight Board or the Financial Accounting Standards Board;
- costs and effects of litigation, including settlements and judgments;
- our ability to implement our branch expansion strategy;
- inability of key third-party vendors to perform their obligations to us; and
- other economic, competitive, governmental, regulatory and technical factors affecting our operations, pricing, products and services and other risks described elsewhere in this Form 10-K and our other reports filed with the U.S. Securities and Exchange Commission.

Any of the forward looking statements that we make in this Form 10-K and in other public statements we make may turn out to be wrong because of inaccurate assumptions we might make, because of the factors illustrated above or because of other factors that we cannot foresee. Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward looking statements and you should not rely on such statements.

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Available Information

The Company provides a link on its investor information page at www.fsbwa.com to filings with the U.S. Securities and Exchange Commission (“SEC”) for purposes of providing copies of its annual report to shareholders, annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and press releases. Other than an investor’s own internet access charges, these filings are available free of charge and also can be obtained by calling the SEC at 1-800-SEC-0330. The information contained on the Company’s website is not included as part of, or incorporated by reference into, this Annual Report on Form 10-K.

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PART 1

Item 1. Business

General

FS Bancorp, Inc. (“FS Bancorp” or the “Company”), a Washington corporation, was organized in September 2011 for the purpose of becoming the holding company of 1st Security Bank of Washington (“1st Security Bank of Washington” or the “Bank”) upon the Bank’s conversion from a mutual to a stock savings bank (“Conversion”). The Conversion was completed on July 9, 2012. At December 31, 2013, the Company had consolidated total assets of \$419.2 million, total deposits of \$336.9 million and stockholders’ equity of \$62.3 million. The Company has not engaged in any significant activity other than holding the stock of the Bank. Accordingly, the information set forth in this Annual Report on Form 10-K (“Form 10-K”), including the consolidated financial statements and related data, relates primarily to the Bank.

1st Security Bank of Washington is a relationship-driven community bank. The Bank delivers banking and financial services to local families, local and regional businesses and industry niches within distinct Puget Sound area communities. The Bank emphasizes long-term relationships with families and businesses within the communities served, working with them to meet their financial needs. The Bank is also actively involved in community activities and events within these market areas, which further strengthens relationships within these markets. The Bank has been serving the Puget Sound area since 1936. Originally chartered as a credit union, and known as Washington’s Credit Union, the Bank served various select employment groups. On April 1, 2004, the Bank converted from a credit union to a Washington state-chartered mutual savings bank. Upon completion of the Conversion in July 2012, 1st Security Bank of Washington became a Washington state-chartered stock savings bank and the wholly owned subsidiary of the Company. At December 31, 2013, the Bank maintained seven bank branch locations and two stand-alone loan origination facilities, along with the headquarters.

The Company is a diversified lender with a focus on the origination of indirect home improvement loans, also referred to as fixture secured loans, home loans, commercial real estate mortgage loans, commercial business loans and second mortgage/home equity loan products. Consumer loans, in particular indirect home improvement loans, represent the largest portion of the loan portfolio and have traditionally been the mainstay of the Company’s lending strategy, a carryover from its days as a credit union. Going forward, the Company plans to place more emphasis on certain lending products, such as commercial real estate loans, one-to-four-family loans, commercial business and residential construction loans, while maintaining the current size of the consumer loan portfolio. The Company reintroduced in-house originations of residential mortgage loans in 2012, primarily for sale into the secondary market, through a mortgage banking program. Future lending strategies are intended to take advantage of: (1) the Company’s historical strength in indirect consumer lending, (2) recent market dislocation that has created new lending opportunities, and (3) relationship lending. Retail deposits will continue to serve as an important funding source. For more information regarding the business and operations of 1st Security Bank of Washington, see Item 7., “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

1st Security Bank of Washington is examined and regulated by the Washington State Department of Financial Institutions (“DFI”), its primary regulator, and by the Federal Deposit Insurance Corporation (“FDIC”). 1st Security Bank of Washington is required to have certain reserves set by the Board of Governors of the Federal Reserve System (“Federal Reserve”) and is a member of the Federal Home Loan Bank of Seattle (“FHLB” or “FHLB of Seattle”), which is one of the 12 regional banks in the Federal Home Loan Bank System.

The principal executive offices of the Company are located at 6920 220th Street SW, Mountlake Terrace, Washington 98043 and its telephone number is (425) 771-5299.

Market Area

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The Company conducts operations out of the main administrative office, two home lending offices and seven full-service bank branch offices in the Puget Sound region of Washington. The administrative office is located in Mountlake Terrace, in Snohomish County, Washington. The home lending offices are located in Bellevue, in King County, Washington including the de novo Capitol Hill branch which opened in May 2013, and Port Orchard, in Kitsap

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County, Washington. Three branch offices are located in Snohomish County, while there are two offices in King County and one office in Pierce County to the south and one office in Kitsap County to the west.

The primary market area for business operations is the Seattle-Tacoma-Bellevue, WA Metropolitan Statistical Area (the "Seattle MSA"). Kitsap County, though not in the Seattle MSA, is also part of the Company's market area. This overall region is typically known as the "Puget Sound" region. The population of the Puget Sound region was an estimated 3.8 million in 2013, over half of the state's population, representing a large population base for potential business. The region has a well-developed urban area in the western portion along Puget Sound, with the north, central and eastern portions containing a mixture of developed residential and commercial neighborhoods and undeveloped, rural neighborhoods.

The Puget Sound region is the largest business center in both the state of Washington and the Pacific Northwest. Currently, key elements of the economy are aerospace, military bases, clean technology, biotechnology, education, information technology, logistics, international trade and tourism. The region is well known for the long presence of The Boeing Corporation and Microsoft, two major industry leaders, and for its leadership in technology. The workforce in general is well-educated and strong in technology. Washington state's location with regard to the Pacific Rim, along with a deepwater port has made international trade a significant part of the regional economy. Tourism has also developed into a major industry for the area, due to the scenic beauty, temperate climate and easy accessibility. King County, the location of the city of Seattle, has the largest employment base and overall level of economic activity. King County's largest employers include The Boeing Company, Microsoft Corporation, and the University of Washington. Companies that are headquartered in King County include Alaska Airlines, Amazon.com, Costco, Starbucks and Microsoft. Pierce County's economy is also well diversified with the presence of military related government employment (Joint Base Lewis-McChord), along with health care (the Franciscan Health System and the Multicare Health System). In addition, there is a large employment base in the economic sectors of shipping (the Port of Tacoma) and aerospace employment (Boeing). Snohomish County to the north has an economy based on aerospace employment (Boeing), military (the Everett Naval Station) along with additional employment concentrations in biotechnology, electronics/computers, and wood products. Eight of the largest employers in the state are headquartered in King County.

The United States Navy is a key element for Kitsap County's economy. The United States Navy is the largest employer in the county, with installations at Puget Sound Naval Shipyard, Naval Undersea Warfare Center Keyport and Naval Base Kitsap (which comprises former Naval Submarine Base Bangor, and Naval Station Bremerton). The largest private employers in the county are the Harrison Medical Center, Wal-Mart, and Port Madison Enterprises.

The projected 2014 median household income and per capita income levels in King, Snohomish, Pierce, and Kitsap counties were higher than the state and national averages. Approximately 86.6% of King County households had income levels in excess of \$50,000 annually in 2010, compared to 82.5% for the State of Washington and 79.2% for the United States. In 2008, the U.S. Census Bureau determined that Seattle has the highest percentage of college and university graduates of any U.S. city; it was listed as the most literate or second most literate city of the country every year since 2005. Seattle's high income and education levels, especially compared to other major cities, result in King County ranking in the top 100 wealthiest counties in the United States.

Unemployment in Washington was an estimated 6.6% as of December 31, 2013, down from a high of 10.2% in March 2010 closely paralleling national trends. Unemployment rates in Pierce, Kitsap, King, and Snohomish counties have improved in the last 36 months after dropping from their 2010 first quarter highs. As of December 2013, the Puget Sound region reported an unemployment rate of 5.4%, down from 6.4% in December 2012. King County had the lowest unemployment rate in the state at 4.7%, much lower than the state average of 6.6% and national average of 6.7% respectively. Year end 2013, estimated unemployment in Pierce County was 7.5%, down from 8.5% as of year end 2012. The estimated unemployment rate in Snohomish County at year end was 5.3%, down from 6.7% at year end 2012. Kitsap County experienced the lowest year over year change and remained at 6.1% unemployment as of December 31, 2013. Of the four counties, Snohomish and King counties reflected the largest improvement year over year with unemployment dropping 1.4% in Snohomish County and 1.3% in King County.

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According to the Washington Center for Real Estate Research, home values in the state of Washington began improving in the first half of 2013. For the quarter ended September 30, 2013, the average home value was \$309,000 in Snohomish County, \$228,000 in Pierce County, \$438,000 in King County, and \$248,000 in Kitsap County. Compared to the statewide average increase in home values of 8.44% in the third quarter of 2013, Snohomish and King counties

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have outperformed the state averages, with 12.9% and 15.3% increases, respectively. Kitsap County was flat year over year, below the state average. Pierce County experienced the first increase home values since 2008 with home prices increasing 11.6% year over year.

For a discussion regarding the competition in the Company's primary market area, see "Competition."

Lending Activities

General. Historically, the Company's primary emphasis was the origination of consumer loans (primarily indirect home improvement and automobile-secured loans), one-to-four-family residential first mortgages, and second mortgage/home equity loan products. More recently, in anticipation of the Company's initial public offering in 2012, while maintaining the active indirect consumer lending program, the Company shifted its lending focus to include non-mortgage commercial business loans, as well as commercial real estate and residential construction and development loans. The Company reintroduced in-house originations of residential mortgage loans in 2012, primarily for sale in the secondary market. While maintaining the Company's historical strength in consumer lending, the Company has added management and personnel in the commercial and home lending areas to take advantage of the relatively favorable long-term business and economic environments prevailing in the markets.

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Loan Portfolio Analysis. The following table sets forth the composition of the loan portfolio by type of loan at the dates indicated.

	December 31, 2013		2012		2011		2010		2009	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
(Dollars in thousands)										
Real estate loans										
Commercial	\$32,970	11.48 %	\$33,250	11.88 %	\$28,931	13.09 %	\$28,061	11.86 %	\$29,099	12.20 %
Construction and development	41,633	14.49	31,893	11.39	10,144	4.59	9,805	4.15	17,390	7.29
Home equity	15,172	5.28	15,474	5.53	14,507	6.56	15,655	6.62	16,448	6.90
One-to-four-family ⁽¹⁾	20,809	7.25	13,976	4.99	8,752	3.96	13,218	5.59	8,233	3.45
Multi-family	4,682	1.63	3,202	1.14	1,175	0.53	1,159	0.49	409	0.17
Total real estate loans	115,266	40.13	97,795	34.93	63,509	28.73	67,898	28.71	71,579	30.01
Consumer Loans										
Indirect home improvement	91,167	31.74	83,786	29.93	81,143	36.70	94,833	40.10	89,883	37.68
Solar	16,838	5.86	2,463	0.89	—	—	—	—	—	—
Marine	11,203	3.90	17,226	6.15	23,315	10.55	22,281	9.42	2,508	1.05
Automobile	1,230	0.43	2,416	0.86	5,832	2.64	12,645	5.35	23,359	9.79
Recreational	553	0.19	742	0.27	1,156	0.52	1,824	0.77	15,503	6.50
Home improvement	463	0.16	651	0.23	934	0.42	1,295	0.55	1,725	0.72
Other	1,252	0.44	1,386	0.50	1,826	0.83	2,887	1.21	4,277	1.80
Total consumer loans	122,706	42.72	108,670	38.83	114,206	51.66	135,765	57.40	137,255	57.54
Commercial business loans	49,244	17.15	73,465	26.24	43,337	19.61	32,841	13.89	29,699	12.45
Total gross loans receivable	287,216	100.00 %	279,930	100.00 %	221,052	100.00 %	236,504	100.00 %	238,533	100.00 %
Less:										
Deferred costs, fees and discounts, net	(1,043)		(283)		424		223		313	
Allowance for loan losses	(5,092)		(4,698)		(4,345)		(5,905)		(7,405)	
Total loans receivable, net	\$281,081		\$274,949		\$217,131		\$230,822		\$231,441	

(1) Excludes loans held for sale.

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The following table shows the composition of the loan portfolio by fixed- and adjustable-rate loans at the dates indicated.

	December 31,		2012		2011		2010		2009	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Fixed-rate loans:										
Real estate loans										
Commercial	\$23,210	8.08 %	\$20,947	7.48 %	\$17,578	7.95 %	\$16,333	6.90 %	\$15,729	6.59 %
Construction and development	525	0.18	3,958	1.41	3,407	1.54	1,556	0.66	501	0.21
Home equity	2,664	0.93	2,557	0.91	2,154	0.97	2,784	1.18	3,839	1.61
One-to-four-family ⁽¹⁾	19,981	6.96	8,328	2.98	5,452	2.47	6,585	2.79	4,552	1.91
Multi-family	3,467	1.21	2,053	0.73	1,175	0.53	1,159	0.49	409	0.17
Total real estate loans	49,847	17.36	37,843	13.51	29,766	13.46	28,417	12.02	25,030	10.49
Consumer	122,346	42.60	108,500	38.76	114,201	51.65	135,752	57.39	137,231	57.53
Commercial business	19,792	6.89	16,959	6.06	8,971	4.07	1,049	0.45	870	0.36
Total fixed-rate loans	191,985	66.85	163,302	58.33	152,938	69.18	165,218	69.86	163,131	68.38
Adjustable-rate loans:										
Real estate loans										
Commercial	9,760	3.40	12,303	4.40	11,353	5.14	11,728	4.96	13,370	5.61
Construction and development	41,108	14.31	27,935	9.98	6,737	3.05	8,249	3.49	16,889	7.08
Home equity	12,508	4.35	12,917	4.61	12,353	5.59	12,871	5.44	12,609	