FS Bancorp, Inc.
Form 10-Q
August 08, 2014
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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 June 30, 2014 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 August 8, 2014, there were 3,235,625 outstanding shares of the registrant's common stock.

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

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

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

	June 30, 2014	December 31, 2013
ASSETS		
Cash and due from banks	$2,049	$1,425
Interest-bearing deposits at other financial institutions	7,106	39,660
Securities available-for-sale, at fair value	58,363	56,239
Federal Home Loan Bank stock, at cost	1,670	1,702
Loans held for sale, at fair value	15,975	11,185
Loans receivable, net	325,495	281,081
Accrued interest receivable	1,366	1,261
Premises and equipment, net	13,763	13,818
Other real estate owned ("OREO")	36	2,075
Deferred tax asset	—	816
Bank owned life insurance ("BOLI")	6,460	6,369
Other assets	3,738	3,556
TOTAL ASSETS	$436,021	$419,187
LIABILITIES		
Deposits		
Noninterest-bearing accounts	$47,685	$45,783
Interest-bearing accounts	303,959	291,093
Total deposits	351,644	336,876
Borrowings	17,552	16,664
Other liabilities	4,041	3,334
Total liabilities	373,237	356,874
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; 3,235,625 and 3,240,125 shares issued and outstanding at June 30, 2014 and December 31, 2013, respectively	32	32
Additional paid-in capital	28,963	30,097
Retained earnings	35,808	35,215
Accumulated other comprehensive loss	(18)	(898)
Unearned shares - Employee Stock Ownership Plan ("ESOP")	(2,001)	(2,133)
Total stockholders' equity	62,784	62,313
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$436,021	$419,187

See accompanying notes to these consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
INTEREST INCOME				
Loans receivable	$5,493	$5,233	$10,674	$10,171
Interest and dividends on investment securities, cash and cash equivalents, and interest-bearing deposits at other financial institutions	356	203	686	440
Total interest and dividend income	5,849	5,436	11,360	10,611
INTEREST EXPENSE				
Deposits	594	464	1,144	936
Borrowings	63	48	121	87
Total interest expense	657	512	1,265	1,023
NET INTEREST INCOME	5,192	4,924	10,095	9,588
PROVISION FOR LOAN LOSSES	450	600	900	1,200
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	4,742	4,324	9,195	8,388
NONINTEREST INCOME				
Service charges and fee income	446	494	844	948
Gain on sale of loans	1,794	2,228	3,302	3,779
Gain on sale of investment securities	10	96	10	264
Other noninterest income	206	113	352	203
Total noninterest income	2,456	2,931	4,508	5,194
NONINTEREST EXPENSE				
Salaries and benefits	3,240	3,135	6,363	5,612
Operations	926	759	1,472	1,517
Occupancy	403	385	801	702
Data processing	300	266	588	532
OREO fair value impairments, net of (gain) loss on sales	(1)	117	30	195
OREO expenses (income)	(29)	16	3	38
Loan costs	391	345	696	645
Professional and board fees	298	333	602	563
FDIC insurance	62	67	125	123
Marketing and advertising	125	158	232	243
Impairment (recovery) on mortgage servicing rights	(1)	22	(1)	(100)
Total noninterest expense	5,714	5,603	10,911	10,070
INCOME BEFORE PROVISION FOR INCOME TAX	1,484	1,652	2,792	3,512
PROVISION FOR INCOME TAX	498	566	931	1,191
NET INCOME	$986	$1,086	$1,861	$2,321
Basic earnings per share	$0.33	$0.36	$0.62	$0.77
Diluted earnings per share	$0.33	$0.36	$0.62	$0.77

See accompanying notes to these consolidated financial statements.

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FS BANCORP, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands) (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net Income	$ 986	$ 1,086	$ 1,861	$ 2,321
Other comprehensive gain (loss), net of tax:				
Unrealized gain (loss) on securities available-for-sale:				
Unrealized holding gain (loss) arising during period	802	(1,299)	1,344	(1,564)
Income tax (provision) benefit related to unrealized gains	(272)	442	(457)	532
Reclassification adjustment for realized gains included in net income	(10)	(96)	(10)	(264)
Income tax benefit related to reclassification for realized gains	3	33	3	90
Other comprehensive gain (loss), net of tax	523	(920)	880	(1,206)
COMPREHENSIVE INCOME	$ 1,509	$ 166	$ 2,741	$ 1,115

See accompanying notes to these consolidated financial statements.

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

	Common Stock				Accumulated		
	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Other Comprehensive Income (Loss)	Unearned ESOP Shares	Total Stockholders' Equity
BALANCE, January 1, 2013	3,240,125	$32	$29,894	$31,746	$ 597	$(2,372)	$ 59,897
Net income	—	—	—	2,321	—	—	2,321
Other comprehensive loss, net of tax	—	—	—	—	(1,206)	—	(1,206)
Dividends paid ($0.05 per share)	—	—	—	(150)	—	—	(150)
ESOP shares allocated	—	—	85	—	—	132	217
BALANCE, June 30, 2013	3,240,125	$32	$29,979	$33,917	$ (609)	$(2,240)	$ 61,079
BALANCE, January 1, 2014	3,240,125	$32	$30,097	$35,215	$ (898)	$(2,133)	$ 62,313
Net income	—	—	—	1,861	—	—	1,861
Dividends paid ($0.11 per share)	—	—	—	(341)	—	—	(341)
Share-based compensation	—	—	110	—	—	—	110
Restricted stock awards	125,105	—	(1)	—	—	—	(1)
Common stock repurchased	(129,605)	—	(1,295)	(927)	—	—	(2,222)
Other comprehensive income, net of tax					880		880
ESOP cash distribution	—	—	(35)	—	—	—	(35)
ESOP shares allocated	—	—	87	—	—	132	219
BALANCE, June 30, 2014	3,235,625	$32	$28,963	$35,808	$ (18)	$(2,001)	$ 62,784

See accompanying notes to these consolidated financial statements.

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

	Six Months Ended June 30, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$1,861	$2,321
Adjustments to reconcile net income to net cash from operating activities		
Provision for loan losses	900	1,200
Depreciation, amortization and accretion	1,677	513
Compensation expense related to stock options and restricted stock awards	110	—
ESOP compensation expense for allocated shares	219	217
Provision for deferred income taxes	816	981
Increase in cash surrender value of BOLI	(91)	—
Gain on sale of loans held for sale	(2,741)	(3,779)
Gain on sale of portfolio loans	(561)	—
Origination of loans held for sale	(103,425)	(132,168)
Proceeds from sale of loans held for sale	100,887	133,978
Gain on sale of investment securities	(10)	(264)
Gain on sale of OREO	(10)	—
Recovery of servicing rights	(1)	(100)
Impairment loss on other real estate owned	40	195
Changes in operating assets and liabilities		
Accrued interest receivable	(105)	(69)
Other assets	(429)	(1,368)
Other liabilities	707	(52)
Net cash from (used by) operating activities	(156)	1,605
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in securities available-for-sale:		
Proceeds from sale of investment securities	11,720	8,786
Maturities, prepayments, and calls	7,964	1,676
Purchases	(20,923)	(13,083)
Loan originations and principal collections, net	(58,734)	(9,496)
Proceeds from sale of portfolio loans	12,849	—
Proceeds from sale of OREO	2,454	163
Purchase of premises and equipment, net	(447)	(1,289)
Net cash used by investing activities	(45,117)	(13,243)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	14,768	11,964
Proceeds from borrowings	30,207	76,454
Repayments of borrowings	(29,319)	(69,630)
Dividends paid	(341)	(150)
Common stock repurchased	(2,222)	—
Net cash from financing activities	13,093	18,638
NET DECREASE IN CASH AND CASH EQUIVALENTS	(32,180)	7,000
CASH AND CASH EQUIVALENTS, beginning of period	38,459	6,787
CASH AND CASH EQUIVALENTS, end of period	$6,279	$13,787

SUPPLEMENTARY DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest	$1,262	$1,017
Income taxes	$175	$210
SUPPLEMENTARY DISCLOSURES OF NONCASH OPERATING, INVESTING AND FINANCING ACTIVITIES		
Change in unrealized gain (loss) on investment securities	$880	$(1,206)
Property received in settlement of loans	$445	$(36)
Transfer portfolio loans to loans held for sale	$—	$3,251

See accompanying notes to these consolidated financial statements.

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

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

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

Financial Statement Presentation – The accompanying unaudited consolidated interim financial statements do not contain all necessary disclosures required by Generally Accepted Accounting Principles in the United States of America (“U.S. GAAP”) for complete financial statements and, therefore, should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013 filed with the Securities and Exchange Commission ("SEC") on March 29, 2014. These unaudited financial statements include all normal and recurring adjustments that management believes are necessary in order to conform to U.S. GAAP and have been reflected as required by Article 10 of Regulation S-X as promulgated by the SEC. The results for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014 or any other future period. Amounts presented in the financial statements and footnote tables are rounded and presented in thousands of dollars. In the narrative footnote discussion amounts are rounded and presented in millions of dollars to one decimal point if the amounts are above $1.0 million. Amounts below $1.0 million are rounded and presented in dollars to the nearest thousands. Certain prior year amounts have been reclassified to conform to the 2014 presentation with no change to net income or stockholders' equity previously reported.

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

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

Use of Estimates – The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect amounts reported in the financial statements. Actual results could differ from these estimates. Material estimates that are particularly susceptible to change in the near term are allowances for loan losses, fair value of measurements, and the estimated realizability related to the deferred tax asset.

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

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

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

Subsequent Events – The Company has evaluated events and transactions subsequent to June 30, 2014 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 June 30, 2014 and December 31, 2013, 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 $7.1 million and $39.7 million as of June 30, 2014 and December 31, 2013, respectively. Certificates of deposits in the amount of $2.9 million and $2.6 million with original maturity dates greater than 90 days were excluded from cash and cash equivalents as of June 30, 2014 and December 31, 2013, respectively.

RECENT ACCOUNTING PRONOUNCEMENTS

In January 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014 - 04, Receivables - Trouble Debt Restructurings by Creditors (Subtopic 310-40) - Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure. This ASU is intended to clarify when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the real estate recognized. This ASU clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either: (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure, or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. This ASU is effective for fiscal years, and interim reporting periods within those annual periods beginning after December 15, 2014. The adoption of this ASU is not expected to have a material impact on the Company’s consolidated financial statements.

In April 2014, the FASB issued ASU No. 2014-08, “Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." ASU 2014-08 raises the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. This ASU is effective for annual periods beginning on or after December 15, 2014. Early adoption is permitted but only for disposals that have not been reported in financial statements previously issued. The adoption of this ASU is not expected to have a material impact on the Company’s consolidated financial statements.

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

NOTE 2 – SECURITIES AVAILABLE-FOR-SALE

The following table presents the amortized costs, unrealized gains, unrealized losses and approximate fair values of securities available-for-sale at June 30, 2014 and December 31, 2013:

	June 30, 2014			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Values
SECURITIES AVAILABLE-FOR-SALE				
Federal agency securities	$6,754	$9	$(216)	$6,547
Municipal bonds	16,027	288	(82)	16,233
Corporate securities	4,997	2	(40)	4,959
Mortgage-backed securities	30,613	171	(160)	30,624
Total securities available-for-sale	$58,391	$470	$(498)	$58,363

	December 31, 2013			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Values
SECURITIES AVAILABLE-FOR-SALE				
Federal agency securities	$12,297	$21	$(651)	$11,667
Municipal bonds	13,347	111	(278)	13,180
Corporate securities	4,005	2	(69)	3,938
Mortgage-backed securities	27,952	66	(564)	27,454
Total securities available-for-sale	$57,601	$200	$(1,562)	$56,239

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

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

Investment securities that were in an unrealized loss position as of June 30, 2014 and December 31, 2013 are presented in the following tables, based on the length of time individual securities have been in an unrealized loss position. In the opinion of management, these securities are considered only temporarily impaired due to changes in market interest rates or the widening of market spreads subsequent to the initial purchase of the securities, and not due to concerns regarding the underlying credit of the issuers or the underlying collateral.

	June 30, 2014					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
SECURITIES AVAILABLE-FOR-SALE						
Federal agency securities	$—	$—	$4,779	$(216)	$4,779	$(216)
Municipal bonds	2,149	(3)	3,534	(79)	5,683	(82)
Corporate securities	2,471	(31)	491	(9)	2,962	(40)
Mortgage-backed securities	—	—	11,061	(160)	11,061	(160)
Total securities available-for-sale	$4,620	$(34)	$19,865	$(464)	$24,485	$(498)

	December 31, 2013					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
SECURITIES AVAILABLE-FOR-SALE						
Federal agency securities	$4,772	$(244)	$3,591	$(407)	$8,363	$(651)
Municipal bonds	5,915	(206)	1,210	(72)	7,125	(278)
Corporate securities	2,443	(59)	490	(10)	2,933	(69)
Mortgage-backed securities	23,696	(564)	—	—	23,696	(564)
Total securities available-for-sale	$36,826	$(1,073)	$5,291	$(489)	$42,117	$(1,562)

There were five investments with unrealized losses of less than one year as of June 30, 2014, and 19 investments with unrealized losses of more than one year. There were 31 investments with unrealized losses of less than one year as of December 31, 2013, and seven investments with unrealized losses of more than one year. 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 was recorded for the six months ended June 30, 2014 or the year ended December 31, 2013.

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

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

The contractual maturities of securities available-for-sale at June 30, 2014 were as follows:

	June 30, 2014	
	Amortized Cost	Fair Value
Due in one year or less	$1,760	$1,765
Due after one year through five years	4,769	4,788
Due after five years through ten years	17,105	16,903
Due after ten years	34,757	34,907
Total	$58,391	$58,363

The proceeds and resulting gains, computed using specific identification, from sales of securities available-for-sale for the three and six months ended June 30, 2014 and 2013 were as follows:

	Three Months Ended June 30, 2014			Six Months Ended June 30, 2014		
	Proceeds	Gross Gains	Gross (Losses)	Proceeds	Gross Gains	Gross (Losses)
Securities available-for-sale	$11,721	$64	$(54)	$11,721	$64	$(54)

	Three Months Ended June 30, 2013			Six Months Ended June 30, 2013		
	Proceeds	Gross Gains	Gross (Losses)	Proceeds	Gross Gains	Gross (Losses)
Securities available-for-sale	$4,718	$96	$—	$8,786	$264	$—

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 at June 30, 2014 and December 31, 2013 was as follows:

	June 30, 2014	December 31, 2013
REAL ESTATE LOANS		
Commercial	$39,832	$32,970
Construction and development	40,736	41,633
Home equity	15,113	15,172
One-to-four-family (excludes held for sale loans)	32,039	20,809
Multi-family	11,448	4,682
Total real estate loans	139,168	115,266
CONSUMER LOANS		
Indirect home improvement	93,905	91,167
Solar	17,026	16,838
Marine	14,518	11,203
Automobile	929	1,230
Recreational	490	553
Home improvement	410	463
Other	1,214	1,252
Total consumer loans	128,492	122,706
COMMERCIAL BUSINESS LOANS	64,584	49,244
Total loans	332,244	287,216
Allowance for loan losses	(5,548)	(5,092)
Deferred costs, fees, and discounts, net	(1,201)	(1,043)
Total loans receivable, net	$325,495	$281,081

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 the Puget Sound market area.

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

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

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

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

Multi-family Lending. Apartment term lending (more than four units) to current banking customers and community reinvestment loans for housing for low to moderate income individuals primarily located in the Puget Sound 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. These indirect home improvement loans include replacement windows, siding, roofing, solar panels, and other home fixture installations in Washington, Oregon and California.

Marine, Automobile and Recreational. Loans originated by the Company secured by boats, automobiles and RVs to borrowers primarily located in the Puget Sound market area.

Other Consumer and Home Improvement Loans. Loans originated by the Company, including direct home improvement loans, loans on deposits and other consumer loans to borrowers located in the Puget Sound market area.

Commercial Business Loans

Commercial Business Lending. Commercial business loans originated by the Company to local small and mid-sized businesses located in the Puget Sound market area are secured primarily by accounts receivable, inventory or personal 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.

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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 June 30, 2014				
ALLOWANCE FOR LOAN LOSSES	Real Estate	Consumer	Commercial Business	Unallocated	Total
Beginning balance	$1,465	$1,462	$1,036	$1,280	$5,243
Provision for loan losses	(76)	503	662	(639)	450
Charge-offs	(3)	(386)	—	—	(389)
Recoveries	61	183	—	—	244
Net charge-offs	58	(203)	—	—	(145)
Ending balance	$1,447	$1,762	$1,698	$641	$5,548
Period end amount allocated to:					
Loans individually evaluated for impairment	$—	$—	$4	$—	$4
Loans collectively evaluated for impairment	1,447	1,762	1,694	641	5,544
Ending balance	$1,447	$1,762	$1,698	$641	$5,548
LOANS RECEIVABLE					
Loans individually evaluated for impairment	$627	$—	$45	$—	$672
Loans collectively evaluated for impairment	138,541	128,492	64,539	—	331,572
Ending balance	$139,168	$128,492	$64,584	$—	$332,244

	At or For the Six Months Ended June 30, 2014				
ALLOWANCE FOR LOAN LOSSES	Real Estate	Consumer	Commercial Business	Unallocated	Total
Beginning balance	$1,963	$1,512	$800	$817	$5,092
Provision for loan losses	(449)	552	973	(176)	900
Charge-offs	(147)	(637)	(75)	—	(859)
Recoveries	80	335	—	—	415
Net charge-offs	(67)	(302)	(75)	—	(444)
Ending balance	$1,447	$1,762	$1,698	$641	$5,548
Period end amount allocated to:					
Loans individually evaluated for impairment	$—	$—	$4	$—	$4
Loans collectively evaluated for impairment	1,447	1,762	1,694	641	5,544
Ending balance	$1,447	$1,762	$1,698	$641	$5,548
LOANS RECEIVABLE					
Loans individually evaluated for impairment	$627	$—	$45	$—	$672
Loans collectively evaluated for impairment	138,541	128,492	64,539	—	331,572
Ending balance	$139,168	$128,492	$64,584	$—	$332,244

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

	At or For the Three Months Ended June 30, 2013				
ALLOWANCE FOR LOAN LOSSES	Real Estate	Consumer	Commercial Business	Unallocated	Total
Beginning balance	$2,264	$1,831	$679	$270	$5,044
Provision for loan losses	317	143	(55)	195	600
Charge-offs	(86)	(460)	(44)	—	(590)
Recoveries	—	222	—	—	222
Net charge-offs	(86)	(238)	(44)	—	(368)
Ending balance	$2,495	$1,736	$580	$465	$5,276
Period end amount allocated to:					
Loans individually evaluated for impairment	$233	$—	$6	$—	$239
Loans collectively evaluated for impairment	2,262	1,736	574	465	5,037
Ending balance	$2,495	$1,736	$580	$465	$5,276
LOANS RECEIVABLE					
Loans individually evaluated for impairment	$4,198	$—	$152	$—	$4,350
Loans collectively evaluated for impairment	109,608	117,930	53,814	—	281,352
Ending balance	$113,806	$117,930	$53,966	$—	$285,702

	At or For the Six Months Ended June 30, 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	971	(7)	(194)	430	1,200
Charge-offs	(201)	(859)	(44)	—	(1,104)
Recoveries	35	444	3	—	482
Net charge-offs	(166)	(415)	(41)	—	(622)
Ending balance	$2,495	$1,736	$580	$465	$5,276
Period end amount allocated to:					
Loans individually evaluated for impairment	$233	$—	$6	$—	$239
Loans collectively evaluated for impairment	2,262	1,736	574	465	5,037
Ending balance	$2,495	$1,736	$580	$465	$5,276
LOANS RECEIVABLE					
Loans individually evaluated for impairment	$4,198	$—	$152	$—	$4,350
Loans collectively evaluated for impairment	109,608	117,930	53,814	—	281,352
Ending balance	$113,806	$117,930	$53,966	$—	$285,702

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

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

	June 30, 2014						
	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due and Accruing	Total Past Due	Non-Accrual	Current	Total Loans Receivable
REAL ESTATE LOANS							
Commercial	$—	$—	$—	$—	$ —	$39,832	$39,832
Construction and development	—	—	—	—	—	40,736	40,736
Home equity	125	231	—	356	—	14,757	15,113
One-to-four-family	—	—	—	—	94	31,945	32,039
Multi-family	—	—	—	—	—	11,448	11,448
Total real estate loans	125	231	—	356	94	138,718	139,168
CONSUMER							
Indirect home improvement	521	288	—	809	212	92,884	93,905
Solar	—	—	—	—	29	16,997	17,026
Marine	—	—	—	—	—	14,518	14,518
Automobile	5	—	—	5	6	918	929
Recreational	38	—	—	38	—	452	490
Home improvement	—	7	—	7	—	403	410
Other	—	7	—	7	4	1,203	1,214
Total consumer loans	564	302	—	866	251	127,375	128,492
COMMERCIAL BUSINESS LOANS	—	—	—	—	—	64,584	64,584
Total	$689	$533	$—	$1,222	$ 345	$330,677	$332,244

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FS BANCORP, INC. AND SUBSIDIARY
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NOTE 3 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

	December 31, 2013						
	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due and Accruing	Total Past Due	Non-Accrual	Current	Total Loans Receivable
REAL ESTATE LOANS							
Commercial	$—	$—	$—	—	$ 567	$32,403	32,970
Construction and development	—	—	—	—	—	41,633	41,633
Home equity	63	146	—	209	172	14,791	15,172
One-to-four-family	—	—	—	—	104	20,705	20,809
Multi-family	—	—	—	—	—	4,682	4,682
Total real estate loans	63	146	—	209	843	114,214	115,266
CONSUMER							
Indirect home improvement	533	218	—	751	258	90,158	91,167
Solar	—	—	—	—	—	16,838	16,838
Marine	33	—	—	33	—	11,170	11,203
Automobile	34	13	—	47	—	1,183	1,230
Recreational	39	—	—	39	—	514	553
Home improvement	7	—	—	7	—	456	463
Other	15	6	—	21	—	1,231	1,252
Total consumer loans	661	237	—	898	258	121,550	122,706
COMMERCIAL BUSINESS LOANS	54	—	—	54	—	49,190	49,244
Total	$778	$383	$—	$1,161	$ 1,101	$284,954	$287,216

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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 Six Months Ended June 30, 2014						
	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	—	—	—	—	—	—	—
One-to-four-family	634	(7)	627	—	627	634	17
Multi-family	—	—	—	—	—	—	—
Indirect home improvement	—	—	—	—	—	—	—
Marine	—	—	—	—	—	—	—
Automobile	—	—	—	—	—	—	—
Recreational	—	—	—	—	—	—	—
Home improvement	—	—	—	—	—	—	—
Other	—	—	—	—	—	—	—
Commercial business loans	—	—	—	—	—	—	—
Subtotal loans	634	(7)	627	—	627	634	17
WITH AN ALLOWANCE RECORDED							
Commercial	—	—	—	—	—	—	—
Construction and development	—	—	—	—	—	—	—
Home equity	—	—	—	—	—	—	—
One-to-four-family			—	—	—		
Multi-family	—	—	—	—	—	—	—
Indirect home improvement	—	—	—	—	—	—	—
Marine	—	—	—	—	—	—	—
Automobile	—	—	—	—	—	—	—
Recreational	—	—	—	—	—	—	—
Home improvement	—	—	—	—	—	—	—
Other	—	—	—	—	—	—	—

Commercial business loans	47	(2)	45	(4)	45 41	48	2
Subtotal loans	47	(2)	45	(4)	41	48	2
Total	$681	$(9)	$672	$(4)	$668	$682	$19

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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, 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	39	—	39	—	39	39	59
One-to-four-family	1,212	(169)	1,043	—	1,043	1,041	—
Multi-family	—	—	—	—	—	—	—
Indirect home improvement	—	—	—	—	—	—	—
Marine	—	—	—	—	—	—	—
Automobile	—	—	—	—	—	—	—
Recreational	—	—	—	—	—	—	—
Home improvement	—	—	—	—	—	—	—
Other	—	—	—	—	—	—	—
Commercial business loans	—	—	—	—	—	—	—
Subtotal loans	1,251	(169)	1,082	—	1,082	1,080	59
WITH AN ALLOWANCE RECORDED							
Commercial	731	(164)	567	(85)	482	622	15
Construction and development	—	—	—	—	—	—	—
Home equity	—	—	—	—	—	—	—
One-to-four-family	—	—	—	—	—	—	—
Multi-family	—	—	—	—	—	—	—
Indirect home improvement	—	—	—	—	—	—	—
Marine	—	—	—	—	—	—	—
Automobile	—	—	—	—	—	—	—
Recreational	—	—	—	—	—	—	—
Home improvement	—	—	—	—	—	—	—
Other	—	—	—	—	—	—	—

Commercial business loans	56	(2)	54	(6)	48	59	—
Subtotal loans	787	(166)	621	(91)	530	681	15
Total	$2,038	$(335)	$1,703	$(91)	$1,612	$1,761	$74

The average recorded investment in impaired loans was $677,000 and $528,000 for the three months ended June 30, 2014 and 2013, respectively, and $682,000 and $4.3 million for the six months ended June 30, 2014 and 2013, respectively. For the three and six months ended June 30, 2014, the Company recognized interest income on impaired loans of $9,000 and $19,000, respectively, compared to $54,000 and $80,000, respectively, for same periods a year ago.

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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 and are typically secured by cash and/or marketable securities.
- 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 FDIC's Uniform Retail Credit Classification and Account Management 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" and 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.

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FS BANCORP, INC. AND SUBSIDIARY
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NOTE 3 - LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES (Continued)

The following tables summarize risk rated loan balances by category:

	June 30, 2014						
	Pass (1 - 5)	Watch (6)	Special Mention (7)	Substandard (8)	Doubtful(9)	Loss (10)	Total
REAL ESTATE LOANS							
Commercial	$38,400	$549	$883	$—	$ —	$—	$39,832
Construction and development	40,736	—	—	—	—	—	40,736
Home equity	15,113	—	—	—	—	—	15,113
One-to-four-family	31,412	—	—	627	—	—	32,039
Multi-family	11,448	—	—	—	—	—	11,448
Total real estate loans	137,109	549	883	627	—	—	139,168
CONSUMER							
Indirect home improvement	93,664	—	—	241	—	—	93,905
Solar	17,026	—	—	—	—	—	17,026
Marine	14,518	—	—	—	—	—	14,518
Automobile	923	—	—	6	—	—	929
Recreational	490	—	—	—	—	—	490
Home improvement	410	—	—	—	—	—	410
Other	1,210	—	—	4	—	—	1,214
Total consumer loans	128,241	—	—	251	—	—	128,492
COMMERCIAL BUSINESS LOANS	43,843	9,701	10,995	45	—	—	64,584
Total	$309,193	$10,250	$11,878	$923	$ —	$—	$332,244

	December 31, 2013						
	Pass (1 - 5)	Watch (6)	Special Mention (7)	Substandard (8)	Doubtful(9)	Loss (10)	Total
REAL ESTATE LOANS							
Commercial	$31,500	$903	$—	$567	$ —	$—	$32,970
Construction and development	41,633	—	—	—	—	—	41,633
Home equity	15,000	—	—	172	—	—	15,172
One-to-four-family	19,766	—	—	1,043	—	—	20,809
Multi-family	4,682	—	—	—	—	—	4,682
Total real estate loans	112,581	903	—	1,782	—	—	115,266
CONSUMER							
Indirect home improvement	90,909	—	—	258	—	—	91,167
Solar	16,838	—	—	—	—	—	16,838
Marine	11,203	—	—	—	—	—	11,203
Automobile	1,230	—	—	—	—	—	1,230
Recreational	553	—	—	—	—	—	553
Home improvement	463	—	—	—	—	—	463

Other	1,252	—	—	—	—	—	1,252
Total consumer loans	122,448	—	—	258	—	—	122,706
COMMERCIAL BUSINESS LOANS	38,492	10,698	—	54	—	—	49,244
Total	$273,521	$11,601	$—	$2,094	$ —	$—	$287,216

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

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

Troubled Debt Restructured Loans

Troubled debt restructured (“TDR”) loans are loans for which the Company, for economic or legal reasons related to the borrower’s financial condition, has granted a significant concession to the borrower that it would otherwise not consider. The loan terms which have been modified or restructured due to a borrower’s financial difficulty include but are not limited to: a reduction in the stated interest rate; an extension of the maturity at an interest rate below current market; a reduction in the face amount of the debt; a reduction in the accrued interest; or re-aging, extensions, deferrals and renewals. TDR loans are considered impaired loans and are individually evaluated for impairment. TDR loans can be classified as either accrual or non-accrual. TDR loans are classified as non-performing loans unless they have been performing in accordance with their modified terms for a period of at least six months in which case they are placed on accrual status. At June 30, 2014, the Company had four TDR loans still on accrual. The Company had two TDR's included in impaired loans at June 30, 2014, and four TDR's at December 31, 2013. In addition, at June 30, 2014 and December 31, 2013, the Company had no TDR loans on non-accrual. The Company had no commitments to lend additional funds on these restructured loans.

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

	June 30, 2014	December 31, 2013
TDR loans still on accrual	$799	$815
TDR loans on non-accrual	—	—
Total TDR loans	$799	$815

The following tables present loans that became TDRs during the following periods:

	At or For the Three Months Ended June 30,							
	2014				2013			
	Number of Contracts	Recorded Investment	Increase in Allowance	Charge-offs to the Allowance	Number of Contracts	Recorded Investment	Increase in Allowance	Charge-offs to the Allowance
Commercial business	—	$ —	$ —	$ —	—	$ —	$ —	$ —
Total	—	$ —	$ —	$ —	—	$ —	$ —	$ —

	At or For the Six Months Ended June 30,							
	2014				2013			
	Number of Contracts	Recorded Investment	Increase in Allowance	Charge-offs to the Allowance	Number of Contracts	Recorded Investment	Increase in Allowance	Charge-offs to the Allowance
Commercial business	—	$—	$—	$ —	1	$35	$—	$ 35
Total	—	$—	$—	$ —	1	$35	$—	$ 35

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

There were no TDRs recorded in the twelve months prior to June 30, 2014 and 2013, that subsequently defaulted in the six months ended June 30, 2014 and 2013.

The recorded investments in the tables 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.

The TDR in the table above was the result of interest rate modifications and extended payment terms. The Company has not forgiven any principal on the above loan.

NOTE 4 – SERVICING RIGHTS

Loans serviced for others are not included on the consolidated balance sheets. The unpaid principal balances of mortgage, commercial, and consumer loans serviced for others were $276.5 million and $243.0 million at June 30, 2014 and December 31, 2013, respectively. The fair market value of the servicing rights' asset was $3.1 million and $3.0 million at June 30, 2014 and December 31, 2013, respectively.

The following tables summarize servicing rights activity for the three and six months ended June 30, 2014 and 2013: