

First Business Financial Services, Inc.

Form 10-Q/A

December 21, 2005

Table of Contents

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

**▶ Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
For the quarterly period ended June 30, 2005
Commission file number 000-51028
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 No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes No

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

The number of shares outstanding of the registrant's sole class of common stock, par value \$0.01 per share, on December 20, 2005 was 2,435,008 shares.

Table of Contents

**FIRST BUSINESS FINANCIAL SERVICES, INC.
INDEX FORM 10-Q/A**

| | Page |
|--|-------------|
| <u>PART I. FINANCIAL INFORMATION</u> | |
| <u>Item 1. Financial Statements (Unaudited)</u> | |
| <u>Consolidated Balance Sheets as of June 30, 2005 and December 31, 2004 (as restated)</u> | 4 |
| <u>Consolidated Statements of Income for the Three and Six Months Ended June 30, 2005 and 2004 (as restated)</u> | 5 |
| <u>Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income for the Six Months Ended June 30, 2005 and 2004 (as restated)</u> | 6 |
| <u>Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2005 and 2004 (as restated)</u> | 7 |
| <u>Notes to Unaudited Consolidated Financial Statements</u> | 8 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (as restated)</u> | |
| <u>Results of Operations</u> | 23 |
| <u>Financial Condition</u> | 29 |
| <u>Asset Quality</u> | 30 |
| <u>Liquidity and Capital Resources</u> | 32 |
| <u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u> | 37 |
| <u>Item 4. Controls and Procedures</u> | 38 |
| <u>PART II. OTHER INFORMATION</u> | |
| <u>Item 1. Legal Proceedings</u> | 39 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 39 |
| <u>Item 3. Defaults upon Senior Securities</u> | 39 |

Table of Contents

| | Page |
|---|-------------|
| <u>Item 4. Submission of Matters to Vote of Security Holders</u> | 39 |
| <u>Item 5. Other Information</u> | 40 |
| <u>Item 6. Exhibits</u> | 40 |
| <u>SIGNATURES</u> | 41 |
| <u>Certification of Chief Executive Officer</u> | |
| <u>Certification of Senior VP and Chief Financial Officer</u> | |
| <u>Section 1350 Certifications</u> | |

This Quarterly Report on Form 10-Q/A for the quarter ended June 30, 2005 has been amended due to the restatement of consolidated financial statements related to hedge accounting. See **Note 2** to the unaudited consolidated financial statements for more information.

Table of Contents

PART I. Financial Information

Item 1. Financial Statements

3

Table of Contents**Consolidated Balance Sheets**

| | (Unaudited) | December |
|---|-----------------------------------|----------------------|
| | June 30, | 31, |
| | 2005 | 2004 |
| | (as | (as restated) |
| | restated) | (as restated) |
| | (In Thousands, Except Share Data) | |
| Assets | | |
| Cash and due from banks | \$ 12,146 | \$ 8,644 |
| Interest-bearing deposits | 13 | 27 |
| Cash and cash equivalents | 12,159 | 8,671 |
| Securities available-for-sale, at fair value | 89,871 | 66,445 |
| Loans and leases receivable, net: | | |
| Held for sale | | 137 |
| Held for investment | 485,742 | 469,801 |
| Leasehold improvements and equipment, net | 1,148 | 1,247 |
| Foreclosed properties | 650 | 665 |
| Cash surrender value of life insurance | 7,622 | 7,441 |
| Goodwill and other intangibles | 2,872 | 2,896 |
| Accrued interest receivable and other assets | 4,775 | 5,648 |
| Total assets | \$ 604,839 | \$ 562,951 |
| Liabilities and Stockholders Equity | | |
| Deposits | \$ 510,572 | \$ 474,677 |
| Securities sold under agreement to repurchase | 588 | 678 |
| Federal Home Loan Bank and other borrowings | 33,149 | 29,303 |
| Junior subordinated debentures | 10,310 | 10,310 |
| Other liabilities | 9,802 | 9,842 |
| | 564,421 | 524,810 |
| Commitments and contingencies | | |
| Stockholders Equity: | | |
| Preferred stock, \$10 par value, 10,000 Series A shares and 10,000 Series B shares authorized, none issued and outstanding | | |
| Common stock, \$.01 par value, 8,000,000 shares authorized, 2,435,462 and 2,429,182 shares issued, 2,418,539 and 2,412,409 outstanding in 2005 and 2004, respectively | 24 | 24 |
| Additional paid-in capital | 22,529 | 22,426 |
| Retained earnings | 19,222 | 16,752 |
| Accumulated other comprehensive loss | (970) | (677) |

Edgar Filing: First Business Financial Services, Inc. - Form 10-Q/A

| | | |
|---|------------|------------|
| Treasury stock (16,923 and 16,773 shares in 2005 and 2004, respectively), at cost | (387) | (384) |
| Total stockholders' equity | 40,418 | 38,141 |
| Total liabilities and stockholders' equity | \$ 604,839 | \$ 562,951 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

4

Table of Contents**Unaudited Consolidated Statements of Income**

| | Three Months | | Six Months Ended, | |
|--|--|--------------|--------------------------|---------------|
| | Ended, | | June 30, | |
| | 2005 | 2004 | 2005 | 2004 |
| | (as restated) | | (as restated) | |
| | (In Thousands, Except Per Share Data) | | | |
| Interest income: | | | | |
| Loans and leases | \$ 8,043 | \$ 6,217 | \$ 15,254 | \$ 12,222 |
| Securities income: | | | | |
| Taxable | 772 | 543 | 1,463 | 1,067 |
| Fed funds sold and other | 48 | 34 | 102 | 73 |
| Total interest income | 8,863 | 6,794 | 16,819 | 13,362 |
| Interest expense: | | | | |
| Deposits | 3,850 | 2,089 | 7,116 | 4,276 |
| Notes payable and other borrowings | 256 | 179 | 434 | 369 |
| Guaranteed trust preferred securities | 234 | 220 | 462 | 440 |
| Total interest expense | 4,340 | 2,488 | 8,012 | 5,085 |
| Net interest income | 4,523 | 4,306 | 8,807 | 8,277 |
| Provision for loan and lease losses | | | 65 | |
| Net interest income after provision for loan and lease losses | 4,523 | 4,306 | 8,742 | 8,277 |
| Non-interest income: | | | | |
| Service charges on deposits | 214 | 250 | 428 | 500 |
| Credit, merchant and debit card fees | 43 | 38 | 81 | 71 |
| Loan fees | 133 | 125 | 278 | 255 |
| Gain on sale of 50% owned joint venture | | | 973 | |
| Increase in cash surrender value of bank-owned life insurance | 93 | 40 | 181 | 84 |
| Trust and investment services fee income | 244 | 179 | 526 | 342 |
| Change in fair value of interest rate swaps | 336 | 1,304 | 272 | 990 |
| Net cash settlement of interest rate swaps | (21) | (289) | (52) | (589) |
| Written option income | | | | 7 |
| Other | 53 | 148 | 96 | 211 |
| Total non-interest income | 1,095 | 1,795 | 2,783 | 1,871 |
| Non-interest expense: | | | | |
| Compensation | 2,148 | 1,948 | 4,355 | 3,934 |
| Occupancy | 264 | 216 | 489 | 463 |
| Equipment | 117 | 132 | 238 | 251 |
| Data processing | 276 | 188 | 476 | 367 |

Edgar Filing: First Business Financial Services, Inc. - Form 10-Q/A

| | | | | |
|--|----------|----------|----------|----------|
| Marketing | 231 | 170 | 394 | 272 |
| Professional fees | 411 | 139 | 626 | 449 |
| Other | 299 | 322 | 743 | 640 |
| Total non-interest expense | 3,746 | 3,115 | 7,321 | 6,376 |
| Minority interest in net (income) loss of consolidated subsidiary | | (3) | | (9) |
| Income before income tax expense | 1,872 | 2,983 | 4,204 | 3,763 |
| Income tax expense | 649 | 1,060 | 1,456 | 1,365 |
| Net income | \$ 1,223 | \$ 1,923 | \$ 2,748 | \$ 2,398 |
| Earnings per share: | | | | |
| Basic | \$ 0.51 | \$ 0.89 | \$ 1.14 | \$ 1.15 |
| Diluted | 0.50 | 0.85 | 1.12 | 1.09 |
| Dividends declared per share | 0.115 | 0.10 | 0.115 | 0.10 |
| See accompanying Notes to Unaudited Consolidated Financial Statements. | | | | |

5

Table of Contents**Unaudited Consolidated Statements of Changes in Stockholders Equity and Comprehensive Income**

| | Common stock | Additional paid-in capital | Retained earnings | Accumulated other comprehensive loss | Treasury stock | Total |
|---|-------------------------|---|------------------------------|---|---------------------------|--------------|
| (Dollars in thousands, except share data) | | | | | | |
| Balance at December 31, 2003, as reported | \$ 20 | \$ 14,108 | \$ 13,861 | \$ (1,978) | \$ (35) | \$ 25,976 |
| Restatement adjustments | | | (861) | 875 | | 14 |
| Balance at December 31, 2003, as restated | \$ 20 | \$ 14,108 | \$ 13,000 | \$ (1,103) | \$ (35) | \$ 25,990 |
| Comprehensive income: | | | | | | |
| Net income, as restated | | | 2,398 | | | 2,398 |
| Unrealized securities losses arising during the period net of minority interest | | | | (709) | | (709) |
| Unrealized derivatives gains arising during the period | | | | 14 | | 14 |
| Reclassification adjustment for realized loss on derivatives | | | | 328 | | 328 |
| Income tax effect | | | | 185 | | 185 |
| Comprehensive income (as restated) | | | | | | 2,216 |
| Cash dividends (\$0.10 per share) | | | (236) | | | (236) |
| Treasury stock purchased (14,973 shares) | | | | | (281) | (281) |
| Conversion of BBG shares (336,205 shares) | 3 | 7,730 | | | | 7,733 |
| Stock options exercised (62,010 shares) | 1 | 332 | | | | 333 |
| Balance at June 30, 2004, as restated | \$ 24 | \$ 22,170 | \$ 15,162 | \$ (1,285) | \$ (316) | \$ 35,755 |

| | Common stock | Additional paid-in capital | Retained earnings | Accumulated other comprehensive loss | Treasury stock | Total |
|---|-------------------------|---|------------------------------|---|---------------------------|--------------|
| (Dollars in thousands, except share data) | | | | | | |
| Balance at December 31, 2004, as reported | \$ 24 | \$ 22,426 | \$ 17,229 | \$ (1,118) | \$ (384) | \$ 38,177 |
| Restatement adjustments | | | (477) | 441 | | (36) |
| Balance at December 31, 2004, as restated | \$ 24 | \$ 22,426 | \$ 16,752 | \$ (677) | \$ (384) | \$ 38,141 |
| Comprehensive income: | | | | | | |
| Net income, as restated | | | 2,748 | | | 2,748 |

Edgar Filing: First Business Financial Services, Inc. - Form 10-Q/A

| | | | | | | |
|--|-------|-----------|-----------|----------|----------|-----------|
| Unrealized securities losses arising during the period | | | | (650) | | (650) |
| Unrealized derivatives gains arising during the period | | | | 2 | | 2 |
| Reclassification adjustment for realized loss on derivatives | | | | 135 | | 135 |
| Income tax effect | | | | 220 | | 220 |
| Comprehensive income (as restated) | | | | | | 2,455 |
| Cash dividends (\$0.115 per share) | | | (278) | | | (278) |
| Treasury stock purchased (150 shares) | | | | | (3) | (3) |
| Stock options exercised (6,280 shares) | | 103 | | | | 103 |
| Balance at June 30, 2005, as restated | \$ 24 | \$ 22,529 | \$ 19,222 | \$ (970) | \$ (387) | \$ 40,418 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents**Unaudited Consolidated Statements of Cash Flows**

| | Six Months Ended June 30, | |
|---|----------------------------------|------------------|
| | 2005 | 2004 |
| | (as | (as |
| | restated) | restated) |
| | (In Thousands) | |
| Operating Activities | | |
| Net income | \$ 2,748 | \$ 2,398 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Deferred income taxes | (1,776) | 1,629 |
| Provision for loan and lease losses | 65 | |
| Depreciation, amortization and accretion, net | 537 | 544 |
| Change in fair value of interest rate swaps | (272) | (990) |
| Written option income | | (7) |
| Sale of loans originated for sale | 137 | 18 |
| Increase in cash surrender value of bank-owned life insurance | (181) | (84) |
| Gain on sale of loans originated for sale | (1) | |
| Gain on sale of 50% owned joint venture | (973) | |
| Minority interest in net income of consolidated subsidiaries | | 9 |
| (Increase) decrease in accrued interest receivable and other assets | (967) | 762 |
| Increase in accrued expenses and other liabilities | 2,145 | 789 |
| Net cash provided by operating activities | 1,462 | 5,068 |
| Investing activities | | |
| Proceeds from maturities of available-for-sale securities | 13,700 | 6,299 |
| Proceeds from sale of 50% owned joint venture | 2,100 | |
| Purchases of available-for-sale securities | (37,120) | (9,122) |
| Net increase in loans and leases | (16,100) | (15,955) |
| Purchases of leasehold improvements and equipment | (27) | (213) |
| Net cash used in investing activities | (37,447) | (18,991) |
| Financing activities | | |
| Net increase in deposits | 35,895 | 17,979 |
| Net increase (decrease) in FHLB line of credit | (11,154) | 5,696 |
| Net increase (decrease) in short-term borrowed funds | 14,910 | (4,284) |
| Exercise of stock options | 103 | 333 |
| Cash dividends | (278) | (236) |
| Purchase of treasury stock | (3) | (281) |
| Net cash provided by financing activities | 39,473 | 19,207 |
| Net increase in cash and cash equivalents | 3,488 | 5,284 |
| Cash and cash equivalents at beginning of period | 8,671 | 12,465 |

| | | |
|--|-----------|-----------|
| Cash and cash equivalents at end of period | \$ 12,159 | \$ 17,749 |
|--|-----------|-----------|

Supplementary cash flow information

Cash paid or credited to accounts:

| | | |
|-------------------------------------|----------|----------|
| Interest on deposits and borrowings | \$ 7,797 | \$ 5,627 |
| Income taxes | 2,142 | 607 |

Non-cash transactions:

| | | |
|--|-----|---------|
| Loans transferred to foreclosed properties | 650 | |
| Deconsolidation of trust preferred securities | | 10,310 |
| Acquisition of minority shares of BBG: | | |
| Increase in common stock and paid-in capital | | 7,733 |
| Elimination of minority interest | | (4,392) |
| Settlement of written option liability | | (654) |
| Increase in goodwill and other intangible assets | | (2,689) |
| Other | | 2 |

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 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 (FBB), and First Business Bank Milwaukee. All significant intercompany balances and transactions have been eliminated in consolidation.

Note 2 Restatement of Consolidated Financial Statements.

On November 8, 2005, FBFS determined that it would restate its previously issued consolidated financial statements for the first two quarters of 2005 and for the years ended December 31, 2004, 2003, 2002, as a result of accounting treatment related to its interest rate swaps associated with money market deposit accounts (MMDAs), variable rate loans (Loans), trust preferred securities (TPSs) and brokered certificates of deposit (CDs).

Since 2001, FBFS has entered into various interest rate swaps to hedge the interest rate risk inherent in its MMDAs and Loans. Since inception of the hedging program, FBFS has applied the short-cut method of cash flow hedge accounting under Statement of Financial Accounting Standards No. 133 (SFAS 133) to account for the interest rate swaps. Subsequent to June 30, 2005, FBFS determined that these hedging relationships did not qualify for the short-cut method because the hedged items consisted of a pool of MMDAs and a pool of loans that were not the same recognized liabilities and assets over the life of the respective swaps.

In December 2001, FBFS Statutory Trust I (the Trust), a business trust wholly owned by FBFS, sold preferred securities and FBFS simultaneously entered into an interest rate swap to hedge the interest rate risk. Since inception of the swap, FBFS has applied the short-cut method of cash flow hedge accounting under SFAS No. 133 to account for the swap. Effective in the year beginning January 1, 2004, in accordance with the application of the Financial Accounting Standards Board Interpretation No. 46 (revised) (FIN 46R) FBFS deconsolidated the Trust. Subsequent to June 30, 2005 FBFS determined that this hedging relationship no longer qualifies for hedge accounting because upon adoption of FIN 46R, FBFS did not dedesignate the existing hedge relationship and redesignate a new hedging relationship.

Additionally, since the third quarter of 2004, FBFS has entered into various interest rate swaps to hedge the interest rate risk inherent in certain of its brokered CDs. Since inception of the hedging program, FBFS has applied the short-cut method of fair value hedge accounting under SFAS No. 133 to account for the swaps. Subsequent to June 30, 2005 FBFS determined that these swaps did not qualify for the short-cut method because the form of payment of the broker fee incurred to acquire the related CD was determined to have caused the swaps not to have a zero value at inception.

It is not known what the effect on the consolidated financial statements would have been had the Corporation applied the long-haul method of documenting the hedges for the MMDA, Loan and CD interest rate swaps rather than the short-cut method. However, management believes these interest rate swaps would have been effective as economic hedges. Hedge accounting under SFAS No. 133 is not allowed for the affected periods because the hedge documentation required for the long-haul method was not in place at the inception of the hedge. Similarly the TPS swap remained economically effective but under SFAS No. 133 hedge accounting is not allowed for the affected periods because the required documentation was not in place on the date FIN 46R was adopted.

At December 31, 2003 and 2004, the consolidated financial statements reflect an adjustment to decrease retained earnings of \$861,000 and \$477,000, respectively, and an increase in accumulated other comprehensive income of \$875,000 and \$441,000, respectively.

As a result the financial statements for all affected periods through March 31, 2005 reflect a cumulative charge of \$522,000, net of income taxes, to account for the interest rate swaps referred to above as if hedge

Table of Contents

accounting was never applied to them. In addition, for the quarter ended June 30, 2005, a benefit of approximately \$146,000, net of income taxes was recorded, to reflect the same treatment.

Cash flow hedge accounting allows a company to record the net settlement of interest payments related to the swap contracts in net interest income and the changes in fair value on the related interest rate swaps in shareholders' equity as part of accumulated other comprehensive income. Eliminating the application of cash flow hedge accounting causes the changes in fair value of the related interest rate swaps to be included in non-interest income (instead of accumulated other comprehensive income in shareholders' equity). Additionally, the net settlement of interest payments related to the swap contracts was reclassified from net interest income to non-interest income.

Fair value hedge accounting allows a company to record the change in fair value of the hedged item, in this case, brokered CDs, as an adjustment to income as an offset to the fair value adjustment on the related interest rate swap. Eliminating the application of fair value hedge accounting reverses the fair value adjustments that have been made to the brokered CDs. Additionally, the net cash settlement payments during each of the above periods for these interest rate swaps were reclassified from net interest income to non-interest income.

The Registration Statement on Form 10/A including financial statements for the years ended December 31, 2004, 2003 and 2002 and interim financial statements for the quarter ended March 31, 2005 was amended to reflect the proper accounting treatment. This Quarterly Report on Form 10-Q/A for the quarter ended June 30, 2005 has been amended to reflect the proper accounting treatment. A Form 8-K was filed on November 21, 2005 which disclosed a summary of the changes to the consolidated balance sheet and consolidated statement of income line items for the periods included in these reports.

Effects of the restatement by line item follow for the periods presented in this Form 10-Q. The tax effect of the adjustments approximates the Corporation's marginal rate of 39.2%.

Impact to Consolidated Balance Sheets
(In thousands)

| | (Unaudited) June 30, 2005 | | | December 31, 2004 | | |
|--|------------------------------|---------------------------|----------------|------------------------------|---------------------------|----------------|
| | As Previously Reported | Restatement Adjustment | As Restated | As Previously Reported | Restatement Adjustment | As Restated |
| Other liabilities | \$ 9,706 | \$ 96 | \$ 9,802 | \$ 9,806 | \$ 36 | \$ 9,842 |
| Total liabilities | 564,325 | 96 | 564,421 | 524,774 | 36 | 524,810 |
| Retained earnings | 19,598 | (376) | 19,222 | 17,229 | (477) | 16,752 |
| Accumulated other comprehensive loss, net of tax | (1,250) | 280 | (970) | (1,118) | 441 | (677) |
| Total shareholders equity | 40,514 | (96) | 40,418 | 38,177 | (36) | 38,141 |

9

Table of Contents

Impact to Consolidated Statements of Income
(In thousands, except per share data) (Unaudited)
Three Months Ended June 30,

| | 2005 | | 2004 | | As Restated | |
|---|------------------------|------------------------|-------------|------------------------|-------------|------------------------|
| | As Previously Reported | Restatement Adjustment | As Restated | As Previously Reported | | Restatement Adjustment |
| Interest expense on deposits | \$3,824 | \$ 26 | \$3,850 | \$2,282 | \$ (193) | \$2,089 |
| Interest expense on junior subordinated debentures | 223 | 11 | 234 | 223 | (3) | 220 |
| Total interest expense | 4,303 | 37 | 4,340 | 2,684 | (196) | 2,488 |
| Net interest income | 4,560 | (37) | 4,523 | 4,110 | 196 | 4,306 |
| Net interest income after provision for loan and lease losses | 4,560 | (37) | 4,523 | 4,110 | 196 | 4,306 |
| Change in fair value of interest rate swaps | | 336 | 336 | | 1,304 | 1,304 |
| Net cash settlement of interest rate swaps | | (21) | (21) | | (289) | (289) |
| Total non interest income | 780 | 315 | 1,095 | 775 | 1,015 | 1,790 |
| Income before income tax expense | 1,594 | 278 | 1,872 | 1,772 | 1,211 | 2,983 |
| Income tax expense | 517 | 132 | 649 | 683 | 377 | 1,060 |
| Net income | 1,077 | 146 | 1,223 | 1,089 | 834 | 1,923 |
| Earnings per share: | | | | | | |
| Basic | \$ 0.45 | \$0.06 | \$ 0.51 | \$ 0.51 | \$ 0.38 | \$ 0.89 |
| Diluted | \$ 0.44 | \$0.06 | \$ 0.50 | \$ 0.48 | \$ 0.37 | \$ 0.85 |

Impact to Consolidated Statements of Income
(In thousands, except per share data) (Unaudited)
Six Months Ended June 30,

| | 2005 | | 2004 | | As Restated | |
|---|------------------------|------------------------|-------------|------------------------|-------------|------------------------|
| | As Previously Reported | Restatement Adjustment | As Restated | As Previously Reported | | Restatement Adjustment |
| Interest expense on deposits | \$7,062 | \$ 54 | \$7,116 | \$4,675 | \$ (399) | \$4,276 |
| Interest expense on junior subordinated debentures | 444 | 18 | 462 | 444 | (4) | 440 |
| Total interest expense | 7,940 | 72 | 8,012 | 5,488 | (403) | 5,085 |
| Net interest income | 8,879 | (72) | 8,807 | 7,874 | 403 | 8,277 |
| Net interest income after provision for loan and lease losses | 8,814 | (72) | 8,742 | 7,874 | 403 | 8,277 |
| | | 272 | 272 | | 990 | 990 |

| | | | | | | |
|---|-------|------|-------|-------|-------|-------|
| Change in fair value of interest rate swaps | | | | | | |
| Net cash settlement of interest rate swaps | | (52) | (52) | | (589) | (589) |
| Total non interest income | 2,563 | 220 | 2,783 | 1,465 | 401 | 1,866 |
| Income before income tax expense | 4,056 | 148 | 4,204 | 2,959 | 804 | 3,763 |
| Income tax expense | 1,409 | 47 | 1,456 | 1,084 | 281 | 1,365 |
| Net income | 2,647 | 101 | 2,748 | 1,875 | 523 | 2,398 |

Earnings per share:

| | | | | | | |
|---------|---------|---------|---------|---------|---------|---------|
| Basic | \$ 1.10 | \$ 0.04 | \$ 1.14 | \$ 0.90 | \$ 0.25 | \$ 1.15 |
| Diluted | \$ 1.07 | \$ 0.05 | \$ 1.12 | \$ 0.85 | \$ 0.24 | \$ 1.09 |

The restatement had no effect on cash flows from operating, investing or financing activities.

Table of Contents**Note 3 Basis of Presentation.**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (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. In the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of the unaudited consolidated financial statements have been included.

In conformity with GAAP, management of the Corporation is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements as well as reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. Material estimates that could experience significant changes in the near-term include the allowance for loan and lease losses, the value of foreclosed property, lease residuals, the value of property under operating leases, derivative financial instruments, hedging activities and accrued and deferred income taxes. The results of operations for the three-month and six-month periods ended June 30, 2005 are not necessarily indicative of results that may be expected for any other interim period or the entire fiscal year ending December 31, 2005. The unaudited consolidated financial statements presented herein should be read in conjunction with the audited consolidated financial statements and related notes thereto included in the Corporation's Report on Form 10/A for the year ended December 31, 2004.

Recent Accounting Changes.

Changes in Accounting Principle. On May 5, 2005, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 154 *Accounting Changes and Error Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3*. SFAS No. 154, which is effective for accounting changes made in fiscal years beginning after December 15, 2005, requires retrospective application for voluntary changes in accounting principle unless it is impracticable to do so. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. The adoption of SFAS No. 154 is not expected to impact the Corporation's consolidated financial statements.

Stock Options. On December 16, 2004, the FASB issued SFAS No. 123 (revised 2004), which is a revision of the SFAS 123, *Accounting for Stock-based Compensation*. SFAS No. 123(R) supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and amends SFAS No. 95, *Statement of Cash Flows*. SFAS No. 123(R), which is effective for FBFS beginning January 1, 2006, requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value at the grant date. The cost is then recognized over the period during which an employee is required to provide service in exchange for the award the requisite service period (usually the vesting period). This statement eliminates the alternative to APB Opinion No. 25's intrinsic value method of accounting that was provided in Statement 123 as originally issued.

Accordingly, the adoption of SFAS No. 123(R)'s fair value method could have an impact on the results of operations, although it will have no impact on the overall financial position. The future impact of unvested options issued prior to adoption of SFAS No. 123(R) will approximate the pro forma calculation below.

Proforma Stock Option Information. The following table illustrates what the Corporation's net income and earnings per share would have been had compensation cost for the Corporation's stock option plans been determined based on the fair value at the date of grant for awards under the stock option plans. As allowed under SFAS No. 123,

Accounting for Stock-Based Compensation (SFAS 123) and SFAS No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure* an amendment of SFAS 123, the Corporation accounts for stock-based compensation cost under the intrinsic value method of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB Opinion 25), and related Interpretations, under which no compensation cost has been recognized for any periods presented, except with respect to restricted stock awards. Compensation expense for employee stock options is not recognized if the exercise price of the option equals or exceeds the fair value of the stock on the date of grant as such options would have no intrinsic value at the date of grant.

Table of Contents

| | Six Months Ended June 30, | |
|--|---|-------------------------------|
| | 2005 (as restated) | 2004 (as restated) |
| | (Dollars in Thousands, Except Per Share Data) | |
| Net Income | | |
| As restated | \$ 2,748 | \$ 2,398 |
| Compensation expense under the fair value method | 179 | 106 |
| Pro forma | 2,569 | 2,292 |
| | | |
| Earnings Per Share Basic | | |
| As restated | 1.14 | 1.15 |
| Compensation expense under the fair value method | 0.08 | 0.05 |
| Pro forma | 1.06 | 1.10 |
| | | |
| Earnings Per Share Diluted | | |
| As restated | 1.12 | 1.09 |
| Compensation expense under the fair value method | 0.05 | 0.03 |
| Pro forma | 1.07 | 1.06 |
| | | |
| | Three Months Ended June 30, | |
| | 2005 (as restated) | 2004 (as restated) |
| | (Dollars in Thousands, Except Per Share Data) | |
| Net Income | | |
| As restated | \$ 1,223 | \$ 1,923 |
| Compensation expense under the fair value method | 90 | 53 |
| Pro forma | 1,133 | 1,870 |
| | | |
| Earnings Per Share Basic | | |
| As restated | 0.51 | 0.89 |
| Compensation expense under the fair value method | 0.04 | 0.03 |
| Pro forma | 0.47 | 0.86 |
| | | |
| Earnings Per Share Diluted | | |
| As restated | 0.50 | 0.85 |
| Compensation expense under the fair value method | 0.04 | 0.03 |
| Pro forma | 0.46 | 0.82 |

The fair value of each option granted is estimated using the minimum value method on the grant date using the Black-Scholes option-pricing model which considers the risk free rate of return based upon 10 year treasury obligations, a 10 year expected life and dividends, if any are declared, but does not consider expected volatility. Option holders have 10 years in which to exercise their options and must exercise vested options upon employment termination. Compensation amounts are amortized over the vesting period of the options in accordance with the vesting terms of the stock options agreements. The per share weighted average fair value of stock options granted during 2005 and 2004 was \$8.18 and \$7.56, respectively.

Table of Contents

For purposes of providing the pro forma disclosures required under SFAS 123, the fair value of stock options granted as of June 30, 2005 and December 31, 2004 was estimated at the date of grant using a Black-Scholes option pricing model, which was originally developed for use in estimating the fair value of traded options that have different characteristics from the Corporation's employee stock options. The model is also sensitive to changes in the subjective assumptions that can materially affect the fair value estimate. As a result, management believes the Black-Scholes model may not necessarily provide a reliable single measure of the fair value of employee stock.

12,000 stock options were granted in February 2005 and 3,750 stock options were granted in May 2005. No options have been granted since May 2005. The estimated fair value of any options granted in the future will be determined pursuant to SFAS 123R and will consider expected volatility.

The table below discusses the weighted average fair values for options granted as of June 30, 2005 and 2004.

| | Six Months Ended June 30, | |
|-------------------------|--------------------------------------|-------------|
| | 2005 | 2004 |
| Expected dividend yield | 0.92% | n/a |
| Risk free interest rate | 4.13-4.21% | 4.38% |
| Expected lives | 10 years | 10 years |

Note 4 Sale of 50% Owned Joint Venture

On January 4, 2005, FBB sold its 50% interest in m2 Lease Funds, LLC (m2), in a cash sale to the owner of the other 50% interest. In this individually negotiated transaction, cash proceeds from the sale were \$2.1 million and resulted in an approximate before tax gain of \$973,000. On January 18, 2005, all secured loans from FBB to m2 were paid in full. FBB no longer holds any equity interest in m2 and has no continuing involvement with m2.

Note 5 Goodwill and Other Intangible Assets.

Goodwill is not amortized but is subject to impairment tests on at least an annual basis. No impairment loss was necessary in 2004 or through June 30, 2005. At June 30, 2005, goodwill was \$2,689,000. There was no change in the carrying amount of goodwill for the six months ended June 30, 2005, as shown below:

| | Three and Six Months Ended June 30, | |
|--------------------------------|--|-------------|
| | 2005 | 2004 |
| | (In Thousands) | |
| Balance at beginning of period | \$ 2,689 | \$ |
| Goodwill acquired | | 2,689 |
| Balance at end of period | \$ 2,689 | \$ 2,689 |

The Corporation has other intangible assets that are amortized consisting of core deposit intangibles and other intangibles, consisting of a purchased client list from a purchased trust business.

Table of Contents

Changes in the gross carrying amount, accumulated amortization and net book value of core deposits and other intangibles were as follows:

| | Six Months Ended June 30, | |
|--------------------------------|--------------------------------------|-------------|
| | 2005 | 2004 |
| | (In Thousands) | |
| Core deposit intangibles: | | |
| Gross carrying amount | \$ 145 | \$ 145 |
| Accumulated amortization | (40) | (22) |
| Net book value | \$ 105 | \$ 123 |
| Additions during the year | \$ | \$ |
| Amortization during the period | (18) | (19) |
| Other intangibles: | | |
| Gross carrying amount | \$ 120 | \$ 120 |
| Accumulated amortization | (42) | (30) |
| Net book value | \$ 78 | \$ 90 |
| Additions during the year | \$ | \$ |
| Amortization during the year | (6) | (6) |

The following table shows the current period and estimated future amortization expense for amortized intangible assets:

Table of Contents

| | Core Deposit Intangibles | Other Intangibles | Total |
|---|---|------------------------------|--------------|
| Six months ended June 30, 2005 | \$ 18 | \$ 6 | \$ 24 |
| Estimate for the six months ended December 31, 2005 | 14 | 6 | 20 |
| Estimate for the year ended December 31, 2006 | 24 | 12 | 36 |
| 2007 | 18 | 12 | 30 |
| 2008 | 13 | 12 | 25 |
| 2009 | 10 | 12 | 22 |
| | \$ 65 | \$ 48 | \$ 113 |

Note 6 Securities.

The amortized cost and estimated fair values of securities available-for-sale are as follows (in thousands):

| Securities available-for-sale | Amortized cost | As of June 30, 2005 | | Estimated fair value |
|--------------------------------------|---------------------------|---|--|---------------------------------|
| | | Gross unrealized holding gains | Gross unrealized holding losses | |
| | | (In Thousands) | | |
| FHLB stock and other | \$ 2,857 | \$ | \$ | \$ 2,857 |
| U.S. Government agencies | 4,198 | | (54) | 4,144 |
| Collateralized mortgage obligations | 83,980 | 8 | (1,118) | 82,870 |
| | \$91,035 | \$ 8 | \$(1,172) | \$89,871 |
| | | As of December 31, 2004 | | |
| Securities available-for-sale | Amortized cost | Gross unrealized holding gains | Gross unrealized holding losses | Estimated fair value |
| | | (In Thousands) | | |
| FHLB stock and other | \$ 2,811 | \$ | \$ | \$ 2,811 |
| U.S. Government agencies | 3,275 | | (22) | 3,253 |
| Collateralized mortgage obligations | 60,873 | 41 | (533) | 60,381 |
| | \$66,959 | \$ 41 | \$ (555) | \$66,445 |

The table below shows the Corporation's gross unrealized losses and fair value of investments, aggregated by investment category and length of time that individual investments have been in a continuous unrealized loss position at June 30, 2005. Such securities have declined in value due to current interest rate environments and not credit quality and do not presently represent realized losses. The Corporation has the ability to and anticipates that these securities,

which have been in a continuous loss position but are not

Table of Contents

other-than-temporarily impaired, will be kept in the portfolio until maturity. If held until maturity, it is anticipated that the investments will be realized with no loss. If the Corporation determines that any of the above securities are deemed other-than-temporarily impaired, the impairment loss will be recognized in the consolidated statement of income.

A summary of unrealized loss information for investment securities, categorized by security type follows (in thousands):

| | Less than 12 months | | As of June 30, 2005 12 months or longer | | Total | |
|-------------------------------------|---------------------|-----------------|--|-----------------|------------|-----------------|
| | Fair Value | Unrealized loss | Fair Value | Unrealized loss | Fair Value | Unrealized loss |
| | (In Thousands) | | | | | |
| U.S. Government agencies | \$ 3,216 | \$ 54 | \$ | \$ | \$ 3,216 | \$ 54 |
| Collateralized mortgage obligations | 51,825 | 608 | 28,446 | 510 | 80,271 | 1,118 |
| | \$ 55,041 | \$ 662 | \$ 28,446 | \$ 510 | \$ 83,487 | \$ 1,172 |

The Corporation has not sold any available-for-sale securities for any of the periods shown and has therefore not realized any gains or losses on such transactions.

At June 30, 2005 and December 31, 2004, securities with a fair value of approximately \$34,499,000 and \$39,895,000, respectively, were pledged to secure public deposits, securities under arrangements to repurchase, and borrowings. Unrealized holding gains and losses, net of tax effect, included in accumulated other comprehensive income at June 30, 2005 and 2004 was \$763,000 and \$758,000, respectively.

Note 7 Loans and Allowance for Loan and Lease Losses

Loan and lease receivables consist of the following (in thousands):

| | As of June 30, 2005 | As of December 31, 2004 |
|-------------------------------------|---------------------------|-------------------------------|
| | (In thousands) | |
| First mortgage loans: | | |
| Commercial real estate | \$ 234,567 | \$ 215,605 |
| Construction | 44,130 | 41,910 |
| Multi-family | 23,947 | 17,786 |
| 1-4 family | 23,965 | 22,814 |
| | 326,609 | 298,115 |
| Commercial business loans | 124,648 | 136,482 |
| Direct financing leases | 21,305 | 25,583 |
| Second mortgage loans | 7,485 | 5,563 |
| Credit card and other | 12,380 | 10,743 |
| | 492,426 | 476,486 |
| Less: | | |
| Allowance for loan and lease losses | 6,437 | 6,375 |

| | | |
|--------------------|------------|------------|
| Deferred loan fees | 247 | 310 |
| | \$ 485,742 | \$ 469,801 |

Table of Contents

An analysis of the allowance for loan and lease losses is presented below (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------------------------------|--|-------------|--------------------------------------|-------------|
| | 2005 | 2004 | 2005 | 2004 |
| | (Dollars in Thousands) | | | |
| Allowance at beginning of period | \$ 6,444 | \$ 6,812 | \$ 6,375 | \$ 6,811 |
| Charge-offs: | | | | |
| Mortgage | | | | |
| Commercial | | | | (3) |
| Lease | | | | |
| Consumer | (9) | | (9) | |
| Total charge-offs | (9) | | (9) | (3) |
| Recoveries: | | | | |
| Mortgage | | | 1 | |
| Commercial | 2 | 1 | 5 | 5 |
| Lease | | 113 | | 113 |
| Consumer | | | | |
| Total recoveries | 2 | 114 | 6 | 118 |
| Net recoveries (charge-offs) | (7) | 114 | (3) | 115 |
| Provision | | | 65 | |
| Allowance at end of period | \$ 6,437 | \$ 6,926 | \$ 6,437 | \$ 6,926 |
| Allowance to gross loans and leases | 1.31% | 1.49% | 1.31% | 1.49% |

Note 8 Deposits

| | As of June 30, 2005 (as restated) | | As of December 31, 2004 (as restated) | |
|--|--|--------------------------------------|--|--------------------------------------|
| | Balance | Weighted Average Rate | Balance | Weighted Average Rate |
| | (Dollars in Thousands) | | | |
| Transaction accounts: | | | | |
| Demand deposits | \$ 36,393 | 0.00% | \$ 40,835 | 0.00% |
| Negotiable order of withdrawal (NOW) accounts | 47,117 | 2.45 | 38,017 | 1.16 |
| | 83,510 | | 78,852 | |
| Money market accounts | 107,210 | 2.60 | 88,324 | 1.34 |
| Certificates of deposit: | | | | |
| 0.00% to 1.99% | 8,793 | 1.58 | 100,385 | 1.68 |
| 2.00% to 2.99% | 91,748 | 2.55 | 96,882 | 2.31 |
| 3.00% to 3.99% | 107,928 | 3.42 | 34,854 | 3.37 |

Edgar Filing: First Business Financial Services, Inc. - Form 10-Q/A

| | | | | |
|-------------------|------------|------|------------|------|
| 4.00% and greater | 111,383 | 4.41 | 75,380 | 4.58 |
| | 319,852 | | 307,501 | |
| | \$ 510,572 | | \$ 474,677 | |

17

Table of Contents**Note 9 Borrowings**

| | As of June 30, 2005 (as restated) | | |
|---|--|---|--------------------------------------|
| | Balance | Weighted Average Balance | Weighted Average Rate |
| | (Dollars in Thousands) | | |
| Fed funds purchased and securities sold under agreement to repurchase | \$ 13,588 | \$ 7,536 | 2.92% |
| FHLB advances | 12,649 | 11,672 | 2.79 |
| Junior subordinated debentures | 10,310 | 10,310 | 8.96 |
| Line of credit | 2,500 | 1,403 | 4.42 |
| Subordinated note payable | 5,000 | 5,000 | 5.20 |
| | \$ 44,047 | \$ 35,921 | 4.99% |
| Short-term borrowings | \$ 27,192 | | |
| Long-term borrowings (due beyond one year) | 16,855 | | |
| | \$ 44,047 | | |

| | As of December 31, 2004 (as restated) | | |
|---|--|---|--------------------------------------|
| | Balance | Weighted Average Balance | Weighted Average Rate |
| | (Dollars in Thousands) | | |
| Fed funds purchased and securities sold under agreement to repurchase | \$ 678 | \$ 2,231 | 2.20% |
| FHLB advances | 23,803 | 22,807 | 1.91 |
| Junior subordinated debentures | 10,310 | 10,310 | 8.66 |
| Line of credit | 500 | 665 | 3.76 |
| Subordinated note payable | 5,000 | 5,000 | 4.62 |
| | \$ 40,291 | \$ 41,013 | 3.99% |
| Short-term borrowings | \$ 23,434 | | |
| Long-term borrowings (due beyond one year) | 16,857 | | |
| | \$ 40,291 | | |

Table of Contents**Note 10 Derivatives (as restated)**

The Corporation uses derivatives to manage the risk of earnings fluctuations caused by interest rate volatility. The effect of interest rate movements on hedged assets or liabilities will generally be offset by the derivative instrument where hedge accounting is permitted. Derivatives used for interest risk management include interest rate swaps. The Corporation currently uses cash flow hedges to hedge interest rate risk associated with variable rate deposits.

A list of the outstanding derivatives is shown in the table below

| | As of June 30, 2005 (as restated) | | | | As of December 31, 2004 (as restated) | | | |
|---|---|------------------|---------------|------------------|---|------------------|---------------|------------------|
| | Notional Amount | Maturity Date | Fixed Rate | Variable Rate | Notional Amount | Maturity Date | Fixed Rate | Variable Rate |
| (In thousands) | | | | | | | | |
| Cash Flow Hedge: | | | | | | | | |
| Pay-fixed interest rate swap | \$ 874 | April, 2009 | 5.24% | 2.98% | \$ 960 | April, 2009 | 5.24% | 2.25% |
| Other Derivatives: | | | | | | | | |
| Pay-fixed interest rate swap | 10,000 | October, 2006 | 3.94 | 3.04 | 10,000 | October, 2006 | 3.94 | 2.25 |
| Pay-fixed interest rate swap | 10,000 | November, 2006 | 3.75 | 3.14 | 10,000 | November, 2006 | 3.75 | 2.25 |
| Pay-fixed interest rate swap | 10,000 | December, 2006 | 4.94 | 3.43 | 10,000 | December, 2006 | 4.94 | 2.51 |
| Callable receive-fixed interest rate swap | 10,000 | January, 2010 | 4.25 | 3.38 | 10,000 | January, 2010 | 4.25 | 2.48 |
| Callable receive-fixed interest rate swap | 10,000 | February, 2010 | 4.35 | 3.24 | 10,000 | February, 2010 | 4.35 | 2.42 |
| Callable receive-fixed interest rate swap | 10,000 | February, 2010 | 4.10 | 3.31 | | | | |
| Callable receive-fixed interest rate swap | 10,000 | November, 2010 | 4.00 | 3.24 | 10,000 | November, 2010 | 4.00 | 2.42 |
| Pay-fixed interest rate swap | 4,763 | June, 2011 | 5.49 | 3.01 | 4,823 | June, 2011 | 5.49 | 2.26 |
| | \$75,637 | | | | \$65,783 | | | |

The fair value of cash flow hedges represented an unrealized loss of \$31,000 at June 30, 2005 and \$45,000 at December 31, 2004. The fair value of other derivatives included in other liabilities totaled \$830,000 at June 30, 2005 and \$1,102,000 at December 31, 2004.

As required by SFAS No. 133, the Corporation is amortizing over the remaining life of the swap the market loss of the interest rate swap that no longer qualifies for cash flow hedge accounting because upon adoption of FIN46R, the Corporation did not de-designate the existing hedge relationship and redesignate a new hedging relationship. At June 30, 2005 and December 31, 2004, the balance of the unamortized market loss on the interest rate swap included

in accumulated other comprehensive income was \$189,000 and \$312,000, respectively.

Table of Contents**Note 11 Earnings Per Share**

Basic earnings per share for the three and six months ended June 30, 2005 and 2004 have been determined by dividing net income for the respective periods by the weighted average number of shares of common stock outstanding.

Diluted earnings per share is computed by dividing net income by the weighted average number of common shares outstanding plus the effect of dilutive securities. The effect of dilutive securities is computed using the treasury stock method.

| | Three Months Ended June 30, | |
|--|------------------------------------|----------------------|
| | 2005 | 2004 |
| | (as | (as restated) |
| | restated) | (as restated) |
| Numerator: | | |
| Net income | \$ 1,223,007 | \$ 1,923,300 |
| | | |
| Numerator for basic earnings per share income available to common stockholders | 1,223,007 | 1,923,300 |
| | | |
| Numerator for diluted earnings per share income available to common stockholders | 1,223,007 | 1,923,300 |
| | | |
| Denominator: | | |
| Denominator for basic earnings per share weighted-average common shares outstanding | 2,418,220 | 2,149,079 |
| | | |
| Effect of dilutive securities: | | |
| Employee stock options | 44,900 | 74,639 |
| BBG employee stock options | | 4,753 |
| Option liability | | 30,003 |
| | | |
| Denominator for diluted earnings per share adjusted weighted-average common shares and assumed conversions | 2,463,120 | 2,258,474 |
| | | |
| Basic earnings per share | \$ 0.51 | \$ 0.89 |
| Diluted earnings per share | 0.50 | 0.85 |

Table of Contents

| | Six Months Ended June 30, | |
|--|----------------------------------|----------------------|
| | 2005 | 2004 |
| | (as | (as restated) |
| | restated) | (as restated) |
| Numerator: | | |
| Net income | \$ 2,748,135 | \$ 2,398,400 |
| Numerator for basic earnings per share income available to common stockholders | 2,748,135 | 2,398,400 |
| (Income) expense option liability | | (7,000) |
| Numerator for diluted earnings per share income available to common stockholders | 2,748,135 | 2,391,400 |
| Denominator: | | |
| Denominator for basic earnings per share weighted-average common shares outstanding | 2,416,052 | 2,085,407 |
| Effect of dilutive securities: | | |
| Employee stock options | 46,836 | 71,543 |
| BBG employee stock options | | 3,777 |
| Option liability | | 30,003 |
| Denominator for diluted earnings per share adjusted weighted-average common shares and assumed conversions | 2,462,888 | 2,190,730 |
| Basic earnings per share | \$ 1.14 | \$ 1.15 |
| Diluted earnings per share | 1.12 | 1.09 |

Table of Contents

Item 2.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Factors

This quarterly report (Form 10-Q) contains or incorporates by reference various forward-looking statements concerning the Corporation's prospects that are based on the current expectations or beliefs of management. Forward-looking statements may also be made by the Corporation from time to time in other reports and documents as well as oral presentations. When used in written documents or oral statements, the words anticipate, believe, estimate, expect, objective and similar expressions and verbs in the future tense, are intended to identify forward-looking statements. The statements contained herein and such future statements involve or may involve certain assumptions, risks, and uncertainties, many of which are beyond the Corporation's control that could cause the Corporation's actual results and performance to differ materially from what is expected. In addition to the assumptions and other factors referenced specifically in connection with such statements, the following factors could impact the business and financial prospects of the Corporation: general economic conditions; legislative and regulatory initiatives; increased competition and other effects of deregulation and consolidation of the financial services industry; monetary and fiscal policies of the federal government; deposit flows; disintermediation; the cost of funds; general market rates of interest; interest rates or investment returns on competing investments; demand for loan products; demand for financial services; changes in accounting policies or guidelines; general economic developments; acts of terrorism and developments in the war on terrorism; and changes in the quality or composition of loan and investment portfolios. See also the factors regarding future operations discussed in **Management's Discussion and Analysis of Financial Condition and Results of Operations**, below.

Overview

The following discussion and analysis is presented to assist in the understanding and evaluation of the Corporation's financial condition and results of operations. It is intended to complement the unaudited consolidated financial statements, footnotes, and supplemental financial data appearing elsewhere in this Form 10-Q and should be read in conjunction with the Form 10-Q. The presentation focuses on the three and six months ended June 30, 2005 and the comparable periods in 2004.

Table of Contents**Results of Operations***Comparison of Three and Six Months Ended June 30, 2005 and 2004*

General. Net income for the three months ended June 30, 2005 decreased \$700,000 and increased \$350,000 for the six months ended June 30, 2005 from \$1.9 million and \$2.4 million, respectively, in the same periods in 2004 to \$1.2 million and \$2.7 million. The three months ended June 30, 2005 included an increase of \$2.1 million in interest income, a decrease in the net cash settlement expense of interest rate swaps of \$268,000 and a decrease in income tax expense of \$411,000. These increases were offset by increases of \$1.9 million in interest expense, a decrease in the gain recognized for the change in fair value of interest rate swaps of \$968,000 and \$635,000 in non-interest expense as compared to the same period in the prior year. The six months ended June 30, 2005 included a gain on the sale of the 50% equity investment in a leasing joint venture, m2 Lease Funds, LLC (m2), of \$973,000. In addition to the gain on sale of the equity investment, interest income increased \$3.5 million, net cash settlement expense of interest rate swaps decreased \$537,000 and trust and investment services fee income increased \$184,000. These components that caused an increase in net income for the six month period were partially offset by increases in interest expense of \$2.9 million, an increase in non-interest expense of \$949,000 and a decrease in the gain recognized for the change in fair value of interest rate swaps of \$718,000. Diluted earnings per share for the three months ended June 30, 2005 decreased to \$0.50 from \$0.85 for the same period in 2004. This was attributable to the decrease in net income as well as the increase in weighted average shares outstanding resulting from the exercise of the written option by BBG shareholders in 2004. Diluted earnings per share for the six months ended June 30, 2005 increased to \$1.12 from \$1.09 as a result of an increase in net income partially offset by the increase in weighted average shares outstanding. The annualized return on average assets for the three and six months ended June 30, 2005 was 0.81% and 0.93%, respectively, as compared to 1.47% and 0.92%, respectively, for the same periods in 2004. The annualized return on average stockholders' equity for the three and six months ended June 30, 2005 was 12.30% and 14.02%, respectively, as compared to 24.52% and 15.54%, respectively for the same periods in 2004.

Net Interest Income. Net interest income increased \$216,000, or 5.0%, and \$529,000, or 6.4% to \$4.5 million and \$8.9 million for the three and six months ended June 30, 2005 from \$4.3 million and \$8.3 million for the same periods in 2004. The improvements in net interest income for the three and six months ended June 30, 2005 were due to increases in average earning assets offset by decreases in net interest margin as compared to the same period in 2004. The net interest margin decreased from 3.37% for the three months ended June 30, 2004 to 3.11% for the same period in 2005. This was also reflected in the decrease in the interest rate spread from 3.09% from the three months ended June 30, 2004 to 2.71% for the same three month period in 2005. The net interest margin decreased from 3.26% for the six months ended June 30, 2004 to 3.09% for the six months ended June 30, 2005. The interest rate spread decreased to 2.71% from 2.98% for the six months ended June 30, 2005 as compared to the same period in 2004. The decreases in the net interest margin were the result of the increases in yields paid on interest-bearing liabilities outpacing the increases in yields earned on interest-earning assets.

Interest income on interest-earning assets increased \$2.1 million and \$3.5 million to \$8.9 million and \$16.8 million for the respective three and six months ended June 30, 2005 from \$6.8 million and \$13.4 million for the same periods in 2004. In particular, interest income on loans and leases increased \$1.8 million to \$8.0 million and \$3.0 million to \$15.3 million for the respective three and six months ended June 30, 2005 from \$6.2 million and \$12.2 million for the same periods in 2004. For both three and six month periods ended June 30, 2005, this was due to an increase in average loans and leases outstanding of \$40.7 million and \$34.9 million, or 9.1% and 7.9%, respectively, accompanied by an increase in average yields earned on loans and leases to 6.53% and 6.31% from 5.58% and 5.53%, respectively, caused by a rise in market rates. Also contributing to the increase in income on interest earning assets was an increase in income on mortgage related securities of \$260,000 and \$467,000 from \$491,000 and \$943,000 for the respective three and six months ended June 30, 2004 to \$751,000 and \$1.4 million for the same periods in 2005. This increase was due to an increase in the average balance of mortgage related securities of \$25.2

Table of Contents

million and \$23.0 million from \$56.9 million and \$55.4 million for the respective three and six months ended June 30, 2004 to \$82.1 million and \$78.4 million for the same periods in 2005 accompanied by an increase in average yields on such securities from the same respective periods of 3.45% and 3.41% in 2004 to 3.66% and 3.60% in 2005.

The average balance of loans increased in all but the consumer loan categories as of the three and six months ended June 30, 2005. Total average loan growth amounted to \$47.1 million and \$41.3 million, or 10.6% and 9.3%, for the respective three and six month periods, which was driven largely by growth in mortgage loans which includes commercial real estate, construction and multi-family loans. For the three and six months ended June 30, 2005, the average balance of mortgage loans grew \$32.2 million, or 10.9%, and \$25.5 million, or 8.9%, from \$294.7 million and \$293.0 million to \$326.9 million and \$318.5 million. The weighted average yield in commercial loans experienced a 253 basis point increase for the three months ended June 30, 2005 from the same period in 2004 principally due to two factors. The first component of this increase was additional interest income of \$110,000 from borrowers who had broken loan covenants which contractually increased their interest yield as provided for in the loan document. The second factor for this increase in commercial loan interest income was an increase of approximately 200 basis points in the average prime rate for the three months ended June 30, 2005 to 5.9% from 4.0% for the same period in 2004. The growth in commercial real estate, construction and multi-family loans has largely been the result of attracting new clients in both of the Banks' two principal markets. Management expects that commercial real estate and commercial loan markets will experience loan growth in the mid to high single digits in 2005 based on expectations of continued success in attracting new clients in the Banks' markets and modest economic growth that should strengthen over the next few quarters in those markets.

The growth in the average balance of mortgage-related securities as of the three and six months ended June 30, 2005, from the same periods in 2004 of \$25.2 million and \$23.0 million, respectively, stemmed from a purchase of roughly \$20.0 million of such securities, as interest rates have become more attractive in those securities resulting from rising mortgage rates. It is the Corporation's policy to diversify assets and part of that diversification includes an investment portfolio that is approximately 10.0% of total assets. This contributed to an increased yield in mortgage-related securities for the three and six months ended June 30, 2005 as compared to the same periods in 2004 from 3.45% to 3.66% and 3.41% to 3.60%, respectively.

Interest expense increased \$1.8 million and \$2.9 million to \$4.3 million and \$8.0 million, respectively, for the three and six months ended June 30, 2005 from \$2.5 million and \$5.1 million for the same periods in 2004. These increases were primarily due to respective \$1.8 million and \$2.8 million increases in interest expense on deposits for the three and six months ended June 30, 2005 with the weighted average rate increasing, respectively, from 2.07% and 2.13% to 3.23% and 3.05% from the same periods in 2004. The increases in interest expense were largely due to rising rates on deposits accompanied by increases in average interest-bearing deposits of \$72.8 million and \$65.6 million for the three and six month periods or 18.0% and 16.3% for the respective periods from \$404.0 million and \$401.6 million for the three and six months ended June 30, 2004 to \$476.8 million and \$467.2 million for the same periods in 2005. These increases were largely a result of growth in average certificates of deposit of \$31.2 million and \$30.5 million from \$286.0 million and \$284.3 million for the three and six months ended June 30, 2004 to \$317.2 million and \$314.8 million for the same periods in 2005, primarily acquired through deposit brokers. These increases were partially offset by decreases in the average balance of Federal Home Loan Bank (FHLB) advances, used as another source of funding, of \$17.4 million and \$11.1 million from \$24.7 million and \$22.7 million for the respective three and six months ended June, 2004 to \$7.4 million and \$11.7 million for the same periods in 2005, or (70.2)% and (48.6)%, respectively, with the average cost of such advances of 3.89% and 2.79% in 2005 as compared to 1.78% and 2.01% for the same periods in 2004. The overall weighted average cost of borrowings increased from 3.76% and 3.99% for the three and six months ended June 30, 2004 to 5.34% and 4.99% for the same periods in 2005. This was a result of increases in other categories of funding as well as increases in interest rates from both periods in 2004.

The Banks' strategies continue to focus on developing deeper relationships through the sale of products and services that meet clients' needs accompanied by incentive programs that encourage the growth of deposits. Specific deposit initiatives include service and retention calling programs, increased

Table of Contents

advertising and identification of high growth potential individuals and businesses. Additionally, the Banks' use of wholesale funding in the form of deposits generated through distribution channels other than the Corporation's own bank locations allows the Banks to gather funds across a wider geographic base at pricing levels considered attractive.

Provision for Loan and Lease Losses. The provision for loan and lease losses increased \$65,000 from \$0 for the six months ended June 30, 2004 to \$65,000 for the same period in 2005 and was unchanged at \$0 for both respective three month periods. The primary reason for the increase for the six month period in 2005 is due to the growth in the loan and lease portfolio and an increase in assets classified substandard of \$219,000 from \$5.5 million at December 31, 2004 to \$5.8 million at June 30, 2005 as compared to a decrease of \$321,000 in assets classified substandard from \$5.0 million at December 31, 2003 to \$4.6 million at June 30, 2004. The increase in assets classified substandard at June 30, 2005 was offset by a decrease in non-performing assets of \$1.1 million from December 31, 2004 while the decrease in assets classified substandard at June 30, 2004 was accompanied by a decrease in non-performing assets of \$1.2 million from December 31, 2003. In order to establish the levels of the allowance for loan and lease losses, management regularly reviews its historical charge-off migration analysis and an analysis of the current level and trend of several factors that management believes provides an indication of losses in the loan and lease portfolio. These factors include delinquencies, volume, average size, average risk rating, technical defaults, geographic concentrations, industry concentrations, loans and leases on the management attention list, experience in the credit granting functions and changes in underwriting standards. The charge-off activity for these periods is inconsequential.

Non-Interest Income. Non-interest income, consisting primarily of deposit and loan related fees, interest rate swaps changes in fair value and net cash settlements as well as fees earned for trust and investment services, decreased \$695,000, to \$1.1 million for the three months ended June 30, 2005 as compared to \$1.8 million for the same period in 2004 and increased \$917,000, or 49.1%, to \$2.8 million for the six months ended June 30, 2005 from \$1.9 million for the same period in 2004. The primary contributor to the decrease for the three months ended June 30, 2005 was the decrease in the gain recognized for the change in fair value of interest rate swaps of \$968,000 partially offset by a decrease in the net cash settlement expense of interest rate swaps of \$268,000. The primary contributors to the increase for the six months ended June 30, 2005 were the gain on sale of \$973,000 from the Corporation's 50% owned joint venture, m2 and a \$184,000 increase in trust and investment services fee income from FBB's trust and investment services area due to successful efforts to increase trust assets under management. Money transferred in from new and existing clients as well as market appreciation contributed to the increase in trust assets managed. In addition to this, there was an increase of \$97,000 in the cash surrender value of bank-owned life insurance for the six months ended June 30, 2005 as compared to the same period in 2004 due to the purchase of additional bank-owned life insurance. These increases were partially offset by decreases in other income of \$115,000 which represents income from the equity earnings of the 50% owned joint venture for the six months ended June 30, 2004 which was sold January 4, 2005. Also contributing to the decrease was a decrease in service charges on demand deposit accounts of \$72,000.

Non-Interest Expense. Non-interest expense increased \$631,000 and \$945,000, or 20.3% and 14.8%, to \$3.7 million and \$7.3 million for the three and six months ended June 30, 2005 from \$3.1 million and \$6.4 million in the same periods for 2004. A significant portion of these increases for the three and six month periods ended June 30, 2005 as compared to the same periods in 2004 was due to increases of \$200,000 and \$421,000 in employee salaries and benefits reflecting additions to staff. Professional and consulting fees increased \$272,000 and \$177,000 for the three and six months ended June 30, 2005 due to additional fees associated with the Corporation's process to register its common stock with the Securities and Exchange Commission. Marketing increased \$61,000 and \$121,000 for the three and six month periods as a result of loan, deposit, and general marketing campaigns. Data processing increased \$88,000 and \$109,000 for the three and six month periods largely to keep pace with internal growth as well as overall technology in the industry. Other expenses increased \$103,000 for the six months ended June 30, 2005 from \$640,000 for the same period in 2004 to \$743,000 largely due to an impairment of \$98,000 in an investment in a community housing project. Occupancy increased \$48,000 and \$26,000 for the three and six months ended June 30, 2005 as compared to the same periods in 2004. These increases were offset by

Table of Contents

decreases of \$15,000 and \$13,000 in equipment for the three and six month periods as compared to the same periods in the prior year.

Minority Interest. The consolidated financial statements for the three and six months ended June 30, 2004 included the accounts of FBFS, its wholly-owned subsidiaries and its 51% share of BBG prior to the acquisition of all of the minority interests in BBG shares effective June 1, 2004. Minority interest in net income of consolidated subsidiary represents the 49% minority ownership interest in BBG. Minority interest in net income for the respective periods in 2004 was \$3,000 and \$9,000.

Income Taxes. Income tax expense was \$649,000 and \$1.5 million for the three and six months ended June 30, 2005, with effective rates of 34.7% and 34.6%, compared to \$1.1 million and \$1.4 million for the same periods in 2004, with effective rates of 35.5% and 36.3%. The effective tax rates for both periods of 2005 have declined from the same periods in 2004 primarily due to certain costs which are not tax deductible related to the acquisition of the remaining shares of BBG in June 2004. Also contributing to the reduction was an increase in the amount of non-taxable income from bank-owned life insurance in 2005.

Average Interest-Earning Assets, Average Interest-Bearing Liabilities and Interest Rate Spread. The tables on the following pages show the Corporation's average balances, interest, average rates, net interest margin and the spread between the combined average rates earned on interest-earning assets and average cost of interest-bearing liabilities for the periods indicated. The average balances are derived from average daily balances.

Table of Contents**Three Months Ended June 30,****2005****(as restated)****2004****(as restated)**

| | Average Balance | Interest | Average Yield/ Cost | Average Balance | Interest | Average Yield/ Cost |
|--|----------------------------|-----------------|------------------------------------|----------------------------|-----------------|------------------------------------|
| | (Dollars in Thousands) | | | | | |
| Interest-Earning Assets | | | | | | |
| Mortgage loans ⁽²⁾ | \$ 326,868 | \$ 4,867 | 5.96% | \$ 294,709 | \$ 4,085 | 5.54% |
| Commercial loans | 139,433 | 2,831 | 8.12 | 122,932 | 1,719 | 5.59 |
| Leases | 22,756 | 295 | 5.19 | 24,375 | 374 | 6.14 |
| Consumer loans | 3,731 | 50 | 5.36 | 3,671 | 39 | 4.25 |
| Total loans and leases receivable ⁽¹⁾ | 492,788 | 8,043 | 6.53 | 445,687 | 6,217 | 5.58 |
| Mortgage-related securities ⁽²⁾ | 82,092 | 751 | 3.66 | 56,872 | 491 | 3.45 |
| Investment securities ⁽²⁾ | 4,155 | 30 | 2.89 | 5,856 | 52 | 3.55 |
| Federal Home Loan Bank stock | 2,816 | 38 | 5.40 | 2,352 | 34 | 5.78 |
| Fed funds sold and other | 142 | 1 | 2.82 | 74 | 0 | 1.02 |
| Interest bearing deposits | 16 | | 0.00 | 50 | 0 | 1.94 |
| Total interest-earning assets | 582,009 | 8,863 | 6.09 | 510,891 | 6,794 | 5.32 |
| Non-interest-earning assets | 21,614 | | | 14,152 | | |
| Total assets | \$ 603,623 | | | \$ 525,043 | | |
| Interest-Bearing Liabilities | | | | | | |
| NOW accounts | \$ 52,197 | \$ 346 | 2.65 | \$ 46,256 | \$ 112 | 0.97 |
| Money market | 107,396 | 741 | 2.76 | 71,728 | 256 | 1.43 |
| Certificates regular | 274,600 | 2,369 | 3.45 | 244,896 | 1,541 | 2.52 |
| Certificates large | 42,607 | 393 | 3.69 | 41,115 | 179 | 1.74 |
| Total deposits | 476,800 | 3,849 | 3.23 | 403,995 | 2,088 | 2.07 |
| Junior subordinated debentures | 10,310 | 234 | 9.08 | 10,310 | 220 | 8.54 |
| FHLB advances | 7,364 | 72 | 3.89 | 24,720 | 110 | 1.78 |
| Other borrowings | 19,051 | 185 | 3.88 | 7,460 | 69 | 3.70 |
| Total interest-bearing liabilities | 513,525 | 4,340 | 3.38 | 446,485 | 2,487 | 2.23 |
| Non-interest-bearing liabilities | 50,324 | | | 43,231 | | |
| Total liabilities | 563,849 | | | 489,716 | | |
| Minority interest in 51% owned subsidiary | | | | 3,962 | | |
| Stockholders equity | 39,774 | | | 31,365 | | |
| Total liabilities and Stockholders equity | \$ 603,623 | | | \$ 525,043 | | |

| | | | | |
|--|-----------|-------|-----------|-------|
| Net interest income/interest rate spread | \$ 4,523 | 2.71% | \$ 4,307 | 3.09% |
| Net interest-earning assets | \$ 68,484 | | \$ 64,406 | |
| Net interest margin | | 3.11% | | 3.37% |
| Ratio of average interest-earning assets to average interest-earning liabilities | 1.13 | | 1.14 | |
| Return on average assets | 0.81% | | 1.47% | |
| Return on average equity | 12.30% | | 24.52% | |
| Average equity to average assets | 6.59% | | 5.97% | |
| Non-interest expense to average assets | 2.57% | | 2.59% | |

(1) The average balances of loans and leases include non-performing loans and leases, interest of which is generally recognized on a cash basis.

(2) Includes amortized cost basis of assets held and available for sale.

Table of Contents**Six Months Ended June 30,**

| | 2005 (as restated) | | | 2004 (as restated) | | |
|--|-----------------------|----------|---|-----------------------|----------|---------------------------|
| | Average Balance | Interest | Average Yield/ Cost (Dollars in Thousands) | Average Balance | Interest | Average Yield/ Cost |
| Interest-Earning Assets | | | | | | |
| Mortgage loans ⁽²⁾ | \$ 318,499 | \$ 9,114 | 5.72% | \$ 292,970 | \$ 7,649 | 5.22% |
| Commercial loans | 138,386 | 5,435 | 7.85 | 121,699 | 3,756 | 6.17 |
| Leases | 23,988 | 630 | 5.25 | 23,972 | 738 | 6.16 |
| Consumer loans | 2,696 | 75 | 5.56 | 3,652 | 79 | 4.33 |
| Total loans and leases receivable ⁽¹⁾ | 483,569 | 15,254 | 6.31 | 442,293 | 12,222 | 5.53 |
| Mortgage-related securities ⁽²⁾ | 78,427 | 1,410 | 3.60 | 55,388 | 943 | 3.41 |
| Investment securities ⁽²⁾ | 4,373 | 62 | 2.84 | 6,983 | 124 | 3.55 |
| Federal Home Loan Bank stock | 2,795 | 76 | 5.44 | 2,334 | 73 | 6.21 |
| Fed funds sold and other | 1,580 | 16 | 2.03 | 60 | 0 | 0.96 |
| Interest bearing deposits | 62 | 1 | 3.23 | 52 | 0 | 1.32 |
| Total interest-earning assets | 570,806 | 16,819 | 5.89 | 507,110 | 13,362 | 5.27 |
| Non-interest-earning assets | 22,460 | | | 13,903 | | |
| Total assets | \$ 593,266 | | | \$ 521,013 | | |
| Interest-Bearing Liabilities | | | | | | |
| NOW accounts | \$ 51,612 | \$ 632 | 2.45 | \$ 46,224 | \$ 210 | 0.91 |
| Money market | 100,843 | 1,313 | 2.60 | 71,041 | 497 | 1.40 |
| Certificates regular | 273,133 | 4,287 | 3.14 | 242,538 | 3,198 | 2.64 |
| Certificates large | 41,619 | 884 | 4.25 | 41,761 | 371 | 1.78 |
| Total deposits | 467,207 | 7,116 | 3.05 | 401,564 | 4,276 | 2.13 |
| Junior subordinated debentures | 10,310 | 462 | 8.96 | 10,310 | 440 | 8.54 |
| FHLB advances | 11,672 | 163 | 2.79 | 22,724 | 228 | 2.01 |
| Other borrowings | 13,939 | 271 | 3.89 | 9,032 | 141 | 3.12 |
| Total interest-bearing liabilities | 503,128 | 8,012 | 3.18 | 443,630 | 5,085 | 2.29 |
| Non-interest-bearing liabilities | 50,945 | | | 42,961 | | |
| Total liabilities | 554,073 | | | 486,591 | | |
| Minority interest in 51% owned subsidiary | | | | 3,555 | | |
| Stockholders equity | 39,193 | | | 30,867 | | |
| Total liabilities and Stockholders equity | \$ 593,266 | | | \$ 521,013 | | |

| | | | | |
|--|-----------|-------|-----------|-------|
| Net interest income/interest rate spread | \$ 8,807 | 2.71% | \$ 8,277 | 2.98% |
| Net interest-earning assets | \$ 67,678 | | \$ 63,480 | |
| Net interest margin | | 3.09% | | 3.26% |
| Ratio of average interest-earning assets to average interest-earning liabilities | 1.13 | | 1.14 | |
| Return on average assets | 0.93% | | 0.92% | |
| Return on average equity | 14.02% | | 15.54% | |
| Average equity to average assets | 6.61% | | 5.92% | |
| Non-interest expense to average assets | 2.57% | | 2.67% | |

(1) The average balances of loans and leases include non-performing loans and leases, interest of which is generally recognized on a cash basis.

(1) Includes amortized cost basis of assets held and available for sale.

Table of Contents**Financial Condition**

General. The total assets of FBFS increased \$42.8 million, or 7.4%, to \$604.8 million at June 30, 2005 from \$563.0 million at December 31, 2004. This increase was funded primarily by net increases in deposits of \$36.1 million. This growth is generally invested in securities and loans and leases receivable.

Securities. Securities available-for-sale increased \$23.4 million at June 30, 2005 from December 31, 2004 as a result of purchases of \$37.1 million net of maturities of \$13.7 million during the year. Mortgage-related securities consisted largely of agency-backed mortgage-derivative securities in the form of REMICs.

Loans and Leases Receivable. Total net loans and leases increased \$15.9 million to \$485.7 million at June 30, 2005 from \$469.8 million at December 31, 2004. The activity in the loan and lease portfolio consisted of originations of \$149.3 million and purchases of \$6.4 million offset by principal repayments of \$139.8 million and an increase in the allowance for loan and lease losses of \$62,000. Deferred loan fees declined \$63,000 to \$247,000 at June 30, 2005 from \$310,000 at December 31, 2004. The primary reason for this decrease was a decrease in loans originated in the Corporation's asset-based lending subsidiary from the prior year ended December 31, 2004 to the six months ended June 30, 2005 accompanied by increased payoff activity in the prior period as compared to the six months ended June 30, 2005. The increased payoff activity in the prior period resulted in accelerated deferred loan fee amortization for those loans that were paid off.

Deposits. As of June 30, 2005, deposits increased \$35.9 million to \$510.6 million from \$474.7 million at December 31, 2004. The increase during the six months ended June 30, 2005 was largely attributable to an increase of \$18.9 million in money market accounts accompanied by an increase in certificates of deposit of \$12.4 million and an increase of \$4.7 million in transaction accounts, respectively. The weighted average cost of deposits increased to 3.05% at June 30, 2005 from 2.33% at December 31, 2004.

Borrowings. The Corporation had borrowings of \$44.0 million as of June 30, 2005, largely consisting of FHLB advances of \$12.6 million which had a weighted average rate of 2.79%. Fed funds purchased and securities sold under agreement to repurchase totaled \$13.6 million and had a weighted average rate of 2.92%. The Corporation also had a \$2.5 million line of credit with a weighted average rate of 4.42%, a \$5.0 million subordinated note payable which carried a weighted average rate of 5.20% and junior subordinated debentures of \$10.3 million with a weighted average rate of 8.96%. Borrowings increased \$3.7 million during the six months ended June 30, 2005. Maturing FHLB advances of approximately \$12.9 million were replaced with Fed funds of approximately \$11.2 million along with the availability of deposits for funding. At December 31, 2004, FHLB advances were \$23.8 million with a weighted average rate of 1.91%. Fed funds purchased and securities sold under agreement to repurchase totaled \$678,000 and had a weighted average rate of 2.20%. The Corporation's line of credit of \$500,000 had a weighted average rate of 3.76%, the subordinated note payable carried a weighted average rate of 4.62% and junior subordinated debentures of \$10.3 million had a weighted average rate of 8.66%.

Stockholders' Equity. As of June 30, 2005, stockholders' equity was \$40.4 million or 6.7% of total assets. Stockholders' equity increased \$2.3 million during the six months ended June 30, 2005 primarily as a result of comprehensive income of \$2.5 million, which includes net income of \$2.7 million. Stock options exercised totaled \$103,000. These increases were partially offset by an increase in accumulated other comprehensive loss of \$293,000, dividends paid of \$278,000 and treasury stock purchases of \$3,000. As of December 31, 2004, stockholders' equity totaled \$38.1 million or 6.8% of total assets.

During the six months ended June 30, 2005, options for 6,280 shares of common stock were exercised at a weighted-average price of \$16.34 per share.

Table of Contents**Asset Quality**

Non-performing Assets. Non-performing assets consists of non-accrual loans and leases of \$1.2 million as of June, 2005, or 0.31% of total assets, as compared to \$2.9 million, or 0.52% of total assets, as of December 31, 2004. This represents a decrease of \$1.1 million in non-performing assets largely due to the receipt of \$750,000 from the sale of printing equipment which was part of the collateral for a non-accrual lease which had a carrying value of \$1.1 million as of December 31, 2004. Management believes it will receive payment in full on the lease.

The Corporation's non-accrual loans and leases consist of the following at June 30, 2005 and December 31, 2004, respectively.

| | As of June 30, 2005 | As of December 31, 2004 |
|---|--|--|
| | (Dollars in Thousands) | |
| Non-accrual loans | \$ 711 | \$ 696 |
| Non-accrual leases | 507 | 1,566 |
| Total non-accrual loans and leases | 1,218 | 2,262 |
| Foreclosed properties and repossessed assets, net | 650 | 665 |
| Total non-performing assets | \$ 1,868 | \$ 2,927 |
| Performing troubled debt restructurings | \$ | \$ |
| Total non-accrual loans and leases to total loans and leases | 0.25% | 0.47% |
| Total non-performing assets to total assets | 0.31 | 0.52 |
| Allowance for loan and lease losses to total loans and leases | 1.31 | 1.34 |
| Allowance for loan and lease losses to non-accrual loans and leases | 528.49 | 281.83 |

At June 30, 2005, the Banks had a total of \$5.8 million in assets classified substandard as compared to \$5.5 million at December 31, 2004. This increase of \$300,000 is primarily attributable to the addition of a foreclosed property which was formerly a first and second mortgage secured by a borrower's residence in the amount of \$650,000. The foreclosure took place in May, 2005. The property is located in Eagle, Wisconsin and FBB Milwaukee believes it will be able to sell the property at or above its carrying amount. The majority of the decrease in substandard assets that offset the addition of the foreclosed property was a lease with a net carrying value of \$115,000 upgraded from substandard due to its performance in accordance with contractual terms.

Included in assets classified substandard are loans and leases of \$4.6 million and \$507,000, respectively at June 30, 2005 and the above foreclosed property with a net carrying value of \$650,000. There are two substandard loans with a net carrying value greater than \$1.0 million as of June 30, 2005. The first is a \$1.5 million loan to a concrete contractor. The second is a \$1.5 million loan to a plastic injection molding company. This loan was subsequently paid in full on July 11, 2005. The loan to the concrete contractor is current as of June 30, 2005. As of December 31, 2004, assets classified substandard with a net carrying value of greater than \$1.0 million included the above loan to a plastic injection molding company with a net carrying value of \$1.3 million and a loan to a metal stamping company with a net carrying value of \$1.7 million. The second loan was removed from the substandard classification as a result of performance in accordance with contractual terms.

Table of Contents

The following represents information regarding the Corporation's impaired loans:

| | As of June 30, 2005 | As of December 31, 2004 |
|--|--|--|
| | | (In Thousands) |
| Impaired loans and leases with impairment reserves required | \$ 1,184 | \$ 2,262 |
| Less: | | |
| Impairment reserve (included in allowance for loan and lease losses) | 378 | 470 |
| Net impaired loans and leases | \$ 806 | \$ 1,792 |
| Average impaired loans and leases | \$ 1,739 | \$ 2,112 |
| Interest income attributable to impaired loans and leases | 80 | 177 |
| Interest income recognized on impaired loans and leases | 13 | 85 |

Loan charge-offs were \$9,000 for the three and six months ended June 30, 2005 and were \$0 for the same periods in 2004, respectively. Recoveries for the three and six months ended June 30, 2005 were \$2,000 and \$6,000 and were \$114,000 and \$118,000 for the same periods in 2004, respectively. The higher level of recoveries in 2004 resulted from a recovery of \$114,000 from a lease to a printer of wall boards for manufactured housing that had been charged off in 2002.

A summary of the activity in the allowance for loan and lease losses follows:

Table of Contents

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------------------------------|--|-------------|--------------------------------------|-------------|
| | 2005 | 2004 | 2005 | 2004 |
| | (Dollars in Thousands) | | | |
| Allowance at beginning of period | \$ 6,444 | \$ 6,812 | \$ 6,375 | \$ 6,811 |
| Charge-offs: | | | | |
| Mortgage | | | | |
| Commercial | | | | (3) |
| Lease | | | | |
| Consumer | (9) | | (9) | |
| Total charge-offs | (9) | | (9) | (3) |
| Recoveries: | | | | |
| Mortgage | | | 1 | |
| Commercial | 2 | 1 | 5 | 5 |
| Lease | | 113 | | 113 |
| Consumer | | | | |
| Total recoveries | 2 | 114 | 6 | 118 |
| Net recoveries (charge-offs) | (7) | 114 | (3) | 115 |
| Provision | | | 65 | |
| Allowance at end of period | \$ 6,437 | \$ 6,926 | \$ 6,437 | \$ 6,926 |
| Allowance to gross loans and leases | 1.31% | 1.49% | 1.31% | 1.49% |

Liquidity and Capital Resources

During the six months ended June 30, 2005 and the years ended December 31, 2004 and 2003, the Banks did not make dividend payments to the Corporation. The Banks are subject to certain regulatory limitations regarding their ability to pay dividends to the Corporation. Management believes that the Corporation will not be adversely affected by these dividend limitations and that any future projected dividends from the Banks will be sufficient to meet the Corporation's liquidity needs. The Corporation's principal liquidity requirements at June 30, 2005 are the repayment of a short-term borrowing of \$2.5 million and interest payments due on subordinated debentures and the junior subordinated debentures during 2005. The Corporation expects to meet its liquidity needs through existing cash flow sources, its bank line of credit and/or dividends received from the Banks. The Corporation and its subsidiaries continue to have a strong capital base and the Corporation's regulatory capital ratios continue to be significantly above the defined minimum regulatory ratios.

FBFS manages its liquidity to ensure that funds are available to each of its Banks to satisfy the cash flow requirements of depositors and borrowers and to ensure the Corporation's own cash requirements are met. The Banks maintain liquidity by obtaining funds from several sources.

The Banks' primary sources of funds are principal and interest repayments on loans receivable and mortgage-related securities, FHLB advances, deposits and other borrowings such as federal funds and Federal Home Loan Bank advances. The scheduled repayments of loans and the repayments of mortgage-related securities are a predictable source of funds. Deposit flows and loan repayments, however, are greatly influenced by general interest rates, economic conditions and competition.

Brokered deposits are used by the Banks, which allows them to gather funds across a larger geographic base at price levels considered attractive. Access to such deposits allows the flexibility to not pursue single service deposit relationships in markets that have experienced some unprofitable pricing levels. Brokered deposits account for

\$262.6 million and \$246.7 million of deposits as of June 30, 2005 and December 31, 2004, respectively. Brokered deposits are utilized to support asset growth and are generally a lower cost source of funds when compared to the interest rates that would need to be offered in

Table of Contents

the local markets to generate a sufficient level of funds. In addition, the administrative costs associated with brokered deposits are considerably less than the administrative costs that would be incurred to administer a similar level of local deposits. Although local market deposits are expected to increase as new client relationships are established and as existing clients increase the balances in their deposit accounts, the usage of brokered deposits will likely remain. In order to provide for ongoing liquidity and funding, all of the brokered deposits are certificates of deposit that do not allow for withdrawal, at the option of the depositor, before the stated maturity. In the event that there is a disruption in the availability of brokered deposits at maturity, the Banks have managed the maturity structure so that at least 90 days of maturities would be funded through other means, including but not limited to advances from the Federal Home Loan Bank, replacement with higher cost local market deposits or cash flow from borrower repayments and security maturities.

The Banks are required by federal regulation to maintain sufficient liquidity to ensure safe and sound operations. Management believes that its Banks have an acceptable liquidity percentage to match the balance of net withdrawable deposits and short-term borrowings in light of present economic conditions and deposit flows.

Under Federal law and regulation, the Banks are required to meet certain tier 1 and risk-based capital requirements. Tier 1 capital generally consists of stockholders' equity plus certain qualifying debentures and other specified items less intangible assets such as goodwill. Risk-based capital requirements presently address credit risk related to both recorded and off-balance sheet commitments and obligations.

As of June 30, 2005 and 2004, the most recent notification from the Federal Deposit Insurance Corporation and the state of Wisconsin Department of Financial Institutions (DFI) categorized the Banks as well capitalized under the regulatory framework for prompt corrective action. The qualification results in lower assessment of FDIC premiums, among other benefits.

In addition, the Banks exceeded minimum net worth requirement of 6.0% as required by the State of Wisconsin at December 31, 2004 and 2003.

The following table summarizes the Corporation and Banks' capital ratios and the ratios required by its federal regulators at June 30, 2005, December 31, 2004 and June 30, 2004, respectively:

Table of Contents

| | Actual | | Minimum Required for Capital Adequacy Purposes | | Minimum Required to be Well Capitalized Under FDIC Requirements | |
|---|----------|--------|--|-------|--|--------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of June 30, 2005 (as restated): | | | | | | |
| Total capital (to risk-weighted assets) | | | | | | |
| Consolidated | \$59,954 | 11.21% | \$42,787 | 8.00% | N/A | N/A |
| First Business Bank | 52,158 | 11.24 | 37,116 | 8.00 | \$46,395 | 10.00% |
| First Business Bank Milwaukee | 8,507 | 11.65 | 5,839 | 8.00 | 7,299 | 10.00 |
| Tier 1 capital (to risk-weighted assets) | | | | | | |
| Consolidated | \$48,517 | 9.07% | \$21,393 | 4.00% | N/A | N/A |
| First Business Bank | 46,874 | 10.10 | 18,558 | 4.00 | \$27,837 | 6.00% |
| First Business Bank Milwaukee | 7,592 | 10.40 | 2,920 | 4.00 | 4,380 | 6.00 |
| Tier 1 capital (to average assets) | | | | | | |
| Consolidated | \$48,517 | 8.08% | \$24,030 | 4.00% | N/A | N/A |
| First Business Bank | 46,874 | 9.03 | 20,770 | 4.00 | \$25,962 | 5.00% |
| First Business Bank Milwaukee | 7,592 | 9.09 | 3,342 | 4.00 | 4,177 | 5.00 |

Table of Contents

| | Actual | | Minimum Required for Capital Adequacy Purposes | | Minimum Required to be Well Capitalized Under FDIC Requirements | |
|---|----------|--------|--|-------|--|--------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of December 31, 2004 (as restated): | | | | | | |
| Total capital (to risk-weighted assets) | | | | | | |
| Consolidated | \$57,296 | 11.03% | \$41,550 | 8.00% | N/A | N/A |
| First Business Bank | 48,611 | 10.75 | 36,164 | 8.00 | \$45,205 | 10.00% |
| First Business Bank Milwaukee | 8,185 | 12.45 | 5,259 | 8.00 | 6,574 | 10.00 |
| Tier 1 capital (to risk-weighted assets) | | | | | | |
| Consolidated | \$45,921 | 8.84% | \$20,775 | 4.00% | N/A | N/A |
| First Business Bank | 43,323 | 9.58 | 18,082 | 4.00 | \$27,123 | 6.00% |
| First Business Bank Milwaukee | 7,360 | 11.20 | 2,629 | 4.00 | 3,944 | 6.00 |
| Tier 1 capital (to average assets) | | | | | | |
| Consolidated | \$45,921 | 8.21% | \$22,365 | 4.00% | N/A | N/A |
| First Business Bank | 43,323 | 8.92 | 19,430 | 4.00 | \$24,287 | 5.00% |
| First Business Bank Milwaukee | 7,360 | 10.09 | 2,918 | 4.00 | 3,648 | 5.00 |

| | | | | | |
|-------------------------------|------------|------------|-----------|-----------|-----------|
| Total contractual obligations | \$ 369,393 | \$ 210,204 | \$ 89,755 | \$ 40,593 | \$ 28,841 |
|-------------------------------|------------|------------|-----------|-----------|-----------|

36

Table of Contents

Off-balance Sheet Arrangements

As of June 30, 2005 the Corporation had outstanding commitments to originate \$153.5 million of loans and commitments to extend funds to or on behalf of clients pursuant to standby letters of credit of \$13.3 million. Commitments to extend funds typically have a term of less than one year; however the Banks have \$53.5 million of commitments which extend beyond one year. No losses are expected as a result of these funding commitments. The Banks have entered into agreements with certain brokers that provide blocks of funds at specified interest rates for agreed upon fees. The Banks also utilize interest rate swaps for the purposes of interest rate risk management. Such instruments are discussed in **Note 10** to the Consolidated Financial Statements. Management believes adequate capital and liquidity are available from various sources to fund projected commitments.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The primary function of asset liability management is to provide liquidity and maintain an appropriate balance between interest-earning assets and interest-bearing liabilities within specified maturities and/or repricing dates. Interest rate risk is the imbalance between interest-earning assets and interest-bearing liabilities at a given maturity or repricing date, and is commonly referred to as the interest rate gap (the gap). A positive gap exists when there are more assets than liabilities maturing or repricing within the same time frame. A negative gap occurs when there are more liabilities than assets maturing or repricing within the same time frame. During a period of rising interest rates, a negative gap over a particular period would tend to adversely affect net interest income over such a period, while a positive gap over a particular period would tend to result in an increase in net interest income.

The Corporation's strategy for asset and liability management is to maintain an interest rate gap that minimizes the impact of interest rate movements to the net interest margin by maintaining a favorable match between the maturities and repricing dates of interest-earning assets and interest-bearing liabilities. This strategy is monitored by the respective Banks' Asset/Liability Management Committees, in accordance with policies approved by the respective Banks' Boards. These committees meet regularly to review the sensitivity of the Corporation's assets and liabilities to changes in interest rates, liquidity needs and sources, and pricing and funding strategies.

The Corporation uses two techniques to measure interest rate risk. The first is simulation of earnings. The balance sheet is modeled as an ongoing entity whereby future growth, pricing, and funding assumptions are implemented. These assumptions are modeled under different rate scenarios that include a simultaneous, instant and sustained change in interest rates.

The second measurement technique used is static gap analysis. This technique measures the difference between the amount of interest-earning assets maturing and/or repricing and the amount of interest-bearing liabilities and interest rate swaps maturing and/or repricing in specified time periods. A significant repricing gap could result in a large impact on net interest margin during periods of changing interest rates.

The Corporation's asset and liability management requires management to make a number of assumptions as to when an asset or liability will reprice or mature. Management believes that its assumptions approximate actual experience and considers them reasonable, although the actual amortization and repayment of assets and liabilities may vary substantially. The Corporation's economic sensitivity to change in rates at June 30, 2005 has not changed materially since December 31, 2004.

Table of Contents

Item 4 Controls and Procedures

Evaluation of Disclosure Controls and Procedures

FBFS maintains disclosure controls and procedures as required under Rule 13a-15 promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act), that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods in the SEC's rules and forms, and that such information is accumulated and communicated to the Corporation's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

At December 31, 2004, March 31, 2005 and June 30, 2005, FBFS's management carried out an evaluation, under the supervision and with the participation of FBFS's Chief Executive Officer and Chief Financial Officer, of the effectiveness of its disclosure controls and procedures. Based on those evaluations, FBFS's management initially concluded that as of December 31, 2004, March 31, 2005 and June 30, 2005, such disclosure controls and procedures were effective. However, on November 8, 2005, management and the Audit Committee of the Board of Directors of FBFS concluded that FBFS had a material weakness in its internal control over financial reporting as described below. Because of this material weakness in its internal control over financial reporting (described below) which impacted the financial statements for the first two quarters of 2005 and as of and for the years ended December 31, 2004, 2003, and 2002, management has, as of the date of the filing of this Form 10-Q/A, concluded that FBFS's disclosure controls and procedures were not effective as of December 31, 2004, March 31, 2005 or June 30, 2005. Management identified the following material weakness in internal control over financial reporting as of December 31, 2004, March 31, 2005 and June 30, 2005:

As of the aforementioned period-ends, FBFS had ineffective policies and procedures relating to the accounting for certain derivative financial instruments under Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (*SFAS 133*). Specifically, FBFS's policies and procedures did not provide for sufficient testing and verification of the criteria for the short cut method to ensure proper application of the provisions of SFAS 133 at inception for certain derivative financial instruments and did not provide for periodic timely review of the proper accounting for certain derivative financial instruments for periods subsequent to inception. In addition, FBFS did not have personnel possessing sufficient technical expertise related to the application of the provisions of SFAS 133, or with a sufficient understanding of derivative instruments. This material weakness has resulted in the restatement of the Company's financial statements for the first two quarters of 2005 and for the years ended December 31, 2004, 2003 and 2002 and the restatement of financial information for the year ended December 31, 2001 and each of the quarters in 2004.

Changes in Internal Control over Financial Reporting

FBFS continually assesses the adequacy of its internal control over financial reporting and enhances its controls in response to internal control assessments and internal and external audit and regulatory recommendations.

There were no changes in our internal control over financial reporting that were implemented during the quarter ended June 30, 2005, that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Since November 8, 2005, we have implemented or are in the process of implementing several important changes in our internal control over financial reporting related to our accounting for derivatives. These actions include:

Enhancing risk management policies and procedures related to reviewing derivative transactions;

Table of Contents

Reviewing policies and procedures related to the initiation and subsequent review of hedge strategies; and

Changing policies and procedures to limit the Corporation's use of the short cut method.

While we believe these actions have significantly improved our internal control over financial reporting, we further believe that additional time and testing are necessary before concluding that the material weakness has been fully remediated. We anticipate that we will have fully remediated the material weakness by December 31, 2005.

Part II. Other Information

Item 1. Legal Proceedings

From time to time, the Corporation and its subsidiaries are engaged in legal proceedings in the ordinary course of their respective businesses. Management believes that any liability arising from any such proceedings currently existing or threatened will not have a material adverse effect on the Corporation's financial position, results of operations, and cash flows.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) The following transactions occurred during the quarter ended June 30, 2005 pursuant to the 2001 Equity Incentive Plan. On April 14, 2005, 275 shares of FBFS common stock were sold for \$4,217.68, 1,050 shares were sold for \$19,950.00 and 750 shares were sold for \$16,500.00. Those transactions were entered into pursuant to the exemption provided in Rule 701.

(b) None.

(c) None.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders

The Annual Meeting of Stockholders was held May 2, 2005. There were 2,418,539 shares of common stock that could be voted, and 1,413,778 shares present at the meeting by holders thereof in person or by proxy, which constituted a quorum. The following is a summary of the results of items voted on:

Table of Contents

| | For | Number of Shares Against | Abstained |
|---|------------|-------------------------------------|------------------|
| Election of Directors for a three-year term expiring in 2008: | | | |
| Jerome J. Smith | 1,409,499 | | 4,279 |
| Leland C. Bruce | 1,406,811 | | 6,967 |
| Loren D. Mortenson | 1,406,127 | | 7,651 |
| Appointment of KPMG as independent auditors for the year ending December 31, 2005 | 1,374,903 | 1,630 | 37,245 |

Item 5. Other Information.

None.

Item 6. Exhibits.

(31.1) Certification of the Chief Executive Officer.

(31.2) Certification of the Senior Vice President and Chief Financial Officer.

(32) Certification of the Chief Executive Officer and Senior Vice President and Chief Financial Officer pursuant to 18 U.S.C. paragraph 1350.

Table of Contents

Signatures

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant has duly caused this amendment to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST BUSINESS FINANCIAL SERVICES, INC.

By: /s/ Jerome J. Smith

Jerome J. Smith
Director and Chief Executive Officer

December 21, 2005

41