

First Business Financial Services, Inc.

Form 10-12G/A

December 21, 2005

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File No. 000-51028

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10
Amendment No. 3
GENERAL FORM FOR REGISTRATION OF SECURITIES
PURSUANT TO SECTION 12(b) OR (g) OF THE
SECURITIES EXCHANGE ACT OF 1934
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

Registrant's telephone number, including area code

Securities to be registered pursuant to Section 12(b) of the Act:

Title of each class
to be so registered

Name of each exchange on which
each class is to be registered

None

N/A

Securities to be registered pursuant to Section 12(g) of the Act:

Common Stock, par value \$0.01

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This Form 10 Registration Statement including consolidated financial statements for the years ended December 31, 2004, 2003 and 2002 and the (unaudited) interim financial statements for the quarter ended March 31, 2005 has been amended due to the restatement of consolidated financial statements related to hedge accounting. See **Item 2, Note 2(b)** to the consolidated financial statements in **Item 13** and **Note 2** to the unaudited consolidated financial statements as of and for the three months ended March 31, 2005 and 2004 for more information.

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**Item 1. Business
General**

First Business Financial Services, Inc. (FBFS or the Corporation) is a registered bank holding company incorporated under the laws of the State of Wisconsin and is engaged in the commercial banking business through its wholly-owned banking subsidiaries First Business Bank and First Business Bank Milwaukee (referred to as the Banks). All of the operations of FBFS are conducted through its Banks and certain subsidiaries of First Business Bank.

First Business Bank (FBB) offers a full line of commercial banking products and services in the greater Madison, Wisconsin area, specifically designed to meet the financial needs of businesses, business owners, executives and professionals. First Business Capital Corp. (FBCC) is a wholly-owned subsidiary of FBB operating as an asset-based commercial finance company specializing in providing secured lines of credit as well as term loans on equipment and real estate assets primarily to manufacturers and wholesale distribution companies located throughout the United States. FBCC sells loans to its wholly-owned Nevada subsidiary, FMCC Nevada Corp. (FMCCNC). First Madison Investment Corp. (FMIC) is an operating subsidiary that is located in and formed under the laws of the state of Nevada. FMIC was organized for the purpose of managing a portion of the Bank's investment portfolio (primarily mortgage-related securities). First Business Leasing, LLC (FBL) purchases certain leases from Lease Funds, LLC (m2). m2 is a commercial finance leasing joint venture specializing in the lease of general equipment to small and middle market companies throughout the United States.

First Business Bank Milwaukee (FBB Milwaukee) offers a wide range of commercial banking products and services tailored to meet the specific needs of businesses, business owners, executives and professionals in the greater Waukesha, Wisconsin area.

FBFS, formerly known as First Business Bancshares, Inc. and previously KD Bancshares, Inc., was organized in 1986 for the purposes of becoming a bank holding company of First Business Bank. In June 2000, FBFS purchased a 51% interest in The Business Banc Group Ltd. (BBG), a corporation formed to act as a bank holding company owning all the stock of a Wisconsin chartered bank to be newly organized and headquartered in Milwaukee. In June 2004 all shares of BBG stock were successfully exchanged for FBFS stock pursuant to a conversion option. Subsequent to this transaction, BBG was dissolved. This transaction resulted in First Business Bank Milwaukee becoming a wholly-owned subsidiary of the Corporation.

In December 2001, FBFS formed FBFS Statutory Trust I (Trust), a statutory trust organized under the laws of the State of Connecticut and a wholly-owned financing subsidiary of FBFS. In December 2001, the Trust issued \$10.0 million in aggregate liquidation amount of floating rate trust preferred securities in a private placement offering. These securities mature 30 years after issuance and are callable at face value after five years. The Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51, Revised (FIN 46 R) to provide guidance on how to identify a variable interest entity and determine when an entity needs to be included in a company's consolidated financial statements. As a result of the adoption of FIN 46R in 2004, the Trust will no longer be consolidated by FBFS. See **Note 12** to the consolidated financial statements.

First Business Bank is a state bank that was chartered in 1909 under the name Kingston State Bank. In 1990, FBB relocated its home office to Madison, Wisconsin and opened a banking facility in University Research Park that focused on providing high-quality banking services to small and medium-sized businesses located in Madison and the surrounding area. FBB's product lines include cash management services, commercial lending, commercial real estate lending, equipment leasing and trust and investment services. In addition, FBB offers professional and executive consumer services including a variety of deposit accounts, personal lines of credit and personal loans.

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First Business Bank Milwaukee is a state bank that was chartered in 2000 in Wisconsin. The FBB Milwaukee office is located in Brookfield, Wisconsin. Its focus is on providing high-quality banking services to small and medium-sized businesses located in Waukesha County, Wisconsin, and the surrounding area. FBB Milwaukee's product lines include cash management services, commercial lending and commercial real estate lending. In addition, FBB Milwaukee also offers professional and executive consumer services which include a variety of deposit accounts, personal lines of credit, and personal loans. For a more detailed discussion of loans and underwriting criteria of the Banks, see **Lending** in this section.

The Corporation maintains a web site at www.fbfinancial.com. This and all of the Corporation's future filings under the Exchange Act are available through that web site, free of charge, including copies of future Annual Reports on Form 10-K, future Quarterly Reports on Form 10-Q, future Current Reports on Form 8-K and any amendments to those reports, on the date that the Corporation files those materials with, or furnishes them to, the SEC.

Cautionary Factors

This registration statement 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.

Competition. The Banks encounter strong competition in attracting both commercial loan and deposit customers. Such competition includes banks, savings institutions, mortgage banking companies, credit unions, finance companies, mutual funds, insurance companies, brokerage firms and investment banking firms. The Banks' market areas include branches of several commercial banks that are substantially larger in terms of loans and deposits. Furthermore, tax exempt credit unions operate in most of the Banks' market areas and aggressively price their products and services to a large portion of the market. The Banks also compete with regional and national financial institutions, many of which have greater liquidity, higher lending limits, greater access to capital, more established market recognition and more resources and collective experience than the Banks. The Corporation's profitability depends upon the Banks' continued ability to successfully maintain and increase market share.

Market Area. One of the primary focal points of the Banks' business development and marketing strategy is serving the needs of growing, small to medium-sized businesses. The origination of loans secured by real estate and business assets of those businesses is the Banks' primary business and the principal source of profits. If customer demand for such loans decreases, the Banks' income could be affected because alternative investments, such as securities, typically earn less income than such loans. Customer demand for these loans could be reduced by a weaker economy, an increase in unemployment, a decrease in real estate values, or an increase in interest rates. Any factors that would adversely affect commercial real estate values in Dane and Waukesha Counties in Wisconsin and surrounding areas in general could be expected to have a similar effect on the earnings and growth potential of the Corporation.

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The principal factors that are used to attract deposit accounts and that distinguish one financial institution from another include rates of return, types of accounts, service fees, convenience of office locations, hours and other services. The primary factors in competing for commercial loans are interest rates, loan fee charges, loan structure and timeliness and quality of service to the borrower.

Most of the Banks' loans are to businesses located in or adjacent to Dane and Waukesha Counties in Wisconsin. Any general adverse change in the economic conditions prevailing in these areas could reduce the Banks' growth rate, impair their ability to collect loans or attract deposits, and generally have an adverse impact on the results of operations and financial condition of the Corporation. If this region experienced adverse economic, political or business conditions, the Banks would likely experience higher rates of loss and delinquency on their loans than if their loans were geographically more diverse.

Loan Portfolio Risk. The Banks originate commercial mortgage, construction, multi-family, 1-4 family, commercial, asset-based, and consumer loans, and leases, all of which are primarily within their respective market areas. Such loans expose a lender to greater credit risk than the home mortgages which form a greater part of the business of many commercial banks, because the collateral securing these loans may not be sold as easily as residential real estate. These loans also have greater credit risk than residential real estate for the following reasons:

- § Commercial mortgage loan repayment is dependent upon cash flow generation sufficient to cover operating expenses and debt service.
- § Commercial loan repayment is dependent upon the successful operation of the borrower's business.
- § Consumer loans are collateralized, if at all, with assets that may not provide an adequate source of payment of the loan due to depreciation, damage or loss.

Loan and Lease Loss Allowance Risk. As lenders, the Banks are exposed to the risk that our loan and lease customers may not repay their loans and leases according to their terms and that the collateral securing the payment of these loans and leases may be insufficient to assure repayment. The Banks may experience significant loan and lease losses which could have a material adverse impact on operating results. There is a risk that various assumptions and judgments about the collectibility of the loan and lease portfolios made by management could be formed from inaccurately assessed conditions leading to and related to such judgments and assumptions. Those assumptions and judgments are based, in part, on assessment of the following conditions:

- § Current economic conditions and their estimated effects on specific borrowers;
- § An evaluation of the existing relationships among loans and leases, potential loan and lease losses and the present level of the allowance for loan and lease losses;
- § Results of examinations of our loan and lease portfolios by regulatory agencies;
- § Management's internal review of the loan and lease portfolios.

The Banks maintain an allowance for loan and lease losses to cover potential losses inherent in the loan and lease portfolios. Additional loan and lease losses will likely occur in the future and may occur at a rate greater than that experienced to date. An analysis of the loan and lease portfolios, historical loss experience and an evaluation of general economic conditions are all utilized in determining the size of the allowance. Additional adjustments may be necessary to allow for unexpected volatility or deterioration in the local or national economy. If material additions must be made to the allowance, this would materially decrease net income. Additionally, regulators periodically review the allowance for loan and lease losses or identify further loan or lease charge-offs to be recognized based on judgments different from those of management. Any increase in the loan or lease allowance or loan or lease charge-offs as required by regulatory agencies could have a material adverse impact on net income.

Interest Rate Risk. The Corporation is subject to interest rate risk. Changes in the interest rate environment may reduce the Corporation's profits. Net interest spreads are affected by the difference between the maturities and repricing characteristics of interest-earning assets and interest-bearing liabilities. They are also affected by the

proportion of interest-earning assets that are funded by interest-bearing liabilities. In general, the Corporation has more assets than liabilities repricing and therefore benefits more in periods of rising interest rates. Loan volume and yield are affected by market interest rates on loans, and rising interest rates are generally associated with a lower volume of loan originations. There is no assurance that the Corporation can minimize its interest rate risk. In addition, a rise in the

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general level of interest rates may adversely affect the ability of certain borrowers to pay their obligations if the reason for that rise in rates is not a result of a general expansion of the economy. Accordingly, changes in levels of market interest rates could materially and adversely affect the Corporation's net interest spread, asset quality, loan origination volume and overall profitability.

Government Regulation and Monetary Policy. The Corporation's businesses are subject to extensive state and federal government supervision, regulation, and control. Existing state and federal banking laws subject the Corporation to substantial limitations with respect to loans, purchases of securities, payment of dividends and many other aspects of the Corporation's businesses. See **Regulation.** There can be no assurance that future legislation or government policy will not adversely affect the banking industry or the operations of the Corporation. In addition, economic and monetary policy of the Federal Reserve may increase the Corporation's cost of doing business and affect its ability to attract deposits and make loans.

Key Personnel. The Corporation's success has been and will be greatly influenced by its continuing ability to retain the services of its existing senior management and, as it expands, to attract and retain additional qualified senior and middle management. The unexpected loss of services of any of the key management personnel, or the inability to recruit and retain qualified personnel in the future, could have an adverse effect on the Corporation's business and financial results.

Technology. The banking industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. The Corporation's future success will depend in part on its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands for convenience as well as create additional efficiencies in the Corporation's operations. A number of the Corporation's competitors have substantially greater resources to invest in technological improvements. There can be no assurance that the Corporation will be able to implement new technology-driven products and services to its customers.

Lending

General. At March 31, 2005, the Banks' net loans and leases totaled \$484.7 million, representing approximately 81.1% of their \$597.6 million in total assets at that date. In addition to \$972,000 of home equity and second mortgage loans which are classified as consumer loans, approximately \$ 329.3 million or 67.0% of the Banks' gross loans and leases, at March 31, 2005 were secured by first or second-liens on real estate.

While the Banks endeavor to make commercial, industrial, commercial real estate and consumer loans, the majority of the Banks' loans are commercial real estate loans secured by properties located primarily in Dane and Waukesha counties and surrounding communities in Wisconsin. In order to increase the yield, minimize interest rate sensitivity, and diversify the risk of their portfolios, the Banks also originate construction, multi-family, commercial, industrial and consumer loans.

Non-real estate loans originated by the Banks consist of a variety of commercial and asset-based loans and leases as well as a small amount of consumer loans. At March 31, 2005, the Banks' gross loans and leases included \$149.9 million of commercial loans and leases, or 30.5% of the total, and \$12.2 million of consumer loans, or 2.5% of the total.

Loan Portfolio Composition. The following table presents information concerning the composition of the Banks' consolidated loans and leases held for investment at the dates indicated.

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	March 31, 2005		2004		December 31, 2003		2002	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in Thousands)							
Mortgage loans:								
Commercial real estate	\$ 234,310	47.68%	\$ 215,605	45.25%	\$ 210,708	47.86%	\$ 195,634	47.13%
Construction	44,747	9.11	41,910	8.80	38,621	8.77	35,858	8.64
Multi-family	23,045	4.69	17,786	3.73	19,005	4.32	18,327	4.42
1-4 family	21,846	4.45	22,814	4.79	17,070	3.88	11,796	2.84
Total mortgage loans	323,948	65.92	298,115	62.57	285,404	64.83	261,615	63.02
Commercial loans and leases:								
Commercial	84,454	17.19	93,041	19.53	87,012	19.77	86,883	20.93
Asset-based	41,510	8.45	43,441	9.12	32,254	7.33	34,844	8.39
Lease receivables	23,968	4.88	25,583	5.37	22,955	5.21	22,658	5.46
Total commercial loans and leases	149,932	30.51	162,065	34.01	142,221	32.31	144,385	34.78
Consumer loans:								
Home equity and second mortgage	6,288	1.28	5,563	1.17	5,558	1.26	3,734	0.90
Credit card	625	0.13	580	0.12	605	0.14	663	0.16
Personal	827	0.17	884	0.19	1,834	0.42	1,225	0.30
Other	9,780	1.99	9,279	1.95	4,600	1.04	3,480	0.84
Total consumer loans	17,520	3.57	16,306	3.42	12,597	2.86	9,102	2.19
Gross loans and leases receivable	491,400	100.00%	476,486	100.00%	440,222	100.00%	415,102	100.00%
Contras to loans and leases:								
Allowance for loan and lease	(6,444)		(6,375)		(6,811)		(5,875)	

losses
Deferred loan
fees

(273)

(310)

(306)

Loan and lease
receivables, net

\$ 484,683

\$ 469,801

\$ 433,105

\$ 409,227

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	December 31,			
	2001		2000	
	Amount	Percent of Total (Dollars in Thousands)	Amount	Percent of Total
Mortgage loans:				
Commercial real estate	\$ 147,870	41.41%	\$ 87,279	35.14%
Construction	30,808	8.63	19,656	7.91
Multi-family	15,394	4.31	13,855	5.58
1-4 family	12,551	3.51	10,573	4.26
Total mortgage loans	206,623	57.86	131,363	52.89
Commercial loans and leases:				
Commercial	92,747	25.97	66,625	26.83
Asset-based	22,681	6.35	19,433	7.82
Lease receivables	21,920	6.14	19,988	8.05
Total commercial loans and leases	137,348	38.46	106,046	42.70
Consumer loans:				
Home equity and second mortgage	3,488	0.98	2,176	0.88
Credit card	637	0.18	604	0.24
Personal	1,974	0.55	1,586	0.64
Other	7,032	1.97	6,587	2.65
Total consumer loans	13,131	3.68	10,953	4.41
Gross loans and leases receivable	357,102	100.00%	248,362	100.00%
Contras to loans and leases:				
Allowance for loan and lease losses	(5,523)		(3,743)	
Loan and lease receivables, net	\$ 351,579		\$ 244,619	

The following table shows the scheduled contractual maturities of the Banks consolidated gross loans and leases held for investment, as well as the dollar amount of such loans and leases which are scheduled to mature after one year which have fixed or adjustable interest rates, as of March 31, 2005.

Commercial Real Estate Loans	Commercial Loans	Construction and Multi-family	Asset-based and Lease Receivables	Consumer and 1-4 Family
---	-----------------------------	--	--	--

(In Thousands)

Amounts due:

In one year or less	\$ 53,575	\$ 57,291	\$ 41,727	\$ 6,247	\$ 26,146
After one year through five years	152,184	24,802	23,515	51,646	13,220
After five years	28,551	2,361	2,550	7,585	
	\$ 234,310	\$ 84,454	\$ 67,792	\$ 65,478	\$ 39,366

Interest rate terms on amounts
due after one year:

Fixed	\$ 124,009	\$ 22,098	\$ 16,900	\$ 16,618	\$ 5,373
Adjustable	\$ 56,726	\$ 5,065	\$ 9,164	\$ 42,613	\$ 7,848

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Commercial Real Estate and Construction Loans. The Banks originate commercial real estate loans which have fixed or adjustable rates and terms of generally up to five years and amortizations of twenty years on existing commercial real estate and twenty-five years on new construction. At March 31, 2005, the Banks had \$234.3 million of loans secured by commercial real estate. This represented 47.7% of the Banks' gross loans and leases.

The Banks originate loans to construct commercial properties. At March 31, 2005, construction loans amounted to \$44.7 million, or 9.1% of the Banks' gross loans and leases. No construction loans are made without permanent take-out financing from the Banks or another financial institution. The Banks' construction loans generally have terms of six to twelve months with adjustable interest rates and fees which are due at the time of origination. Loan proceeds are disbursed in increments as construction progresses and as inspections by title companies warrant.

Multi-family Loans. The Banks also originate multi-family loans that amounted to \$23.0 million at March 31, 2005, or 4.7% of gross loans and leases. These loans are primarily secured by apartment buildings and are mainly located in Dane County.

1-4 Family Loans. The Banks have a small amount of single-family loans which totaled \$21.8 million at March 31, 2005 or 4.5% of gross loans and leases. Such loans are focused on the professional and executive consumer loan needs with maximum loan to value of typically 80% and amortization of thirty years.

Commercial Loans. At March 31, 2005, commercial loans amounted to \$84.5 million or 17.2% of gross loans and leases. The Banks' commercial loan portfolio is comprised of loans for a variety of purposes and generally is secured by inventory, accounts receivable, equipment, machinery and other corporate assets. Commercial loans generally have terms of five years or less and interest rates that float in accordance with a designated published index or fixed rates with typical amortization of four to seven years. Most accounts receivable advances do not exceed 65% of receivables less than 90 days past due from invoices; however this may be increased to 75% if the Banks receive a borrower's certificate and accounts receivable aging on a quarterly or more frequent basis. Advances on raw material and finished goods inventory generally do not exceed 50% and advances on machinery and equipment typically do not exceed 65% of net book value. Advances on new equipment and new vehicles generally do not exceed 80% of cost. Substantially all of such loans are secured and backed by personal guarantees of the owners of the borrowing business.

Asset-Based Loans. Asset-based loans are originated through FBCC, the asset based lending subsidiary, and amounted to \$41.5 million as of March 31, 2005. This represented 8.5% of gross loans and leases. Because asset-based borrowers are usually highly leveraged, such loans have higher interest rates and fees accompanied by close monitoring of assets. The controls include dominion over all cash receipts of the borrowers either through a lockbox collection service or cash collateral account in the name of FBCC with all cash receipts applied to the lines of credit daily. The accounts receivable borrowing bases are updated daily. Eligibility of accounts receivable and inventories is based on restrictive requirements designed to exclude low-quality or disputed receivables and low-quality, slow moving or obsolete inventories. Management of FBCC monitors adherence to these requirements by conducting periodic on-site audits of all borrowers including assessing the quality of those assets, and determining the financial operating trends of those borrowers.

These loans generally have terms of two to three years with interest rates that float in accordance with designated published indices. They are typically secured by accounts receivable, inventories, equipment and/or real estate. Receivable advances do not exceed 85% of eligible receivables less than 90 days from original invoice date. The receivable advance rate is determined by a number of factors including concentrations of business with customers, amount of dilution and the credit quality of the customer base. Inventory advance rates will range from 40% to 60% of eligible inventories. Typically, slow moving, obsolete and work-in-process inventories are not eligible for the borrowing base. Advances on equipment loans are generally limited to 85% of the forced sale value of the equipment based on independent appraisals and advances on real estate loans are typically limited to 70% of the fair market value of the property. Personal guarantees of payment are usually obtained from the principals of closely held companies.

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Leases. Leases are originated through FBCC and FBL (the Leasing Companies) and amounted to \$24.0 million as of March 31, 2005 and represented 4.9% of gross loans and leases. Such leases are generally secured by equipment and machinery located principally in Wisconsin. While \$8.8 million or 36.7% of the leases are to printing businesses, this does not constitute a concentration when compared to the loan and lease portfolio as a whole. Leases are typically originated with a fixed rate and a term of seven years or less. It is customary in the leasing industry to provide 100% financing, however, the Leasing Companies will, from time-to-time, require a down payment or lease deposit to provide a credit enhancement. All equipment leases must have an additional insured endorsement and a loss payable clause in the interest of the Leasing Companies and must carry sufficient physical damage and liability insurance.

The Leasing Companies lease machinery and equipment to customers under leases which qualify as direct financing leases for financial reporting and as operating leases for income tax purposes. Under the direct financing method of accounting, the minimum lease payments to be received under the lease contract, together with the estimated unguaranteed residual value (approximating 3 to 15% of the property cost of the related equipment), are recorded as lease receivables when the lease is signed and the lease property is delivered to the customer. The excess of the minimum lease payments and residual values over the cost of the equipment is recorded as unearned lease income. Unearned lease income is recognized over the term of the lease on a basis which results in an approximate level rate of return on the unrecovered lease investment. Lease payments are recorded when due under the lease contract. Residual value is the estimated fair market value of the equipment on lease at lease termination. In estimating the equipment's fair value, the Leasing Companies rely on historical experience by equipment type and manufacturer, published sources of used equipment pricing, internal appraisals and, where available, valuations by independent appraisers, adjusted for known trends. The Leasing Companies' estimates are reviewed continuously to ensure reasonableness; however, the amounts the Leasing Companies will ultimately realize could differ from the estimated amounts. The majority of the equipment is leased to businesses in the printing, (45.8%), manufacturing (15.8%) and construction (12.5%) industries as of December 31, 2004.

Consumer Loans. The Banks originate a small amount of consumer loans. Such loans amounted to \$17.5 million at March 31, 2005 and consist of home equity and second mortgages and credit card and other personal loans for professional and executive customers of the Banks. The maximum loan to value on home equity loans is 80% with proof of property value required and annual personal financial statements after the initial loan application. The maximum loan to value on new automobiles and trucks is 80%. These loans represented 3.6% of the Banks' gross loans and leases at March 31, 2005.

Net Fee Income from Lending Activities. Loan and lease origination and commitment fees and certain direct loan and lease origination costs are deferred and the net amounts are amortized as an adjustment to the related loan and lease yields.

The Banks also receive other fees and charges relating to existing loans, which include prepayment penalties, loan monitoring fees, late charges and fees collected in connection with loan modifications.

Origination of Loans and Leases. Applications for all types of loans and leases are received at the Banks' two lending offices as well as two satellite lending offices located in Chicago, Illinois and Mason, Ohio. Loans and leases are approved by the Officers Loan Committee within designated lending limits. Depending on the type and amount of loans and leases, approval by the Directors Loan Committee also may be required. Lending officers can also make loans up to certain amounts.

The Banks' general policy with regard to real estate secured loans is to lend up to 75% of the cost or independently appraised value, whichever is less (generally referred to as the loan-to-value ratio) except in the case of owner-occupied real estate where they will lend up to 80%. The Banks will lend more than 75% of the appraised value of the property on a loan by loan basis. The maximum that the Banks will lend up to for raw land that is held for speculation or development is 50% of land value. At March 31, 2005, the Banks had approximately \$12.8 million of loans with loan-to-value ratios greater than 75%, where the policy limited the advance rate to 75%, and of those loans, 3 all of them have loan-to-value ratios greater than 80%.

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Property appraisals on real estate secured loans are made by independent appraisers approved by the Banks Boards of Directors with recertification required on construction loans once a project is completed. Appraisals are performed in accordance with federal regulations and policies. The Banks underwriting criteria generally require minimum debt service coverage ratios on a stabilized basis of 115% to 120%. Additionally, surveys are often required. For construction loans, Bank personnel or the title company make periodic on-site visits during construction, with supervision and inspections by an architect required for certain construction loans.

The portfolio of commercial real estate and commercial loans and leases is reviewed on a continuing basis to identify any potential risks that exist regarding the property management, financial criteria of the loan or lease, operating performance, competitive marketplace and collateral evaluation. The frequency of review is a function of the size of the loan or lease and the risk rating assigned to any particular loan or lease. Reviews are completed monthly on higher risk loans and as infrequently as annually for lower risk loans. The account officers along with the credit analysts are responsible for identifying and reporting credit risk quantified through a loan and lease rating system and making recommendations to mitigate credit risk in the portfolio. These and other underwriting standards are documented in written policy statements, which are periodically updated and approved by the Banks Boards of Directors.

The Banks obtain title insurance policies on first mortgage real estate loans of \$100,000 or greater. Title insurance is also obtained on most first mortgage real estate loans less than \$100,000. Borrowers must also obtain hazard insurance prior to closing.

The Banks encounter certain environmental risks in their lending activities. Under federal and state law, lenders may become liable for costs of cleaning up hazardous materials found on secured properties. Certain states may also impose liens with higher priorities than first mortgages on properties to recover funds used in such efforts. The Banks attempt to control their exposure to environmental risks with respect to loans secured by larger properties by monitoring available information on hazardous waste disposal sites and occasionally requiring environmental inspections of such properties prior to closing the loan, as warranted. No assurance can be given, however, that the value of properties securing loans in the Banks portfolio will not be adversely affected by the presence of hazardous materials or that future changes in federal or state laws will not increase the Banks exposure to liability for environmental cleanup.

The following table shows the Banks consolidated total loans and leases originated, purchased, sold, and repaid during the periods indicated.

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	Three Months Ended March 31, 2005	Year Ended December 31,		
		2004	2003	2002
		(In Thousands)		
Gross loans receivable and leases at beginning of year	\$ 476,623	\$ 440,222	\$ 415,102	\$ 357,102
Loans and leases originated for investment:				
Commercial real estate	38,786	66,433	92,138	91,833
Commercial	12,797	148,974	58,637	76,522
Construction	5,172	20,161	8,978	14,003
Asset-based		23,294	10,525	17,995
Lease receivables	861	12,507	7,310	7,203
Consumer	654	10,899	4,324	8,661
Loans purchased for investment	5,100	6,368		2,607
Total originations and purchases	63,370	288,636	181,912	218,824
Repayments	(48,593)	(252,372)	(156,792)	(160,824)
Net activity in loans and leases held for investment	14,777	36,264	25,120	58,000
Loans originated for sale:				
1-4 family		4,434	3,382	
Sales		(4,297)	(3,382)	
Net activity in loans held for sale		137		
Gross loans and leases receivable at end of period	\$ 491,400	\$ 476,623	\$ 440,222	\$ 415,102

Delinquency Procedures. When a borrower fails to make a required payment on a loan or lease, a number of steps are taken to induce the borrower to cure the delinquency and restore the loan or lease to current status. Management is required by policy to continuously monitor the status of the loan and lease portfolio and report to the Board of Directors. These reports include information on delinquent loans and leases and foreclosed real estate.

Real estate acquired as a result of foreclosure or by deed in lieu of foreclosure and other repossessed assets are classified as foreclosed property until sold. When acquired, the property is carried at the lower of carrying amount or estimated fair value at the date of acquisition, with charge-offs, if any, charged to the allowance for loan and lease losses prior to transfer to foreclosed property. All costs incurred at acquisition are expensed. Any costs associated with improvement or development of the property are capitalized to the extent of the property's fair value. Valuations are periodically performed by management and independent appraisers. An allowance is established by a charge to expense if the carrying value of a foreclosed property exceeds its fair value less costs to sell. Any remaining gain or loss on the ultimate disposal of the property is recorded in non-interest income.

Loan and Lease Delinquencies. Loans and leases are placed on non-accrual status when, in the judgment of management, the probability of collection of interest is deemed to be insufficient to warrant further accrual.

Previously accrued but unpaid interest is deducted from interest income at that time. The Banks do not accrue interest on loans or leases past due beyond 90 days.

The interest income that has been reported during the three months ended March 31, 2005 attributable to the Banks' non-accrual loans and leases at the end of the period was \$69,000. The amount of foregone interest for the three months ended March 31, 2005, was \$56,000. The amount of foregone interest for the three months ended March 31, 2004, was \$58,000. For fiscal year 2004, the amount of interest income attributable to non-accrual loans and leases was \$165,000. The amount of foregone interest for the year ended December 31, 2004 was \$92,000. For the year ended December 31, 2003, the amount of interest income attributable to non-accrual loans and leases was \$45,000. The amount of foregone interest for the year ended December 31, 2003 was \$322,000.

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The following table sets forth information relating to delinquent loans and leases at the dates indicated.

Days Past Due	March 31, 2005		2004		December 31, 2003		2002	
	Balance	% of Gross Loans and Leases	Balance	% of Gross Loans and Leases	Balance	% of Gross Loans and Leases	Balance	% of Gross Loans and Leases
(Dollars in Thousands)								
30 to 59 days	\$ 49	0.01%	\$ 230	0.05%	\$ 96	0.02%	\$ 514	0.12%
60 to 89 days	111	0.02	2	0.00		0.00	230	0.06
90 days and over	14	0.00		0.00	14	0.00		0.00
Total	\$ 174	0.05%	\$ 232	0.06%	\$ 110	0.02%	\$ 744	0.18%

For additional discussion of the Corporation's asset quality, see **Management's Discussion and Analysis of Financial Condition and Results of Operations - Financial Condition-Non-Performing Assets.**

Classified Assets. Federal regulations require that each insured financial institution classify its assets on a regular basis. In addition, in connection with examinations of insured banks, examiners have authority to identify problem assets and, if appropriate, require them to be classified in one of three categories. The three categories of loan classifications for problem assets are: substandard, doubtful, and loss. Substandard assets have one or more defined weaknesses and are characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. Doubtful assets have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions, and values. An asset that is classified as a loss is considered uncollectible and of such little value, that continuance as an asset of the institution is not warranted. Another category, designated special mention, also must be established and maintained for assets that do not currently expose an insured institution to a sufficient degree of risk to warrant classification as substandard, doubtful or loss but do possess credit deficiencies or potential weaknesses deserving management's close attention.

Assets classified as substandard or doubtful can result in the institution establishing a specific allowance for losses if there is a collateral shortfall based on management's evaluation. If an asset or portion thereof is classified as a loss, the insured institution must either establish specific allowances for losses in the amount of 100% of the portion of the assets classified as a loss or charge-off such an amount.

At March 31, 2005, there were \$6.3 million of assets classified as substandard. There were no assets classified as doubtful or loss for the period. This represents an \$800,000 increase in loans classified as substandard from the year ended December 31, 2004 and is primarily attributable to the addition of a commercial loan to a construction company with a net carrying value of \$1.5 million which was classified substandard due to deterioration in the borrower's financial condition. A \$1.1 million lease was added to classified assets in the prior year ended December 31, 2004. As of March 31, 2005, a cash payment from the sale of the lessee's printing press is anticipated for a minimum proceeds of \$700,000. Additionally, there are two other liquid assets intended for liquidation. As such, the Corporation does not anticipate any loss from the lease as of March 31, 2005 and the plan of liquidation indicates that all creditors will be made substantially whole.

At December 31, 2004 and 2003, there were \$5.5 million and \$5.0 million of assets classified as substandard, respectively. The increase in classified assets of \$500,000 from December 31, 2003 to December 31, 2004 is primarily a result of the addition of a lease to a printer with a net investment of \$1.1 million offset by the improvement of credit quality for a lease to a tool and die manufacturer with a net investment of \$530,000. The lease to the tool and die manufacturer was removed from the substandard

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classification. There were two substandard loans with a carrying value greater than \$1.0 million as of December 31, 2004 and 2003, respectively. At December 31, 2004, the substandard loans were a commercial loan to a manufacturer of metal stampings with a carrying value of \$1.7 million and a commercial loan to a manufacturer of injection moldings with a carrying value of \$1.3 million. Their respective carrying values at December 31, 2003 were \$1.6 million and \$1.3 million. Both loans are current as of December 31, 2004 and are considered well-collateralized. The lease to the printer discussed above is the only substandard lease with a carrying value greater than \$1.0 million as of December 31, 2004. The lease to the printer is current as to all contractually required payments. The lessee is in the process of liquidation and the plan of liquidation indicates that all creditors will be made substantially whole. The Corporation does not anticipate any loss from the lease as of December 31, 2004. There were no leases with a carrying value of greater than \$1.0 million as of December 31, 2003. Also, there were no assets classified as doubtful or as a loss at the same periods.

The criteria for classification of assets comes from information causing management to have doubts as to the ability of such borrowers to comply with the present loan or lease repayment terms and indicating that such loans and leases have the potential to be included as non-accrual, past due or impaired (as defined by Statement of Financial Accounting Standards (SFAS) No. 114), in future periods. However, no loss is anticipated at this time.

Securities General

The Banks Boards of Directors (Boards) review and approve the investment policy on an annual basis. Management, as authorized by the Boards, implements this policy. The Boards review investment activity on a monthly basis.

Investment objectives are formed to meet liquidity requirements and generate a favorable return on investments without compromising other business objectives and levels of interest rate risk and credit risk. Consideration is also given to investment portfolio concentrations. Federal and state chartered banks are allowed to invest in various types of assets, including U.S. Treasury obligations, securities of various federal agencies, state and municipal obligations, mortgage-related securities, certain time deposits of insured financial institutions, repurchase agreements, loans of federal funds, and, subject to certain limits, corporate debt and equity securities, commercial paper and mutual funds. The Corporation s investment policy provides that it will not engage in any practice that the Federal Financial Institutions Examination Council considers an unsuitable investment practice.

The Banks investment policies allow participation in hedging strategies or the use of financial futures, options or forward commitments or interest rate swaps with prior Board approval. The Banks utilize derivative hedging instruments in the course of their asset/liability management. These hedging instruments are primarily interest rate swap agreements which are used to convert variable-rate payments or receipts to fixed-rate payments or receipts thereby hedging the cash flow of the instrument being hedged and convert fixed-rate payments to variable rate payments thereby hedging the fair value of the hedged item.

Securities are classified as available-for-sale, held-to-maturity and trading. Available-for-sale securities are carried at fair value, with the unrealized gains and losses, net of tax, reported as a separate component of stockholder s equity. There were no securities designated as held-to-maturity or trading as of March 31, 2005.

The Corporation s investment securities include U.S. government obligations and securities of various federal agencies as well as a small amount of money market investments and corporate stock.

The Corporation also purchases mortgage-related securities, in particular, agency-backed mortgage-derivative securities to supplement loan production and to provide collateral for borrowings. Management believes that certain mortgage-derivative securities represent attractive alternative investments due to the wide variety of maturity and repayment options available and due to the limited credit risk associated with such investments. Mortgage-derivative securities include real estate mortgage investment conduits (REMICS) which are securities derived by reallocating cash flows from mortgage pass-through securities or from pools of mortgage loans held by a trust. The Corporation invests in mortgage-related securities which are insured or guaranteed by FHLMC, FNMA, or GNMA, which are backed by FHLMC, FNMA, and GNMA mortgage-backed securities. Of the total available-for-sale

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mortgage-derivative securities at March 31, 2005, \$54,112,000, \$22,753,000, and \$4,215,000 were insured or guaranteed by FHLMC, FNMA, and GNMA, respectively. The Corporation has no held-to-maturity mortgage-derivative securities at March 31, 2005.

Mortgage-related securities are subject to inherent risks based upon the future performance of the underlying collateral, mortgage loans, for these securities. Among the risks are prepayment risk, extension risk, and interest rate risk. Should general interest rates decline, the mortgage-related securities portfolio would be subject to prepayments caused by borrowers seeking lower financing rates. A decline in interest rates could also cause a decline in interest income on adjustable-rate mortgage-related securities. Conversely, an increase in general interest rates could cause the mortgage-related securities portfolio to be subject to a longer term to maturity caused by borrowers being less likely to prepay their loans. Such a rate increase could also cause the fair value of the mortgage-related securities portfolio to decline.

The Corporation has mortgage-backed securities available-for-sale at March 31, 2005 with a fair value of \$3,200,000. Of these securities, \$1,460,000 are insured or guaranteed by FHLMC, \$491,000 are insured or guaranteed by FNMA and \$487,000 are insured by FHLB.

At March 31, 2005, \$46,344,000 million of the Corporation's mortgage-related securities were pledged to secure various obligations of the Corporation.

The table below sets forth information regarding the amortized cost and fair values of the Corporation's investments and mortgage-related securities at the dates indicated.

	March 31, 2005		2004		December 31, 2003		2002	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(In Thousands)								
Securities available-for-sale								
FHLB stock and other	\$ 2,857	\$ 2,857	\$ 2,811	\$ 2,811	\$ 2,369	\$ 2,369	\$ 3,708	\$ 3,708
U.S. Treasury securities and obligations of the U.S. Government corporations and agencies	3,272	3,200	3,275	3,253	8,095	8,152	3,403	3,564
Collateralized mortgage obligations	82,762	81,081	60,873	60,381	53,569	53,050	40,530	41,134
	\$ 88,891	\$ 87,138	\$ 66,959	\$ 66,445	\$ 64,033	\$ 63,571	\$ 47,641	\$ 48,406

The following table sets forth the maturity and weighted average yield characteristics of the Corporation's debt securities at March 31, 2005, classified by term maturity. The balances are reflective of fair value.

	One to Five Years		Five to Ten Years		Over Ten Years		
	Balance	Weighted Average Yield	Balance	Weighted Average Yield	Balance	Weighted Average Yield	Total
(Dollars in Thousands)							
Available for sale	\$ 3,200	3.05%	\$	0.00%	\$	0.00%	\$ 3,200

U.S. Treasury
securities and
obligations of the U.S.
Government
corporations and
agencies

Collateralized mortgage obligations	575	5.92	17,295	2.63	63,211	3.78	81,081
	\$ 3,775	3.65%	\$ 17,295	3.28%	\$ 63,211	3.44%	\$ 84,281

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Hedging Activities. The Corporation uses derivative instruments, principally interest rate swaps, to protect against the risk of adverse price or interest rate movements on the value of certain assets and liabilities and on future cash flows. For further discussion on the Corporation's interest rate risk management activities and use of derivatives, see management's discussion of critical accounting policies in **Item 2, Note 1** and **Note 2b** to the Consolidated Financial Statements.

Deposits. Deposits are a major source of the Banks' funds for lending and other investment activities. A variety of accounts are designed to attract both short and long-term deposits. These accounts include time deposits, money market and demand deposits. The Banks' deposits are obtained primarily from Dane and Waukesha Counties. At March 31, 2005, \$246.7 million of the Corporation's time deposits were comprised of brokered certificates of deposit with \$58.9 million maturing in three months or less, \$41.9 million maturing in over three to six months, \$41.3 million in over six to twelve months and \$104.6 million maturing in over twelve months. The Banks enter into agreements with certain brokers who provide funds for a specified fee. The Banks' liquidity policy limits the amount of brokered deposits to 75% of total deposits.

Deposit terms offered by the Banks vary according to minimum balance required, the time period the funds must remain on deposit, U.S. Treasury securities offerings and the interest rates charged on other sources of funds, among other factors. In determining the characteristics of deposit accounts, consideration is given to profitability of the Banks, matching terms of the deposits with loan and lease products, the attractiveness to customers and the rates offered by the Banks' competitors.

The following table sets forth the amount and maturities of the Banks' certificates of deposit at March 31, 2005.

Interest Rate	Three Months and Less	Over Three Months Through	Over Six Months Through	Over	Total
		Six	Twelve	Twelve	
		Months	Months	Months	
(In Thousands)					
0.00% to 1.99%	\$ 34,100	\$ 8,720	\$ 33		\$ 42,853
2.00% to 2.99%	49,357	31,075	33,703	14,659	128,794
3.00% to 3.99%	204	3,044	11,583	41,330	56,161
4.00% and greater	1,808	7,706	15,055	62,998	87,567
	\$ 85,469	\$ 50,545	\$ 60,374	\$ 118,987	\$ 315,375

At December 31, 2004, time deposits included \$37.0 million of certificates of deposit in denominations greater than or equal to \$100,000. Of these certificates, \$16.3 million are scheduled to mature in three months or less, \$8.9 million in greater than three through six months, \$8.6 million in greater than six through twelve months and \$3.2 million in greater than twelve months.

Borrowings. The Banks obtain advances from the Federal Home Loan Bank (FHLB). Such advances are made pursuant to several different credit programs, each of which has its own interest rate and maturity. The FHLB may prescribe acceptable uses for these advances as well as limitations on the size of the advances and repayment provisions. The Banks pledge a portion of their 1-4 family loans, commercial loans, and mortgage-related securities as collateral.

The Banks may also enter into repurchase agreements with selected clients. Repurchase agreements are accounted for as borrowings by the Banks and are secured by mortgage-related securities.

The Corporation has a short-term line of credit to fund short-term cash flow needs. The interest rate is based on the London Interbank Offer Rate (LIBOR) plus a spread of 1.75% with an embedded floor of 3.75% and is payable

monthly. The final maturity of the credit line is April 30, 2005. The Corporation also has a subordinated note payable with an interest rate based on LIBOR plus 2.35% subject to a floor of 4.25% which matures on December 31, 2011. See **Note 8** to the Corporation's Consolidated Financial Statements for more information on borrowings.

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The following table sets forth the outstanding balances, weighted average balances and weighted average interest rates for the Corporation's borrowings (short-term and long-term) as indicated.

	March 31, 2005			2004 (as restated)			December 31, 2003			2002		
	(as restated) Weighted Average	Weighted Average		(as restated) Weighted Average	Weighted Average		Weighted Average	Weighted Average		Weighted Average	Weighted Average	
	Balance	Balance	Rate	Balance	Balance	Rate	Balance	Balance	Rate	Balance	Balance	Rate
	(Dollars in Thousands)											
Fed funds purchased and securities sold under agreement to repurchase	\$ 632	\$ 2,949	2.03%	\$ 678	\$ 2,231	2.20%	\$ 5,965	\$ 2,663	1.08%	\$ 520	\$ 2,646	1.53%
FHLB advances	2,051	16,026	2.28	23,803	22,807	1.91	19,837	18,519	3.13	13,944	17,210	4.37
Junior subordinated debentures/Trust preferred securities	10,310	10,310	8.85	10,310	10,310	8.66	10,000	10,000	8.83	10,000	10,000	8.99
Line of credit	1,000	822	4.38	500	665	3.76	10	10	3.75	10	530	3.75
Subordinated note payable	5,000	5,000	4.96	5,000	5,000	4.62	5,000	5,000	4.25	5,000	1,451	4.25
	\$ 18,993	\$ 35,107	4.63%	\$ 40,291	\$ 41,013	3.99%	\$ 40,812	\$ 36,192	3.15%	\$ 29,474	\$ 31,837	3.95%
Short-term borrowings	\$ 2,138			\$ 23,434			\$ 23,758			\$ 7,605		
Long-term borrowings (due beyond one year)	16,855			16,857			17,054			21,869		
	\$ 18,993			\$ 40,291			\$ 40,812			\$ 29,474		

The following table sets forth maximum amounts outstanding at month-end for specific types of borrowings for the periods indicated.

	Three Months Ended March 31, 2005	Year Ended December 31, 2004 2003 2002		
		(In Thousands)		
Maximum month-end balance:				
FHLB advances	\$ 23,503	\$ 32,209	\$ 33,917	\$ 26,046
	1,921	7,271	12,524	9,806

Fed funds purchased and securities sold under
agreement to repurchase

Non-bank Subsidiaries

First Madison Investment Corporation. FMIC is an operating subsidiary of First Business Bank that was incorporated in the State of Nevada in 1993. FMIC was formed for the purpose of managing a portion of the Bank's investment portfolio (primarily mortgage-related securities). FBB also sells commercial real estate, multi-family, commercial and some 1-4 family loans to FMIC in the form of loan participations with FBB retaining servicing and charging a servicing fee of .25%. As an operating subsidiary, FMIC's results of operations are combined with FBB's for financial and regulatory purposes. FBB's investment in FMIC amounted to \$147.3 million at December 31, 2004. FMIC had net income of

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\$4.2 million for the year ended December 31, 2004. This compares to a total investment of \$143.2 million at December 31, 2003 and net income of \$4.2 million for the year ended December 31, 2003.

First Business Capital Corp. FBCC is a wholly-owned subsidiary of First Business Bank formed in 1995 and headquartered in Madison, Wisconsin. FBCC is a commercial finance company designed to meet the needs of growing, highly leveraged manufacturers and wholesale distribution businesses and specializes in providing secured lines of credit as well as term loans on equipment and real estate assets. FBB's investment in FBCC at December 31, 2004 was \$6.9 million and net income for the year ended December 31, 2004 was \$1.0 million. This compares to a total investment of \$5.9 million and net income of \$1.0 million, respectively, at and for the year ended December 31, 2003.

FBCC has a wholly-owned subsidiary, FMCC Nevada Corp. (FMCCNC) incorporated in the state of Nevada in 2000 and formed for the purpose of managing a portion of FBCC's loan portfolio. FBCC's total investment in FMCCNC at December 31, 2004 was \$17.9 million. FMCCNC had net income of \$742,000 for the year ended December 31, 2004. This compares to a total investment of \$17.1 million and net income of \$568,000, respectively, at and for the year ended December 31, 2003.

First Business Leasing, LLC. FBL, headquartered in Madison, Wisconsin, was formed in 1998 for the purpose of purchasing leases from m² Lease Funds, LLC (m²) and to originate leases. Until its sale on January 4, 2005, FBB had a 50% equity interest in m², which is a commercial finance joint venture specializing in the lease of general equipment to small and medium-sized companies nationwide. FBB's total investment in FBL at December 31, 2004 was \$3.0 million and net income was \$614,000 for the year ended December 31, 2004. This compares to a total investment of \$2.4 million and a net loss of \$63,000, respectively, at and for the year ended December 31, 2003.

Employees

At December 31, 2004, the Corporation had 82 full-time and 30 part-time employees. The Corporation promotes equal employment opportunity, and management considers its relationship with its employees to be good. The employees are not represented by a collective bargaining unit.

Regulation

Below is a brief description of certain laws and regulations that relate to the Corporation and the Banks. This narrative does not purport to be complete and is qualified in its entirety by reference to applicable laws and regulations.

General

The Banks are chartered in the State of Wisconsin and are subject to regulation and supervision by the Division of Wisconsin Banking Review Board (the Division), and more specifically the Wisconsin Department of Financial Institutions (WDFI), and are subject to periodic examinations. The Banks' deposits are insured by the Bank Insurance Fund (BIF). The BIF is administered by the Federal Deposit Insurance Corporation (FDIC), and therefore the Banks are also subject to regulation by the FDIC. Periodic examinations of both Banks are also conducted by the FDIC. The Banks must file periodic reports with the FDIC concerning their activities and financial condition and must obtain regulatory approval prior to entering into certain transactions such as mergers with or acquisitions of other depository institutions and opening or acquiring branch offices. This regulatory structure gives the regulatory authorities extensive direction in connection with their supervisory and enforcement activities and examination policies, including policies regarding the classification of assets and the establishment of adequate loan and lease loss reserves.

Wisconsin banking laws restrict the payment of cash dividends by state banks by providing that (i) dividends may be paid only out of a bank's undivided profits, and (ii) prior consent of the Division is required for the payment of a dividend which exceeds current year income if dividends declared have exceeded net profits in either of the two immediately preceding years. The various bank regulatory agencies have authority to prohibit a bank regulated by them from engaging in an unsafe or unsound practice; the payment of a dividend by a bank could, depending upon the circumstances, be considered as such. In the event that (i) the FDIC or the Division should increase minimum required levels of capital; (ii)

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the total assets of the Banks increase significantly; (iii) the income of the Banks decrease significantly; or (iv) any combination of the foregoing occurs, then the Boards of Directors of the Banks may decide or be required by the FDIC or the Division to retain a greater portion of the Banks' earnings, thereby reducing dividends.

The Banks are subject to certain restrictions imposed by the Federal Reserve Act on any extensions of credit to their parent holding company, FBFS. Also included in this act are restrictions on investments in stock or other securities of FBFS and on taking of such stock or securities as collateral for loans to any borrower. Under this act and regulations of the Federal Reserve Board, FBFS and its Banks are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit or any property or service.

The Corporation

FBFS is a financial holding company registered under the Bank Holding Company Act of 1956, as amended (the "BHCA"), and is subject to regulation, supervision, and examination by the Board of Governors of the Federal Reserve System (the "FRB"). The Corporation is required to file an annual report with the FRB and such other reports as the FRB may require. Prior approval must be obtained before the Corporation may merge with or consolidate into another bank holding company, acquire substantially all the assets of any bank or bank holding company, or acquire ownership or control of any voting shares of any bank or bank holding company if after such acquisition it would own or control, directly or indirectly, more than 5% of the voting shares of such bank or bank holding company.

In reviewing applications for such transactions, the FRB considers managerial, financial, capital and other factors, including financial performance of the bank or banks to be acquired under the Community Reinvestment Act of 1977, as amended (the "CRA"). Also, under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, as amended, state laws governing interstate banking acquisitions subject bank holding companies to some limitations in acquiring banks outside of their home state without regard to local law.

The Gramm-Leach Bliley Act of 1999 (the "GLB") eliminates many of the restrictions placed on the activities of bank holding companies. Bank holding companies such as FBFS can expand into a wide variety of financial services, including securities activities, insurance, and merchant banking without the prior approval of the FRB.

The Banks

As state-chartered BIF-insured banks, the Banks are subject to extensive regulation by the WDFI and the FDIC. Lending activities and other investments must comply with federal statutory and regulatory requirements. This federal regulation establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the BIF, the FDIC, and depositors.

Insurance of Deposits. The Banks' deposits are insured up to \$100,000 under the BIF of the FDIC. The FDIC assigns institutions to a particular capital group based on the levels of the Banks' capital: well-capitalized, adequately capitalized, or undercapitalized. These three groups are then divided into three subgroups reflecting varying levels of supervisory concern, ranging from those institutions considered to be healthy to those that represent substantial supervisory concern. The result is nine assessment risk classifications, with well-capitalized, financially sound institutions paying lower rates than those paid by undercapitalized institutions that pose a risk to the insurance fund.

The Banks' assessment rate depends on the capital category to which they are assigned. Assessment rates for deposit insurance currently range from 0 to 27 basis points. The Banks are well capitalized. The supervisory subgroup to which the Banks are assigned by the FDIC is confidential and may not be disclosed. The Banks' rate of deposit insurance assessments will depend upon the category or subcategory to which the Banks are assigned. Any increase in insurance assessments could have an adverse effect on the earnings of the Banks.

Regulatory Capital Requirements. The FRB monitors the capital adequacy of the Banks since, on a consolidated basis they have assets in excess of \$150.0 million. A combination of risk-based and

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leverage ratios are determined by the FRB. Failure to meet these capital guidelines could result in supervisory or enforcement actions by the FRB. Under the risk-based capital guidelines, different categories of assets, including certain off-balance sheet items, such as loan commitments in excess of one year and letters of credit, are assigned different risk weights, with perceived credit risk of the asset in mind. These risk weighted assets are calculated by assigning risk-weights to corresponding asset balances to determine the risk-weight of the entire asset base. Total capital, under this definition, is defined as the sum of Tier 1 and Tier 2 capital elements, with Tier 2 capital being limited to 100% of Tier 1 capital. Tier 1 capital, with some restrictions, includes common stockholders' equity, any perpetual preferred stock, qualifying trust preferred securities, and minority interests in any unconsolidated subsidiaries. Tier 2 capital, with certain restrictions, includes any perpetual preferred stock not included in Tier 1 capital, subordinated debt, any trust preferred securities not qualifying as Tier 1 capital, specific maturing capital instruments and the allowance for loan and lease losses (limited to 1.25% of risk-weighted assets). The regulatory guidelines require a minimum total capital to risk-weighted assets of 8%, of which at least 4% must be in the form of Tier 1 capital. The FRB also has a leverage ratio requirement which is defined as Tier 1 capital divided by average total consolidated assets. The minimum leverage ratio required is 3%. See **Note 13** to the Consolidated Financial Statements for further discussion of regulatory capital requirements and the Corporation and Banks' capital ratios.

The Corporation and Banks' actual capital amounts and ratios are presented in the table below and reflect the Banks' well-capitalized positions.

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	Actual		Minimum Required for Capital Adequacy Purposes		Minimum Required to be Well Capitalized Under FDIC Requirements	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of March 31, 2005						
(as restated):						
Total capital (to risk-weighted assets)						
Consolidated	\$58,987	10.97%	\$43,019	8.00%	N/A	N/A
First Business Bank	50,451	10.86	37,181	8.00	\$46,476	10.00%
First Business Bank Milwaukee	8,353	11.66	5,731	8.00	7,164	10.00
Tier 1 capital (to risk-weighted assets)						
Consolidated	\$47,543	8.84%	\$21,509	4.00%	N/A	N/A
First Business Bank	45,160	9.72	18,590	4.00	\$27,886	6.00%
First Business Bank Milwaukee	7,454	10.40	2,866	4.00	4,298	6.00
Tier 1 capital (to average assets)						
Consolidated	\$47,543	8.18%	\$23,246	4.00%	N/A	N/A
First Business Bank	45,160	8.95	20,192	4.00	\$25,240	5.00%
First Business Bank Milwaukee	7,454	9.78	3,049	4.00	3,811	5.00
As of March 31, 2004						
(as restated):						
Total capital (to risk-weighted assets)						
Consolidated	\$51,858	10.77%	\$38,531	8.00%	N/A	N/A
First Business Bank	43,769	10.37	33,776	8.00	\$42,220	10.00%
First Business Bank Milwaukee	8,267	14.23	4,648	8.00	5,810	10.00
Tier 1 capital (to risk-weighted assets)						
Consolidated	\$40,828	8.48%	\$19,265	4.00%	N/A	N/A
First Business Bank	38,483	9.11	16,888	4.00	\$25,332	6.00%
First Business Bank Milwaukee	7,540	12.98	2,324	4.00	3,486	6.00
Tier 1 capital						

(to average assets)

Consolidated	\$40,828	7.91%	\$20,634	4.00%	N/A	N/A
First Business Bank	38,483	8.56	17,991	4.00	\$22,489	5.00%
First Business Bank Milwaukee	7,540	11.26	2,679	4.00	3,349	5.00

Prompt Corrective Action. The Banks are also subject to capital adequacy requirements under the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), whereby the Banks could be required to guarantee a capital restoration plan, should they become undercapitalized as defined by FDICIA. The maximum liability under such a guarantee would be the lesser of 5% of the Banks total assets at the time they became undercapitalized or the amount necessary to bring the Banks into compliance with the capital restoration plan. The Corporation is also subject to the source of strength doctrine per the FRB, which requires that holding companies serve as a source of financial and managerial strength to their subsidiary banks.

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If banks fail to submit an acceptable restoration plan, they are treated under the definition of significantly undercapitalized and would thus be subject to a wider range of regulatory requirements and restrictions. Such restrictions would include activities involving asset growth, acquisitions, branch establishment, establishment of new lines of business and also prohibitions on capital distributions, dividends and payment of management fees to control persons, if such payments and distributions would cause undercapitalization.

The following table sets forth the FDIC's definition of the five capital categories, in the absence of a specific capital directive.

Category	Total Capital to Risk Weighted Assets	Tier 1 Capital to Risk Weighted Assets	Tier 1 Leverage Ratio
Well capitalized	≥ 10%	≥ 6%	≥ 5%
Adequately capitalized	≥ 8%	≥ 4%	≥ 4%*
Undercapitalized	< 8%	< 4%	< 4%*
Significantly undercapitalized	< 6%	< 3%	< 3%
Critically undercapitalized	Tangible assets to capital of 2%		

* 3% if the Banks receive the highest rating under the uniform system.

Limitations on Dividends and Other Capital Distributions. Federal and state regulations impose various restrictions or requirements on state-chartered banks with respect to their ability to pay dividends or make various other distributions of capital. Generally, such laws restrict dividends to undivided profits or profits earned during preceding periods. Also, FDIC-insured institutions may not pay dividends while undercapitalized or if such a payment would cause undercapitalization. The FDIC also has authority to prohibit the payment of dividends if such a payment constitutes an unsafe or unsound practice in light of the financial condition of a particular bank. At December 31, 2004, subsidiary retained earnings of approximately \$18,140,000 could be transferred to the Corporation in the form of cash dividends without prior regulatory approval, subject to the capital needs of each subsidiary.

Liquidity. 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.

Federal Reserve System. The Banks are required to maintain non-interest bearing reserves at specified levels against their transaction accounts and non-personal time deposits. As of December 31, 2004, the Banks were in compliance with these requirements. Because required reserves must be maintained in the form of cash or non-interest bearing deposits at the FRB, the effect of this requirement is to reduce the Banks' interest-earning assets.

Federal Home Loan Bank System. The Banks are members of the FHLB of Chicago. The FHLB serves as a central credit facility for its members. The FHLB is funded primarily from proceeds from the sale of obligations of the FHLB system. It makes loans to member banks in the form of FHLB advances. All advances from the FHLB are required to be fully collateralized as determined by the FHLB.

As a member, each Bank is required to own shares of capital stock in the FHLB in an amount equal to the greatest of \$500, 1% of its aggregate unpaid residential mortgage loans, home purchase contracts or similar obligations at the beginning of each year, or 20% of its outstanding advances. The FHLB also imposes various limitations on advances relating to the amount and type of collateral, the amount of advances and other items. At December 31, 2004, the Banks owned a total of \$2.8 million in FHLB stock and were in compliance with their respective requirements. The Banks received combined dividends from the FHLB totaling \$146,000 for fiscal 2004 as compared to \$139,000 for fiscal 2003.

Restrictions on Transactions with Affiliates. The Banks' loans to their own and the Corporation's executive officers, directors and owners of greater than 10% of any of their respective stock

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(so-called "insiders") and any entities affiliated with such insiders are subject to the conditions and limitations under Section 23A of the Federal Reserve Act and the Federal Reserve Bank's Regulation O. Under these regulations, the amount of loans to any insider is limited to the same limit imposed in the loans-to-one borrower limits of the respective Banks. All loans to insiders must not exceed the Banks' unimpaired capital and unimpaired surplus. Loans to executive officers, other than loans for the education of the officers' children and certain loans secured by the officers' residence, may not exceed the greater of \$25,000 or 2.5% of the Banks' unimpaired capital and unimpaired surplus, and may never exceed \$100,000. Regulation O also requires that loans to insiders must be approved in advance by a majority of the Board of Directors, at the bank level. Such loans, in general, must be made on substantially the same terms as, and with credit underwriting procedures no less stringent than those prevailing at the time for, comparable transactions with other persons.

The Banks can make exceptions to the foregoing procedures if they offer extensions of credit that are widely available to employees of the Banks and that do not give any preference to insiders over other employees of the Banks.

Community Reinvestment Act. The Community Reinvestment Act ("CRA") requires each Bank to have a continuing and affirmative obligation in a safe and sound manner to help meet the credit needs of its entire community, including low and moderate income neighborhoods. Federal regulators regularly assess the Banks' record of meeting the credit needs of their respective communities. Applications for additional acquisitions would be affected by the evaluation of the Banks' effectiveness in meeting its CRA requirements.

Riegle Community Development and Regulatory Improvement Act of 1994. Federal regulators have adopted guidelines establishing general standards relating to internal controls, information and internal audit systems, loan documentation, credit underwriting, interest rate risk, asset growth, asset quality, earnings and compensation, fees, and benefits. These guidelines require, in general, that appropriate systems and practices are in place to identify and manage the risks and exposures specified by the guidelines. Such prohibitions include excessive compensation when amounts paid appear to be unreasonable or disproportionate to the services performed by executive officers, employees, directors or principal shareholders.

USA Patriot Act of 2001. The USA Patriot Act requires banks to establish anti-money laundering programs; to establish due diligence policies, procedures, and controls with respect to private banking accounts and correspondent banking accounts involving foreign individuals and specific foreign banks; and to avoid establishing, maintaining, administering or managing correspondent accounts in the United States for or on behalf of foreign banks that maintain no presence in any country. Additionally, the USA Patriot Act encourages cooperation among financial institutions, regulatory authorities, and law enforcement with respect to individuals or organizations that could reasonably be suspected of engaging in terrorist activities. Federal regulators have begun proposing and implementing regulations in efforts to interpret the USA Patriot Act. The Banks must comply with Section 326 of the Act which provides for minimum procedures in the verification of identification of new customers.

Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act was established to provide a comprehensive framework for the modernization and reform of the oversight of public company auditing, to improve the quality and transparency of financial reporting by such companies, and to strengthen the independence of auditors. The Act stemmed from the systemic and structural weaknesses identified in the capital markets in the United States and perceptions that such structural weakness contributed to recent corporate scandals. The legislation's significant reforms are listed below.

§ Creation of the PCAOB – the Public Company Accounting Oversight Board. The PCAOB is empowered to set auditing, quality control and ethics standards, inspect public accounting firms, and institute disciplinary actions for those firms. The PCAOB is subject to oversight and review by the SEC and is funded by mandatory fees assessed against all public companies. This legislation also strengthened the Financial Accounting Standards Board by giving it full financial independence from the accounting industry.

§ Auditor independence was strengthened, among other things, by limiting the scope of consulting services that auditors can offer their public company audit clients.

§ The responsibility of public company directors and senior managers for the quality of financial reporting and disclosures made by their companies was heightened.

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- § A number of provisions to deter wrongdoing were contained in the legislation. CEOs and CFOs have to certify that company financial statements fairly present the company's financial condition and results of operations. If a restatement of financial results stemmed from a misleading financial statement resulting from misconduct, the CEO and CFO are required to forfeit and return to the company any bonus, stock or stock option compensation received within the twelve months following the misleading financial report. Company officers and directors are also prohibited from attempting to mislead or coerce an auditor. The SEC is also empowered to bar certain persons from serving as officers or directors of a public company. The act also prohibits insider trading during pension fund blackout periods and requires the SEC to adopt rules requiring attorneys to report securities law violations as well as imposing civil penalties for the benefit of harmed investors.
- § A range of new corporate disclosures are also required. These requirements include off-balance-sheet transactions and conflicts as well as pro forma disclosures designed in ways that are not misleading or are in accordance with SEC disclosure requirements. Accelerated reporting requirements require that insider transactions be reported by the end of the second business day following the covered transaction and that annual reports filed with the SEC include a statement by management asserting their responsibility for creating and maintaining adequate controls and assessing the effectiveness of those controls. The act requires companies to disclose whether or not they have adopted an ethics code for senior financial officers, and, if not, why not. Companies must also disclose whether the audit committee includes at least one financial expert, as defined by the SEC in accordance with specified requirements. The SEC will regularly and systematically review corporate filings.
- § Provisions in the legislation seek to limit and, at the same time, expose to public view possible conflicts of interest affecting securities analysts.
- § A range of new criminal penalties for fraud and other wrongful acts can be brought against companies or their insiders.

Effective August 29, 2002, as prescribed by Sections 302(a) and 906 (effective July 29, 2002) of Sarbanes-Oxley, a public company's CEO and CFO each are required to certify that the company's quarterly and annual reports do not contain any untrue statements of a material fact and that the financial statements, and other financial information included in each such report, fairly present in all material respects the financial condition, results of operations and cash flows of the company for the periods presented in that report.

Section 404 of Sarbanes-Oxley, which does not become effective for the Corporation until the filing of its annual report for the year ended December 31, 2007, requires that the CEO and CFO certify that they (i) are responsible for establishing, maintaining, and regularly evaluating the effectiveness of the Corporation's internal controls; (ii) have made certain disclosures to the Corporation's auditors and the audit committee of the Corporation's board of directors (the Board) about the Corporation's internal controls; and (iii) have included information in the Corporation's quarterly and annual reports about their evaluation and whether there have been significant changes in the Corporation's internal controls or in other factors that could significantly affect internal controls subsequent to such evaluation. The Corporation intends to be prepared for timely compliance with these requirements.

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Item 2. Financial Information

Restatement of Prior Years Consolidated Financial Statements related to the Written Option. Prior to issuing consolidated financial statements as of and for the year ended December 31, 2004, FBFS determined that, pursuant to SEC guidance on the application of U.S. generally accepted accounting principles related to written options, the prior accounting treatment of the written option issued to minority shareholders of its majority owned subsidiary, BBG, in connection with the organization of BBG, which began operations in June 2000, was incorrect. As a result, the Company has restated its consolidated financial statements for the years 2000 through 2003 to account for the option at estimated value. Previously, the written option was not initially recorded at its fair value and was not subsequently marked to fair value through earnings. See **Note 3** to the consolidated financial statements for more information about the written option.

The effect of this restatement was to record the written option in 2000 at its fair value of \$1,938,000 with a charge to expense equal to the fair value of the written option, less the amount of \$20,188 received in cash from the BBG shareholders in payment for the written option, and a credit to liability. Subsequent to initial recording, the fair value of the written option is adjusted each reporting period to its then fair value and reported in income or expense as appropriate. See **Note 2(a)** to the consolidated financial statements.

Restatement of Consolidated Financial Statements related to Hedge Accounting. 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 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 133 to account for the swaps. On November 8, 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 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 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.

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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 or decrease in accumulated other comprehensive income of \$875,000 and \$441,000, respectively.

As a result the consolidated financial statements for all affected periods through December 31, 2004 reflect a cumulative charge of \$477,000, net of income taxes, to account for the interest rate swaps referred to above as if hedge accounting was never applied to them. In addition, for the quarter ended March 31, 2005, a charge of approximately \$45,000, 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.

This Form 10 Registration Statement including consolidated financial statements for the years ended December 31, 2004, 2003 and 2002 and the (unaudited) interim financial statements for the quarter ended March 31, 2005 has been amended to reflect the proper accounting treatment. The Corporation also plans to amend its Quarterly Report on Form 10 Q/A for the quarter ended June 30, 2005 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. See **Note 2(b)** to the consolidated financial statements in **Item 13** and **Note 2** to the unaudited consolidated financial statements as of March 31, 2005 and for the three months ended March 31, 2005 and 2004.

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	Unaudited		At or for the Years Ended December 31,				
	At or for the Three						
	Months Ended						
	Ended March 31,						
	2005	2004	2004	2003	2002	2001	2000
	(as restated)	(as restated)	(as restated)	(as restated)	(as restated)	(as restated)	(as restated)
	(Dollars in Thousands, Except Per Share Data)						
Earnings (loss) per share:							
Basic	\$ 0.63	\$ 0.24	\$ 1.89	\$ 2.81	\$ (0.09)	\$ 1.23	\$ 0.13
Diluted	0.62	0.22	1.83	2.02	(0.09)	1.18	0.12
Interest income	7,956	6,568	28,136	27,005	27,643	26,705	23,341
Interest expense	3,672	2,598	11,250	11,677	14,966	15,220	14,096
Net interest income	4,284	3,970	16,886	15,328	12,677	11,485	9,245
Provision for loan and lease losses	65		(540)	200	3,614	1,940	1,078
Gain on sale of 50% owned joint venture*	973						
Non-interest income	715	69	3,238	2,205	(1)	2,395	1,435
Written option income (expense)		7	7	1,361	(39)	(343)	(1,620)
Non-interest expense	3,575	3,261	13,148	11,432	10,525	8,544	7,648
Minority interest in (income) loss of consolidated subsidiary		(6)	(9)	(741)	787	338	551
Income taxes	807	305	3,255	873	(528)	965	643
Net income (loss)	1,525	475	4,259	5,648	(187)	2,426	242
Total assets	597,602	513,307	562,951	518,472	480,061	410,221	308,541
Securities	87,138	64,841	66,445	63,571	48,406	39,203	43,081
Loans and leases, net	484,683	429,467	469,938	433,105	409,227	351,579	244,619
Deposits	528,714	428,882	474,677	436,886	414,407	345,459	244,321
Borrowed funds	8,683	33,949	29,981	30,812	19,474	18,806	34,666
Junior subordinated debentures/Guaranteed trust preferred securities	10,310	10,310	10,310	10,000	10,000	10,000	
Option liability		654		661	2,022	1,983	1,640
Minority interest in consolidated subsidiary		4,376		4,353	3,562	4,302	4,633
Stockholders' equity	39,032	26,987	38,141	25,990	20,824	21,381	19,646
Shares outstanding	2,416,464	2,412,409	2,412,409	2,021,033	1,985,466	1,979,927	1,913,512
Book value per share at end of period	16.15	11.19	15.81	12.86	10.49	10.80	10.27

Dividends declared per share			0.21	0.25	0.15		
Dividend payout ratio	0.00%	0.00%	11.09%	8.90%	N.M.	0.00%	0.00%
Yield on earning assets	5.69	5.22	5.42	5.65	6.42	7.82	8.64
Cost of funds	2.98	2.36	2.48	2.77	3.94	5.14	6.07
Interest rate spread	2.71	2.86	2.93	2.88	2.47	2.68	2.57
Net interest margin	3.06	3.16	3.25	3.21	2.94	3.37	3.42
Return on average assets	1.04	0.37	0.79	1.14	-0.04	0.69	0.09
Return on average equity	15.80	7.04	13.81	24.09	-0.87	12.16	1.25
Average equity to average assets	6.61	5.22	5.74	4.75	4.80	5.65	6.80

* See Sale of m2 in Recent Developments in this section and **Note 8** to the Unaudited Consolidated Financial Statements for further discussion.

N.M. Not Meaningful

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

Forward-Looking Statements

When used in this registration statement, and in any oral statements made with the approval of an authorized executive officer, the words or phrases may, could, should, hope, might, believe, expect, plan, assume, estimate, anticipate, project, will likely result, or similar expressions are intended to identify forward-looking statements. Such statements are subject to risks and uncertainties, including, without limitation, changes in economic conditions in the market area of First Business Bank (FBB) or First Business Bank Milwaukee (FBB Milwaukee), changes in policies by regulatory agencies, fluctuation in interest rates, demand for loans in the market area of FBB or FBB Milwaukee, borrowers defaulting in the repayment of loans, competition, and the other risks set forth under

Cautionary Factors, that could cause actual results to differ materially from what FBFS has anticipated or projected. These risk factors and uncertainties should be carefully considered by potential investors. Investors should not place undue reliance on any such forward-looking statements, which speak only as of the date made. The factors described within this registration statement could affect the financial performance of FBFS and could cause actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods.

Where any such forward-looking statement includes a statement of the assumptions or bases underlying such forward-looking statement, FBFS cautions that, while its management believes such assumptions or bases are reasonable and are made in good faith, assumed facts or bases almost always vary from actual results, and the differences between assumed facts or bases and actual results can be material, depending on the circumstances. Where, in any forward-looking statement, an expectation or belief is expressed as to future results, such expectation or belief is expressed in good faith and believed to have a reasonable basis, but there can be no assurance that the statement of expectation or belief will result in, or be achieved or accomplished.

FBFS does not intend to update any forward-looking statements, whether written or oral, to reflect change. Furthermore, FBFS specifically disclaims any obligation to publicly release the result of any revisions which may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

The following discussion and analysis is intended as a review of significant factors affecting the financial condition and results of operations of FBFS for the periods indicated. The discussion should be read in conjunction with the Consolidated Financial Statements and the Notes thereto and the Selected Consolidated Financial Data presented herein.

Overview

The principal business of FBFS is conducted by FBB and FBB Milwaukee and consists of a full range of community-based financial services focusing on small and medium-sized businesses. Products include commercial lending, asset-based lending, leasing, trust and investment services and a broad range of deposit products. The profitability of FBFS depends primarily on its net interest income, provision for loan and lease losses, other income, and other expenses. Net interest income is the difference between the income FBFS receives on its loans, leases and investment securities, and its cost of funds, which consists of interest paid on deposits and borrowings. The provision for loan and lease losses reflects the cost of credit risk in the loan and lease portfolio of FBFS. Other income consists of service charges on deposit accounts, securities gains, loan and lease fees, trust fees, and other income. Other expenses include salaries and employee benefits, occupancy, equipment expenses, professional services, marketing expenses, other non-interest expenses, and taxes.

Net interest income is dependent on the amounts of and yields on interest-earning assets as compared to the amounts of and rates on interest-bearing liabilities. Net interest income is sensitive to changes in market rates of interest and the asset/liability management procedures used by FBFS in responding to such changes. The provision for loan and lease losses is dependent upon management's assessment of the collectibility of loans and leases under current economic conditions. Other expenses are influenced by the growth of operations, with additional employees necessary to staff such growth. Growth

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in the number of relationships directly affects such expenses as data processing costs, supplies, postage, and other miscellaneous expenses.

In the following discussion, as required by generally accepted accounting principles, FBFS's interest income, interest expense, provision for loan and lease losses, net interest income, non-interest income, non-interest expense, income tax expense, and all balance sheet items other than shareholders' equity include 100% of the amounts reported by BBG for the periods and as of the dates stated, although FBFS owned only 51% of the outstanding shares of BBG stock as of December 31, 2003. FBFS's net income and stockholders' equity are reported net of adjustment to reflect the 49% outstanding minority interests of BBG. As of June 1, 2004, FBFS owned 100% of the shares of BBG. BBG was subsequently dissolved and as a result First Business Bank - Milwaukee became a direct wholly-owned subsidiary of FBFS. See **Item 13 Financial Statements and Supplementary Data**.

Recent Developments

Tax Audit. Like the majority of financial institutions located in Wisconsin, First Business Bank transferred investment securities and loans to out-of-state investment subsidiaries. The Bank's Nevada investment subsidiaries now hold and manage these assets. The investment subsidiaries have not filed returns with, or paid income or franchise taxes to, the State of Wisconsin. The Wisconsin Department of Revenue (the Department) recently implemented a program to audit Wisconsin financial institutions which formed investment subsidiaries located outside of Wisconsin, and the Department has generally indicated that it intends to assess income or franchise taxes on the income of the out-of-state investment subsidiaries of Wisconsin financial institutions. FBB has received a Notice of Audit from the Department that would cover years 1999 through 2002 and would relate primarily to the issue of income of the Nevada subsidiaries. During 2004, the Department offered a blanket settlement agreement to most banks in Wisconsin having Nevada investment subsidiaries. The Department has not issued an assessment to the bank, but the Department has stated that it intends to do so if the matter is not settled.

If the Department of Revenue should be successful in taxing the income of FBB's investment subsidiaries, future income may be reduced. At this time FBB does not know if the Department of Revenue will attempt to collect any taxes, penalties or interest for prior periods. If the Department of Revenue made such an attempt and were successful, such assessment could be an amount in a range up to \$2.2 million, based on net taxable income of the Nevada subsidiaries. In addition, FBB is likely to incur expenses in addressing the audit, including legal and accounting fees. Any amounts paid to resolve this matter will be deductible for Federal income tax purposes. Due to the incomplete nature of the audit, FBB management is unable to determine the ultimate amount of additional taxes, if any, it will be assessed. FBB may be presented with an option to settle this dispute that would be prudent to accept based on the facts and circumstances at that time and has accrued an estimated liability of an amount that is within a range of probable settlement amounts.

Sale of m2 Lease Funds, LLC. On January 4, 2005, FBB sold its 50% equity interest in m2 Lease Funds, LLC (m2), in a cash sale. See **Note 7 Sale of 50% Owned Joint Venture** in the consolidated financial statements as of and for the period ended March 31, 2005.

The primary function of m2 was to originate direct financing leases for its own account and to provide, on an agency basis, direct financing lease originations to First Business Leasing on a right of first refusal basis. m2 also originated and sold leases to non-affiliated banks. The Corporation intends to add experienced origination staff to First Business Leasing in order to continue offering leasing alternatives to businesses in our targeted markets. During the anticipated time to fill the position, the Corporation may continue to purchase leases that meet our underwriting criteria from m2 on a limited basis.

In 2004 the Corporation's equity in earnings of m2 was \$124,000. The investment in m2 was accounted for under the equity method. The historical recognition of annual net income was immaterial to the overall performance of the Corporation. As a result of replacing the source of originations, the Corporation expects that there will be no material effect on future results of operations due to the sale of m2.

Historically, the Corporation has not received any cash flow from m2 until the sale in 2005 and therefore future cash flow and liquidity will not be affected by the sale.

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Resignation of Executive Officer. On June 24, 2005, C. James Munhofen resigned his positions with the company in order to pursue other opportunities. The vacated responsibilities will be assumed by other employees of the Corporation. Mr. Munhofen had served as CEO and Director of the Corporation's asset-based lending subsidiary, FBCC.

On August 31, 2005, Joan LaCroix resigned her position with the company to pursue other opportunities. The vacated responsibilities will be assumed by other employees of the Corporation. Ms. LaCroix had served as Vice President and Controller of the Corporation.

Resignation of Director. On July 18, 2005, Donald D. Wahlin resigned as a Director of the Corporation in which capacity he has served since January, 1994. He also served as a member of the Compensation Committee.

Appointment of New Director. Effective July 18, 2005, the Board of Directors (the Board) of the Corporation elected Mark D. Bugher as a new director to fill the vacancy created by the retirement of Donald D. Wahlin from the Board, also on July 18, 2005. Mr. Bugher may be appointed to serve as a member of one or more committees of the Board, but no decision has been made to appoint him to any specific committee as of July 18, 2005.

Mr. Bugher, age 56, is currently the Director of University Research Park in Madison, Wisconsin. Prior to this role, Mr. Bugher served as the Secretary of the State of Wisconsin Department of Administration from 1996 to 1999. From 1988 to 1996, he served as Secretary of the State of Wisconsin Department of Revenue. Mr. Bugher serves in leadership positions as chair or board member to many organizations promoting economic development in Wisconsin.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management 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 and the reported amounts of revenues and expenses during the reporting period. By their nature, changes in these assumptions and estimates could significantly affect the financial position or results of operations for FBFS. Actual results could differ from those estimates. Please refer to **Note 1** to the Consolidated Financial Statements for a discussion of the most significant accounting policies followed by FBFS. Discussed below are certain policies that are critical to FBFS. Management views critical accounting policies to be those which are highly dependent on subjective or complex judgments, estimates, and assumptions, and where changes in those estimates and assumptions could have a significant impact on the financial statements.

Allowance for Loan and Lease Losses. The allowance for loan and lease losses represents management's recognition of the risks of extending credit and its evaluation of the quality of the loan and lease portfolio and as such, requires the use of judgment as well as other systematic objective and quantitative methods. The risks of extending credit and the accuracy of management's evaluation of the quality of the loan and lease portfolio are neither static nor mutually exclusive and could result in a material impact on the Corporation's financial statements. Management could over-estimate the quality of the loan and lease portfolio resulting in a lower allowance for loan and lease losses than necessary, overstating net income and equity. Conversely, management could under-estimate the quality of the loan and lease portfolio, resulting in a higher allowance for loan and lease losses than necessary, understating net income and equity. The allowance for loan and lease losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan and lease losses and decreased by charge-offs, net of recoveries. Management estimates the allowance balance required and the related provision for loan and lease losses based on quarterly evaluations of the loan and lease portfolio, with particular attention paid to loans and leases that have been specifically identified as needing additional management analysis because of the potential for further problems. During these evaluations, consideration is also given to such factors as the level and composition of impaired and other non-performing loans and leases, historical loss experience, results of examinations by regulatory agencies, independent loan and lease reviews, the market value of collateral, the strength and availabilities of guarantees, concentration of credits and other factors. Allocations of the allowance may be made for specific loans or leases, but the entire allowance is available for any loan or lease that, in management's judgment, should be charged off. Loan and lease losses are

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charged against the allowance when management believes that the uncollectibility of a loan or lease balance is confirmed.

Historical loss rates for the various classifications and pools of loans and leases may be adjusted by management from time to time for significant factors that, in management's judgment reflect the effect of current conditions on loss recognition. The loss rates used also consider the imprecision in estimating losses on individual loans and leases or pools of loans and leases.

FBFS charged off three significant loans and one lease during 2002. As a result of these charge-offs, FBFS incurred net loan and lease losses of \$3.2 million in 2002, \$768,000 of which was recovered in 2003. Two of the loans were originated by FBB Milwaukee and participated to FBB Madison under an expedited intercompany approval process.

The policy at the time the above mentioned loans were originated included a provision that allowed loans that were approved through the complete loan approval process by one of the subsidiary banks and were an amount greater than the internal lending limit of that subsidiary bank, to be participated to the other subsidiary bank with prior approval of the Intercompany Loan Committee, as opposed to the entire Officers Loan Committee, and Directors Loan Committee, of the participating bank.

The make-up of the Intercompany Loan Committee included two representatives from each subsidiary bank's credit granting process. This smaller loan approval committee was established to improve the response time to customers. Subsequent to the charge-offs, in July 2002, FBFS changed the policy to eliminate the Intercompany Loan Committee. The policy in place since that time requires that all loans and leases originated by one of the banks, purchased from related subsidiaries or purchased from unrelated sources must be reviewed through the standard loan approval process in order to draw on the experience and oversight of the full committee. Whereas this change will not eliminate all future charge-offs related to intercompany loans it is expected to bring consistency to the Corporation's credit granting process.

Management also continues to pursue all practical and legal methods of collection, repossession and disposal, and adheres to high underwriting standards in the origination process in order to continue to maintain strong asset quality. Although management believes that the allowance for loan and lease losses is adequate based upon current evaluation of loan and lease delinquencies, non-performing assets, charge-off trends, economic conditions and other factors, there can be no assurance that future adjustments to the allowance will not be necessary. Should the quality of loans or leases deteriorate, then the allowance for loan and lease losses would be expected to increase relative to total loans and leases. When loan or lease quality improves, then the allowance would be expected to decrease relative to total loans and leases.

Income Taxes. FBFS and its subsidiaries which are at least 80% owned file a consolidated Federal income tax return and separate state tax returns. Subsidiaries for which FBFS's interest is less than 80% file a separate Federal tax return from FBFS. Deferred income taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. The determination of current and deferred income taxes is based on complex analyses of many factors, including the interpretation of Federal and state income tax laws, the difference between the tax and financial reporting basis of assets and liabilities (temporary differences), estimates of amounts currently due or owed, such as the timing of reversals of temporary differences and current accounting standards. The Federal and state taxing authorities who make assessments based on their determination of tax laws periodically review the Corporation's interpretation of Federal and state income tax laws. Tax liabilities could differ significantly from the estimates and interpretations used in determining the current and deferred income tax liabilities based on the completion of taxing authority examinations. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred taxes is recognized in income in the period that includes the enactment date. FBFS and its subsidiaries have State of Wisconsin net operating loss (NOL) carryforwards as of December 31, 2003 of approximately \$35,100,000, which expire in years 2014 through 2018.

FBFS has made its best estimates on valuation allowances needed for deferred tax assets on certain net operating loss carryforwards and other temporary differences and has made its best estimate of the probable loss

related to a state tax exposure matter (see **Note 16** to the consolidated financial

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statements). These estimates are subject to changes. Changes in these estimates could adversely affect future consolidated results of operations. Through 2003, BBG, which was consolidated by FBFS for financial reporting, but not tax purposes, had NOL carryforwards that were generated in the first three years of BBG's existence. Realization of the net deferred tax assets related to such NOLs over time was dependent upon BBG generating sufficient taxable income in future periods. Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes*, requires establishment of a valuation allowance reserve for some portion or all of the NOLs if it is more likely than not that sufficient taxable income will not be generated in future periods to utilize the NOLs before they expire. A valuation allowance was established for the benefit of NOLs accumulated through December 31, 2002. In 2003, there was a reduction in the allowance of \$1,206,000 against the deferred income tax assets at the consolidated bank subsidiary.

The NOL carryforwards were the result of the bank's start-up operations from its inception in June 2000 through the year ended December 31, 2002 and due to the loan loss charge-offs in 2002 totaling \$2,876,000 for two large commercial loans originated by FBB Milwaukee. Were it not for these two loan charge-offs, FBB Milwaukee would have had taxable income in 2002. In 2003, FBB Milwaukee had taxable income and the bank was then expected to have taxable income in 2004 and future years. Furthermore, a portion of the loans charged off in 2002 were recovered in 2003. During 2003, FBFS determined the benefit of these NOL carryforwards to be probable of realization in full based upon the profitability of FBB Milwaukee in 2003, its recovery in 2003 of \$773,000 of the loans charged-off in 2002, the significant reduction in non-performing loans, the ability of FBFS to sell earning assets to FBB Milwaukee, the achievement of a growth in earning assets sufficient to forecast future earnings more than sufficient to utilize the full NOL, and the length of the remaining life of the NOL carryforwards which range from 17 to 19 years. FBB Milwaukee had taxable income in 2004.

As noted elsewhere herein, in July 2004, BBG shareholders completed the exchange of their 49% minority ownership in BBG to FBFS for shares of FBFS. This event resulted in FBFS owning 100% of BBG shares. BBG was subsequently dissolved and as a result, FBB Milwaukee became a direct wholly-owned subsidiary of FBFS. Beginning in 2004, FBFS will file a consolidated Federal tax return with FBB Milwaukee enabling the usage of FBB Milwaukee's NOL carryforwards to offset consolidated taxable income, subject to certain IRS annual limitations. This event increases further the probability that all of the benefits related to these NOL carryforwards will be fully realized. FBFS will continue to evaluate the probability of the usage of the NOL carryforwards and if in the future it is no longer deemed more likely than not that the benefit of the NOL carryforwards will be realized, then a valuation allowance will be established through a charge to income tax expense.

Valuation of Securities. The Corporation's available-for-sale security portfolio is reported at fair value. The fair value of a security is determined based on quoted market prices. If quoted market prices are not available, fair value is determined based on quoted prices of similar instruments. Available-for-sale and held-to-maturity securities are reviewed quarterly for possible other-than-temporary impairment. The review includes an analysis of the facts and circumstances of each individual investment such as the length of time the fair value has been below cost, the expectation for that security's performance, the credit worthiness of the issuer and the Corporation's intent and ability to hold the security to maturity. A decline in value that is considered to be other-than-temporary is recorded as a loss within non-interest income in the Consolidated Statements of Income.

The Corporation infrequently sells securities available for sale, having no sales in 2004 or 2003. The Corporation holds debt securities of the U.S. Government and collateralized mortgage derivatives. The fair value of these securities is affected mostly by changes in interest rates. It is the Corporation's intent and ability to hold securities with unrealized losses until maturity or until recovery of any unrealized losses.

Lease Residuals. The Corporation leases machinery and equipment to customers under leases which qualify as direct financing leases for financial reporting and as operating leases for income tax purposes. Under the direct financing method of accounting, the minimum lease payments to be received under the lease contract, together with the estimated unguaranteed residual value (approximating 3 to 15% of the property cost of the related equipment), are recorded as lease receivables when the lease is signed and the lease property is delivered to the customer. Residual value is the estimated fair market value of the equipment on lease at lease termination. In estimating the equipment's fair value, the Corporation relies on historical experience by equipment type and manufacturer published sources of

used equipment prices, internal appraisals and, where available, valuations by independent appraisers, adjusted for known trends.

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The Corporation's estimates are reviewed regularly to ensure reasonableness; however, the amounts the Corporation will ultimately realize could differ from the estimated amounts. Where residual amounts are estimated to be other-than-temporarily impaired, the amount is reduced and a loss is recorded.

Derivatives. The Corporation uses derivative instruments, principally interest rate swaps, to protect against the risk of adverse price or interest rate movements on the value of certain assets and liabilities and on future cash flows.

SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, requires all derivative instruments to be carried at fair value on the balance sheet. The accounting for the gain or loss due to changes in the fair value of the derivative instrument depends on whether the derivative instrument qualifies as a hedge. If the derivative instrument does not qualify as a hedge, the gains or losses are reported in earnings when they occur. However, if the derivative instrument qualifies as a hedge the accounting varies based on the type of risk being hedged.

Derivative instruments designated in a hedge relationship to mitigate exposure to changes in the fair value of an asset, liability or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges under SFAS 133. Derivative instruments designated in a hedge relationship to mitigate exposure to variability in expected future cash flows or other types of forecasted transactions, are considered cash flow hedges. The Corporation, at the inception of the hedge, formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking each hedge transaction.

For fair value hedges, gains or losses on derivative hedging instruments are recorded in earnings. In addition, gains or losses on the hedged item are recognized in earnings in the same period and the same income statement line as the change in fair value of the derivative. Consequently, if gains or losses on the derivative hedging instrument and the related hedged item do not completely offset, the difference (i.e. the ineffective portion of the hedge) is recognized currently in earnings.

For cash flow hedges, the reporting of gains or losses on derivative hedging instruments depends on whether the gains or losses are effective at offsetting the cash flows of the hedged item. The effective portion of the gain or loss is accumulated in other comprehensive income and recognized in earnings during the period that the hedged forecasted transaction affects earnings. The ineffective portion of the hedge is recognized currently in earnings.

At the inception of each hedge and at least quarterly thereafter, a formal assessment is performed to determine whether changes in the fair values or cash flows of the derivative instruments have been highly effective in offsetting changes in the fair values or cash flows of the hedged items and whether they are expected to be highly effective in the future. If it is determined that a derivative instrument has not been or will not continue to be highly effective, hedge accounting is discontinued. Thereafter, the derivative instrument would continue to be marked to market with changes in fair value charged or credited to earnings.

When available, the fair values of derivatives and the hedged assets or liabilities are obtained from third party sources. Such fair values are based upon interest rates using discounted cash flow modeling techniques in the absence of market quotes. Therefore, management must make estimates regarding the amount and timing of cash flows, which are susceptible to significant change in future periods based upon changes in interest rates. The assumptions used by management in the cash flow models are based on yield curves, forward yield curves and implied volatilities observable in the cash and derivatives markets. The pricing models are validated periodically by testing through comparison with other third parties.

Goodwill and Other Intangibles. Goodwill was recorded as a result of the acquisition of BBG on June 1, 2004, the purchase price of which exceeded the fair value of the net assets acquired. Goodwill is reviewed at least annually, for impairment. This review requires judgment. The price paid for the acquisition is analyzed and compared to a number of current indices. If goodwill is determined to be impaired, a reduction in value would be expensed in the period in which it became impaired. See Note 4 to the Consolidated Financial Statements for further discussion of goodwill and other intangibles.

Judgment is also used in the valuation of other intangible assets consisting of a core deposit intangible and a customer list from purchased trust business. Core deposit intangibles were recorded for

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core deposits acquired in the BBG acquisition which was accounted for as a purchase business combination. The core deposit intangible assets were recorded using the assumption that they provide a more favorable source of funding than wholesale borrowings. An intangible asset was recorded for the present value of the difference between the expected interest to be incurred on these deposits and interest expense that would be expected if these deposits were replaced by wholesale borrowings, over the expected lives of the core deposits. The current estimate of the underlying lives of core deposits is fifteen years and ten years for the customer list. If it is determined that the deposits or the customer list have shorter lives, the assets will be adjusted to reflect an expense associated with the amount that is impaired.

Results of Operations

Comparison of Three Months Ended March 31, 2005 and 2004

General. Net income increased \$1.0 million to \$1.5 million for the three months ended March 31, 2005 from \$475,000 in the same period of 2004. The three months ended March 31, 2005 included a gain on the sale of FBB's 50% equity interest in m2 of \$973,000. In addition to the gain on sale of the subsidiary, interest income increased \$1.4 million. These components that caused an increase in net income were partially offset by increases in interest expense of \$1.1 million and an increase in non-interest expense of \$315,000. The returns on average assets and average stockholders' equity for the three months ended March 31, 2005 were 1.04% and 15.80%, respectively, as compared to .37% and 7.04%, respectively, for the same period in 2004.

Net Interest Income. Net interest income increased \$314,000, or 7.90%, to \$4.3 million for the three months ended March 31, 2005 from \$4.0 million for the same period in 2004. The improvement in net interest income was due to an increase in average earning assets partially offset by a decrease in net interest margin. Net interest margin decreased from 3.16% for the three month period ended March 31, 2004 to 3.06% in the same period of 2005. This was because the increase in yields paid on interest-bearing liabilities was greater than the increase in yields earned on interest-bearing assets. This was also reflected in the decrease in the interest rate spread from 2.86% for the three months ended March 31, 2004 to 2.71% for the same period in 2005.

Interest income on total interest-earning assets increased \$1.4 million to \$8.0 million for the three months ended March 31, 2005 from \$6.6 million for the same period in 2004. In particular, interest income on loans and leases increased \$1.2 million to \$7.2 million as of the three months ended March 31, 2005 from \$6.0 million for the same period of 2004 due to an increase in average loans and leases outstanding of \$35.5 million, or 8.1%, accompanied by an increase in average yields earned on loans and leases from 5.47% to 6.08% 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 \$207,000 from \$452,000 for the three months ended March 31, 2004 to \$659,000 for the same period in 2005. This increase was due to an increase in the average balance of mortgage related securities of \$20.8 million from \$53.9 million as of March 31, 2004 to \$74.7 million for the same period in 2005 accompanied by an increase in average yields on such securities from 3.35% in 2004 to 3.53% in 2005.

The average balance of loans increased in all categories except for consumer loans, which experienced a decrease from an average balance of \$3.6 million as of March 31, 2004 to \$1.7 million for the same period in 2005. Total average mortgage loan growth amounted to \$19.8 million, or 6.8%, which was driven largely by growth in commercial real estate and construction loans, as well as 1-4 family loans. Commercial loans grew \$16.1 million, or 13.3%, while leases grew \$544,000 or 6.2%. The rate of growth in commercial real estate, construction and commercial loans has largely been the result of attracting new customers in the Bank's two principal markets. Existing borrowers are successfully managing their businesses through the slower economic conditions and using cash flow to pay down loan balances. The healthy cash flow of the underlying customer base that has resulted in such pay downs of loan balances has contributed to the improvement in nonperforming loans. 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 customers in the Bank's 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 months ended March 31, 2005 stemmed from a purchase of roughly \$20.0 of such securities, as interest rates have become more attractive in those securities resulting from rising mortgage rates. It is the Corporation's

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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 months ended March 31, 2005 as compared to the same period in 2004 from 3.35% to 3.53%.

Interest expense on interest-bearing liabilities increased \$1.1 million to \$3.7 million for the three months ended March 31, 2005 from \$2.6 million for the same period in 2004 due to an \$1.1 million increase in interest expense on deposits with the weighted average rate increasing from 2.19% to 2.85%. The increase in interest expense was largely due to rising rates on deposits accompanied by an increase in average interest-bearing deposits of \$58.6 million or 14.7% from \$399.4 million as of the three months ended March 31, 2004 to \$458.0 million for the same period in 2005. This increase was largely a result of growth in average certificates of deposit of \$31.6 million from \$240.1 million as of the three months ended March 31, 2004 to \$271.7 million in 2005, primarily acquired through deposit brokers. This was partially offset by a decrease in the average balance of Federal Home Loan Bank (FHLB) advances, used as another source of funding, of \$4.7 million from \$20.7 million for the three months ended March 31, 2004 to \$16.0 million for the same period in 2005, or 22.7%, with the average cost of such advances remaining constant at 2.28% for both periods. The overall weighted average cost of borrowings increased from 3.95% for the three months ended March 31, 2004 to 4.63% for the same period in 2005. This was a result of increases in the other categories of borrowings.

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 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. Such deposits provide flexibility as opposed to single service time deposit relationships.

Provision for Loan and Lease Losses. The provision for loan and lease losses increased \$65,000 from \$0 for the three months ended March 31, 2004 to \$65,000 for the same period in 2005. The primary reason for the increase is due to the growth in the loan and lease portfolio and an increase in of \$787,000 in assets classified substandard. Analysis shows no collateral shortfall, therefore, no specific allowance for loan and lease losses was required. Total assets classified as substandard increased from \$5.5 million for the year ended December 31, 2004 to \$6.3 million for the three months ended March 31, 2005 as compared to no change in assets classified substandard from \$5.0 million for both the year ended December 31, 2003 and the three months ended March 31, 2004. The increase in assets classified substandard for the three months ended March 31, 2005 was offset by a decrease in non-performing assets of \$880,000 from the year ended December 31, 2004 while the decrease in assets classified substandard for the three months ended March 31, 2004 was accompanied by a decrease in non-performing assets of \$630,000 from the year ended December 31, 2003. Management regularly reviews the loan and lease losses including incorporating 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.

Non-Interest Income. Non-interest income, consisting primarily of deposit and loan related fees, fees earned for trust and investment services as well as interest rate swap changes in fair value and net cash settlements, increased \$1.6 million, or 212.1%, to \$1.7 million for the three months ended March 31, 2005 from \$76,000 for the same period in 2004. The primary contributor to this increase was the gain of \$973,000 on the sale of FBB's 50% equity interest in m2. See **Note 8, Sale of 50% Owned Joint Venture**, to the unaudited Consolidated Financial Statements as of and for the period ended March 31, 2005. Other contributing factors included a decrease in the loss recognized for the change in fair value of interest rate swaps of \$250,000 and a decrease in net cash settlement expense of interest rate swaps of \$269,000. In addition to this, there was an \$119,000 increase in trust fee income from FBB's trust services subsidiary due to successful efforts to increase assets under management. Money transferred in from new and existing customers as well as market appreciation contributed to the increase in assets. Sales activity and account retention were positive

for the first quarter of 2005. Non-interest income also increased \$44,000 for the three months ended March 31, 2005 from the same period in 2004 due to income from the increase in cash surrender value of bank owned life insurance. These increases were partially offset by a

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decrease in service charges on deposits of \$36,000 due to efforts to remain competitive in the current interest rate market, other income of \$21,000, and written option income of \$7,000.

Non-Interest Expense. Non-interest expense increased \$315,000, or 9.6%, to \$3.6 million for the three months ended March 31, 2005 from \$3.3 million in the same period for 2004. A significant portion of this increase was due to an increase of \$221,000 in employee salaries and benefits reflecting additions to staff. Other expenses increased \$126,000 from \$318,000 for the three months ended March 31, 2004 to \$444,000 for the same period in 2005 largely due to impairment in the investment in a community housing project of \$98,000. Marketing increased \$95,000 as a result of loan, deposit, and general marketing campaigns. Data processing increased \$21,000. These increases were offset by a decrease in professional and consulting fees of \$95,000 associated with the Corporation's process during 2004 to become a publicly registered company and other fees associated with additional consulting necessary due to regulatory changes such as Sarbanes-Oxley. The remainder of the decrease is attributable to a decrease in occupancy of \$22,000, due to a prior year additional occupancy charge.

Minority Interest. The consolidated financial statements for the three months ended March 31, 2004 included the accounts of FBFS, its wholly-owned subsidiaries and its 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.

Income Taxes. FBFS recorded income tax expense of \$807,000 for the three months ended March 2005, an effective rate of 34.6%, as compared to \$305,000 for the same period in 2004, an effective rate of 39.1%. The reduction in the effective tax rate is principally due to the increase in income from bank owned life insurance.

Comparison of Years Ended December 31, 2004 and 2003

General. Net income decreased \$1.4 million to \$4.2 million in fiscal 2004 from \$5.6 million in the same period of 2003. 2003 included a non-cash gain of \$1.3 million related to the change in fair value during 2003 of the written option held by BBG's minority interest shareholders. (See **Note 3** to the Consolidated Financial Statements.) The decrease is related to a \$2.4 million increase in income tax expense principally resulting from an increase in income before tax and a change in estimate for certain tax exposure items. In 2003, the lower effective tax rate was attributable to the reversal of a valuation reserve against net deferred tax assets previously established for net operating losses incurred by BBG. In addition to this net increase from the prior year's taxes, non-interest expense increased \$1.7 million and non-interest income decreased \$321,000. These components that caused a decrease in net income were partially offset by increases in net interest income of \$1.6 million, a \$740,000 reduction in the provision for loan and lease losses and a decrease in minority interest in net income of consolidated subsidiary of \$732,000. The returns on average assets and average stockholders' equity for fiscal 2004 were 0.79% and 13.81%, respectively, as compared to 1.14% and 24.09%, respectively, for the same period in 2003.

Net Interest Income. Net interest income increased \$1.6 million, or 10.2%, to \$16.9 million for fiscal 2004 from \$15.3 million for the same period in 2003. The improvement in net interest income was due to an increase in average earning assets accompanied by an increased net interest margin. Net interest margin increased from 3.21% in fiscal 2003 to 3.25% in the same period of 2004. This was because the decrease in yields paid on interest-bearing liabilities was greater than the decrease in yields earned on interest-bearing assets. This was also reflected in the increase in the interest rate spread from 2.88% in 2003 to 2.93% in 2004.

Interest income on total interest-earning assets increased \$1.1 million to \$28.1 million in fiscal 2004 from \$27.0 million in 2003. In particular, interest income on loans and leases increased \$640,000 to \$25.9 million in fiscal 2004 from \$25.2 million in the same period of 2003 due to an increase in average loans and leases outstanding of \$30.1 million, or 7.1%, offset by a decrease in average yields earned on loans and leases from 5.97% to 5.70% caused by a decline in market rates. Also contributing to the increase in income on interest earning assets was an increase in income on mortgage related securities of \$610,000 from \$1.3 million in 2003 to \$1.9 million in 2004. This increase was due to an increase in the average balance of mortgage related securities of \$13.6 million from \$43.5 million in 2003 to \$57.1 million in 2004 accompanied by an increase in average yields on such securities from 3.03% in 2003 to 3.38% in 2004.

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The average balance of loans increased in all categories. Total average mortgage loan growth amounted to \$17.9 million, or 6.4%, which was driven largely by growth in commercial real estate and construction loans, as well as 1-4 family loans. Commercial loans grew \$9.9 million, or 8.3%, while leases grew \$1.5 million or 6.2%. Consumer loans grew \$848,000. The rate of growth in commercial real estate, construction and commercial loans has largely been the result of attracting new customers in the Banks' two principal markets. Existing borrowers are successfully managing their businesses through the slower economic conditions and using cash flow to pay down loan balances. The healthy cash flow of the underlying customer base that has resulted in such pay downs of loan balances has contributed to the improvement in nonperforming loans. Management expects that commercial real estate and commercial loan markets will experience loan growth in the high single digits in 2005 based on expectations of continued success in attracting new customers 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 from 2003 to 2004 represented a replacement of investment securities stemming from a drop in such securities from 2003 to 2002, due to prepayments during that period, as mortgage rates fell. 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. As mortgage-related security prepayments increased during the prior period, the amortization of the premiums associated with those securities was accelerated. This contributed to a decreased yield in mortgage-related securities in 2003 as compared to 2004.

Interest expense on interest-bearing liabilities decreased \$427,000 to \$11.3 million in fiscal 2004 from \$11.7 million in 2003 primarily due to a \$355,000 decrease in interest expense on deposits with the weighted average rate decreasing from 2.58% to 2.33%. The decrease in interest expense was largely due to repricing opportunities on deposits which were partially offset by an increase in average interest-bearing deposits of \$26.1 million or 6.8% from \$385.9 million in 2003 to \$412.0 million in 2004. This increase was largely a result of growth in average certificates of deposit of \$28.4 million from \$224.4 million in 2003 to \$252.8 million in 2004, primarily acquired through deposit brokers. The average balance of Federal Home Loan Bank (FHLB) advances, used as another source of funding, increased \$4.3 million from \$18.5 million in 2003 to \$22.8 million in 2004, or 23.1%, while the average cost of such advances of 3.13% in 2003 decreased to 1.91% 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 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. Such deposits provide flexibility as opposed to single service time deposit relationships discussed previously.

Provision for Loan and Lease Losses. The provision for loan and lease losses decreased \$740,000 from \$200,000 for fiscal 2003 to a negative provision of \$540,000 for the same period in 2004. The primary reason for the negative provision was a reduction in classified loan balances and a reduction in specific reserves for impaired and substandard loans and leases. This net reduction is a result of an improvement of \$829,000 in the values of collateral versus carrying value of a loan to an injection moldings manufacturer and two leases (one to a tool and die manufacturer and the other to a metal stamping manufacturer), partially offset by a \$165,000 increase in specific reserve on a commercial loan to a manufacturer of plastic injection moldings. Also contributing to the decrease in provision were net recoveries in 2004 of \$104,000 and a reduction in reserves allocated to impaired loans and leases. Contributing to the reduction in the allowance is management's regular review of the loan and lease loss methodology including incorporating 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. This change resulted in an overall reduction in the allowance for loan and lease reserve of \$295,000. Offsetting the factors mentioned above was the growth in the loan and lease portfolio required a provision for loan and lease losses of \$523,000.

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Non-Interest Income. Non-interest income, consisting primarily of deposit and loan related fees, fees earned for trust and investment services and interest rate swap changes in fair value and net cash settlements, decreased \$321,000, or 9.0%, to \$3.3 million for fiscal 2004 from \$3.6 million in the same period of 2003. The largest contributor to this decrease was a \$1.3 million decrease in income relating to the year-end valuation of the conversion options issued in 2000 to the minority shareholders of BBG. For further discussion of the written option, see **Note 3** to the Consolidated Financial Statements. Other contributing factors included an increase in the gain recognized for the change in fair value of interest rate swaps of \$691,000 partially offset by an increase in the net cash settlement expense of interest rate swaps of \$176,000. In addition to this, there was a \$31,000 decrease in service charges on deposits due to efforts to remain competitive in the current interest rate market. Offsetting these decreases was an increase of \$256,000 in trust fee income from FBB's trust services subsidiary due to successful efforts to increase assets under management. Money transferred in from new and existing customers as well as market appreciation contributed to the increase in assets. Sales activity and account retention were positive in 2004. Another source of increased income was an increase of \$169,000 in loan fees stemming from loan growth and loan prepayment premiums. Non-interest income also increased \$70,000 from 2003 to 2004 due to income from the increase in cash surrender value of bank owned life insurance. Equity in earnings of the Bank's 50% owned joint venture, m2, increased \$46,000. Credit, merchant and debit card fees increased \$8,000.

Non-Interest Expense. Non-interest expense increased \$1.7 million, or 15.0%, to \$13.1 million in fiscal 2004 from \$11.4 million in the same period for 2003. A significant portion of this increase was due to an increase of \$990,000 in employee salaries and benefits reflecting additions to staff combined with annual merit increases. Other expenses increased \$258,000 from \$1.2 million in 2003 to \$1.4 million in 2004 largely due to computer software expenses resulting from increased technology and information protection needs and also from increased recruitment expense as the organization met increased staffing needs. Professional and consulting fees increased \$190,000 associated with the Corporation's process to become a publicly registered company and other fees associated with additional consulting necessary due to regulatory changes such as Sarbanes-Oxley. Marketing increased \$105,000 as a result of loan, deposit, and general marketing campaigns. The remainder of the increase is attributable to increases in occupancy of \$102,000, equipment of \$79,000, and data processing of \$68,000. These increases were offset by a decrease in collection fees of \$73,000 associated with a return to a more acceptable level of delinquency and charge-off activity in the loan and lease portfolio. A discussion of previous levels of troubled loans and leases is under Non-interest expense in the comparison of results of operations from 2003 to 2002.

Minority Interest. The consolidated financial statements for the year ended December 31, 2004 included the accounts of FBFS, its wholly-owned subsidiaries and its 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 which was eliminated from the consolidated results of operations of FBFS. Net income for BBG for the first five months of 2004, until the minority interests were eliminated through the conversion option, was \$19,000, \$9,000 of which represents the minority interest in net income of the consolidated subsidiary. For the year ended December 31, 2003, BBG reported net income of \$1.1 million with minority interest of \$741,000 eliminated from the results of operations of FBFS.

Income Taxes. FBFS recorded income tax expense of \$3.3 million for the year ended 2004, an effective rate of 43.3%, as compared to \$873,000 for the same period in 2003, an effective rate of 13.4%. This represents an increase of \$2.4 million principally resulting from an increase in income before tax and a change in estimate for certain tax exposure items in 2004. The higher than expected effective rate in 2004 is a result of an accrual made in 2004 related to tax exposure items. The lower than expected rate in 2003 was attributable to the reversal in 2003 of a valuation allowance against net deferred tax assets established in 2002 for net operating losses at BBG. For a discussion of the tax exposure items, see **Income Taxes** under **Recent Developments** in this section and **Note 16** to the consolidated financial statements.

Comparison of Years Ended December 31, 2003 and 2002

General. Net income increased \$5.8 million to \$5.6 million in 2003 from a net loss of \$187,000 in 2002. The primary components of this increase were a \$3.4 million decrease in the provision for loan and lease losses which reflects the reduction in non-performing loans and the net loan recoveries in 2003, an increase of \$1.4 million in

written option income relating to the year-end revaluation of the written

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options issued in 2000 to the minority shareholders of BBG and a loss of \$2 million related to the change in the fair value of interest rate swaps during 2002 as compared to a gain of \$285,000 related to the change in the fair market value of interest rate swaps during 2003. These components that caused an increase in net income were partially offset by increases in non-interest expense of \$907,000, minority interest in net income of consolidated subsidiary of \$1.5 million and income tax expense of \$1.4 million. The returns on average assets and average stockholders' equity for fiscal 2003 were 1.14% and 24.%, respectively, as compared to (0.04)% and (0.87)%, respectively, for fiscal 2002.

Written Options. The written options sold by FBFS to the BBG minority shareholders enabled the shareholders to exchange their shares of BBG common stock for shares of FBFS common stock having an aggregate book value equal to the aggregate book value of the BBG shares exchanged (with certain immaterial adjustments). This conversion formula was agreed upon because there was not an established public market for either stock, nor was it expected that one would develop before the options were exercisable. To ensure fairness to existing shareholders of FBFS as well as BBG shareholders, the formula was designed to eliminate any potential dilution of book value per share for the FBFS shareholders, and to provide for a concise, understandable and verifiable exchange ratio based on audited financial results.

The issuance of the written options was recorded by FBFS as a liability at their fair value less the proceeds from issuance, as required by generally accepted accounting principles. FBFS engaged the services of Keefe, Bruyette & Woods (KBW) to assist in determining the fair value of the options upon issuance, and at the end of each subsequent financial period prior to the exercise of the options. KBW is recognized as one of the largest market makers in financial services stocks in the United States, and regularly provides evaluation and fairness opinions on transactions within the financial services industry. To determine the fair value of the written options, KBW used Merton's perpetual put option valuation formula, which is based on Black-Scholes option valuation models. The basic assumptions included: (1) the stock price of BBG, (2) the exercise price, which is defined as the projected conversion ratio times the FBFS stock price, (3) volatility, which is the calculated FBFS monthly annualized volatility for the respective time periods, (4) the risk-free interest rate, defined as the 10-year treasury rate at the respective valuation dates, and (5) the BBG dividend rate, which is 0.0%. There was no established market for either FBFS or BBG stock at any relevant time; however, both stocks were privately and sporadically traded from time to time, and such data as was obtainable about these arm's-length transactions was used by KBW in determining the first three assumptions above.

The effect of this dual-indexed exercise formula is that the monetary value of the options increased in relation to increases in the fair value, per share, of FBFS' common stock as compared to FBFS' book value per share, and decreased in relation to increases in the fair value, per share, of BBG's common stock as compared to BBG's book value per share. The effect of these variations was somewhat mitigated because as the owner of 51% of the outstanding BBG shares, FBFS recorded on its consolidated balance sheet at each balance sheet date just over one-half of the aggregate increase or decrease in BBG's book value.

For each fiscal period, FBFS was required by generally accepted accounting principles to recognize, as an element of income or loss, all decreases or increases, respectively, in the aggregate value of the outstanding written options during that period. For the year ended December 31, 2002, FBFS expensed \$39,000 due to an increase in the independently determined fair value of the options. For the year ended December 31, 2003, FBFS recognized \$1,361,000 of income due to a corresponding decrease in the value of the options. This change in the independently determined fair value during 2003 was primarily due to two factors: observed private transactions of BBG shares between unrelated parties reflected an increase in the premium of sale price to book value during 2003, whereas observed private transactions of FBFS shares between unrelated parties reflected a decrease in the premium of share price to book value during the same period.

Net Interest Income. Net interest income increased \$2.6 million, or 20.9%, to \$15.3 million in 2003 from \$12.7 million in 2002. The improvement in net interest income was due to a combination of an increase in the average balance of interest-earning assets accompanied by decreases in the interest paid on interest-bearing liabilities which outpaced decreases in interest earned on interest-earning assets. This was reflected in the increase in the interest rate spread from 2.47% in 2002 to 2.88% in 2003. Net interest margin, which is the excess of interest income over interest expense divided by average earning assets, increased from 2.94% in 2002 to 3.21% for 2003. This was primarily a result of a decrease in yields paid on interest-bearing liabilities surpassing a decrease in yields earned on

interest-earning assets.

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Interest income on total interest-earning assets decreased \$638,000 to \$27.0 million in 2003 from \$27.6 million in 2002. In particular, interest income on loans and leases decreased \$315,000 to \$25.2 million in 2003 from \$25.5 million in 2002 due to a decrease in average rates earned on loans and leases from 6.62% to 5.97% caused by a decline in market rates and offset by an increase in average loans and leases outstanding of \$34.8 million from ongoing originations.

Interest expense on interest-bearing liabilities decreased \$3.3 million to \$11.7 million in 2003 from \$15.0 million in 2002, as a result of a \$3.2 million decrease in interest expense on deposits with the weighted average rate decreasing from 3.80% to 2.58%. The decrease in interest expense was largely due to repricing opportunities on deposits which were partially offset by an increase in average interest-bearing deposits of \$38.1 million primarily acquired through deposit brokers.

Provision for Loan and Lease Losses. The provision for loan and lease losses decreased \$3.4 million, or 94.5%, to \$200,000 in 2003 from \$3.6 million in 2002. The primary reason for the decrease from 2002 was the reduction in non-performing loans; and net loan recoveries in 2003, whereas in 2002 there was a provision to cover probable credit losses relating to certain specifically impaired large loans. These charge-offs, net of recoveries in 2002, totaled \$3.3 million, whereas there were net recoveries in 2003 of \$736,000.

Non-Interest Income. Non-interest income, consisting primarily of deposit and loan related fees, fees earned for trust and investment services as well as interest rate swap changes in fair value and net cash settlements, increased \$3.6 million to \$3.6 million in 2003 from a negative \$40,000 in 2002. The increase in total non-interest income in 2003 was primarily due to a loss of \$2 million related to the change in the fair value of interest rate swaps during 2002 as compared to a gain of \$285,000 related to the change in the fair market value of interest rate swaps during 2003, an increase of written option income of \$1.4 million relating to the year-end revaluation of the written options issued in 2000 to the minority shareholders of BBG and an increase in fees earned in connection with trust and investment services of \$190,000.

Non-Interest Expense. Non-interest expense increased \$907,000, or 8.6%, to \$11.4 million in 2003 from \$10.5 million in 2002. A significant portion of this increase was due to a \$468,000 increase in employee salaries and benefits reflecting additions to staff combined with annual merit increases. The remainder of the increase is attributable to a combined increase of \$560,000 in occupancy, equipment, data processing, marketing and professional fees associated with unsuccessful negotiations to repurchase FBFS shares as well as preparations to become an SEC registered corporation. These increases were partially offset by a reduction of \$221,000 in collection fees on troubled loans. The troubled loans were largely composed of three commercial loans and one lease which were partially or completely charged-off in 2002. A partial charge-off of \$362,000 was made on a loan to a plastics manufacturer with a carrying value of \$723,000 as of December 31, 2003. The loan was restructured and classified as substandard and reported in non-accrual loans. A second loan to a commercial real estate general contractor for \$2.2 million was charged-off in 2002 but experienced \$706,000 in recoveries in 2003. The third loan for \$336,000 to a tool manufacturer was charged off in 2002 but experienced recoveries of \$300,000 in 2003. The lease to a specialty paper finisher was charged-off in the amount of \$480,000 in 2002.

Minority Interest. The consolidated financial statements for the year ended December 31, 2003 included the accounts of FBFS and its wholly-owned subsidiaries as well as its 51%-owned subsidiary BBG and BBG's wholly-owned subsidiary, FBB Milwaukee. Minority interest in net income of consolidated subsidiaries represents BBG's outside ownership interest of 49% which was eliminated from the consolidated results of operations of FBFS. Net income for BBG for the year ended December 31, 2003 was \$1.5 million, \$741,000 of which represents the minority interest in net income of the consolidated subsidiary. For the same period in 2002, BBG reported a net loss of \$1.6 million with minority interest of \$787,000 eliminated from the results of operations of FBFS. This change represents an increase of \$1.6 million in FBFS's portion of income from BBG from a loss of \$813,000 to net income of \$759,000 and the respective increase in minority interest income of \$1.5 million.

Income Taxes. FBFS reported income tax expense for the year ended December 31, 2003 of \$873,000 with an effective tax rate of 13.4% as compared to an income tax benefit of \$528,000 with an effective tax rate of 73.9% for the same period in 2002. The increase in income tax expense is the result of higher income before taxes. The reduction in the effective tax rate is due to the reversal in 2003 of a valuation allowance of \$1,206,000 against deferred income

tax assets established in 2002 at BBG. The

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losses giving rise to the net operating loss carry forward in 2002 were related primarily to significant losses on two loans. BBG had taxable income in 2003 and would have had earnings in 2002 were it not for the two significant loan losses discussed previously. Recovery of the related deferred tax asset is more likely than not considering these earnings, excluding the loan losses in 2002, and projecting the earnings over the net operating loss carry forward periods.

Net Interest Income Information

Average Interest-Earning Assets, Average Interest Bearing Liabilities, Interest Rate Spread, and Net Interest Margin. The following tables show the Corporation's average balances, average rates, the spread between combined average rates earned on the Corporation's interest-earning assets and interest-bearing liabilities and the net interest margin for both the three months ended March 31, 2005 and 2004 as well as the years ended December 31, 2004, 2003 and 2002.

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	Three Months Ended March 31,					
	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⁾	\$ 310,959	\$ 4,247	5.46%	\$ 291,114	\$ 3,705	5.09%
Commercial loans	136,543	2,604	7.63	120,466	1,896	6.30
Leases	25,035	335	5.36	23,579	364	6.17
Consumer loans	1,704	25	5.77	3,627	40	4.37
Total loans and leases receivable ⁽¹⁾	474,241	7,211	6.08	438,786	6,005	5.47
Mortgage-related securities ⁽²⁾	74,719	659	3.53	53,898	452	3.35
Investment securities ⁽²⁾	4,595	32	2.81	8,109	72	3.55
Federal Home Loan Bank stock	2,773	38	5.48	2,317	39	6.73
Fed funds sold and other	3,036	15	1.98	46	0	0.87
Interest bearing deposits	101	1	3.96	54	0	0.74
Total interest-earning assets	559,465	7,956	5.69	503,210	6,568	5.22
Non-interest-earning assets	24,556			14,079		
Total assets	\$ 584,021			\$ 517,289		
Interest-Bearing Liabilities						
NOW accounts	\$ 51,021	\$ 286	2.24	\$ 46,191	\$ 98	0.85
Money market	94,712	572	2.42	70,669	241	1.36
Certificates regular	271,690	2,153	3.17	240,139	1,656	2.76
Certificates large	40,580	255	2.51	42,398	192	1.81
Total deposits	458,003	3,266	2.85	399,397	2,187	2.19
Junior subordinated debentures	10,310	228	8.85			0.00
Guaranteed trust preferred securities			0.00	10,310	220	8.54
FHLB advances	16,026	91	2.28	20,720	118	2.28
Other borrowings	8,771	86	3.92	10,599	73	2.75
Total interest-bearing liabilities	493,110	3,672	2.98	441,026	2,598	2.36

Non-interest-bearing liabilities	52,312		44,915	
Total liabilities	545,422		485,941	
Minority interest in 51% owned subsidiary			4,368	
Stockholders' equity	38,599		26,980	
Total liabilities and Stockholders' equity	\$ 584,021		\$ 517,289	
Net interest income/interest rate spread	\$ 4,284	2.71%	\$ 3,970	2.86%
Net interest-earning assets	\$ 66,355		\$ 62,184	
Net interest margin		3.06%		3.16%
Ratio of average interest-earning assets to average interest-earning liabilities	1.13		1.14	
Return on average assets	1.04%		0.37%	
Return on average equity	15.80%		7.04%	
Average equity to average assets	6.61%		5.22%	
Non-interest expense to average assets	2.56%		2.75%	

(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.

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	Year Ended December 31,								
	2004			2003			2002		
	(as restated)			(as restated)			(as restated)		
	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
(Dollars in Thousands)									
Interest-Earning Assets									
Mortgage loans ⁽²⁾	\$ 296,078	\$ 15,890	5.37%	\$ 278,181	\$ 15,812	5.68%	\$ 241,868	\$ 15,473	6.40%
Commercial loans	129,164	8,346	6.46	119,301	7,719	6.47	121,997	8,308	6.81
Leases	25,030	1,481	5.92	23,577	1,588	6.74	21,516	1,643	7.64
Consumer loans	3,206	144	4.49	2,358	102	4.33	2,265	112	4.94
Total loans and leases receivable ⁽¹⁾	453,478	25,861	5.70	423,417	25,221	5.96	387,646	25,536	6.59
Mortgage-related securities ⁽²⁾	57,134	1,929	3.38	43,519	1,319	3.03	34,014	1,659	4.88
Investment securities ⁽²⁾	5,959	195	3.27	7,994	299	3.74	5,373	307	5.71
Federal Home Loan Bank stock	2,494	146	5.85	2,221	139	6.26	1,435	77	5.37
Fed funds sold and other	254	4	1.57	1,046	27	2.58	2,272	64	2.82
Interest bearing deposits	55	1	1.43	37	0	0.81	29	0	1.38
Total interest-earning assets	519,374	28,136	5.42	478,234	27,005	5.65	430,769	27,643	6.42
Non-interest-earning assets	17,844			15,753			14,368		
Total assets	\$ 537,218			\$ 493,987			\$ 445,137		
Interest-Bearing Liabilities									
NOW accounts	\$ 43,233	\$ 500	1.16	\$ 45,516	\$ 474	1.04	\$ 43,220	\$ 678	1.57
Money market	75,137	1,004	1.34	74,758	1,345	1.80	85,795	2,314	2.70
Certificates regular	252,780	7,329	2.90	224,381	7,250	3.23	180,812	8,891	4.92
Certificates large	40,827	782	1.92	41,267	900	2.18	37,965	1,322	3.48
Total deposits	411,977	9,615	2.33	385,922	9,969	2.58	347,792	13,205	3.80
Junior subordinated debentures	10,310	893	8.66						
Guaranteed trust preferred securities				10,000	883	8.83	10,000	899	8.99

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FHLB advances	22,807	436	1.91	18,529	580	3.13	17,210	752	4.37
Other borrowings	7,896	306	3.88	7,663	245	3.20	4,627	110	2.38
Total interest-bearing liabilities	452,990	11,250	2.48	422,114	11,677	2.77	379,629	14,966	3.94
Non-interest-bearing liabilities	51,613			44,699			41,044		
Total liabilities	504,603			466,813			420,673		
Minority interest in consolidated subsidiary	1,775			3,724			3,091		
Stockholders equity	30,840			23,450			21,373		
Total liabilities and Stockholders equity	\$ 537,218			\$ 493,987			\$ 445,137		
Net interest income/interest rate spread		\$ 16,886	2.93%		\$ 15,328	2.88%		\$ 12,677	2.47%
Net interest-earning assets	\$ 66,384			\$ 56,120			\$ 51,140		
Net interest margin			3.25%			3.21%			2.94%
Ratio of average interest-earning assets to average interest-earning liabilities	1.15			1.13			1.13		
Return on average assets	0.79%			1.14%			-0.04%		
Return on average equity	13.81%			24.09%			-0.87%		
Average equity to average assets	5.74%			4.75%			4.80%		
Non-interest expense to average assets	2.64%			2.48%			2.51%		

(1) The average balances of

loans and leases
include
non-performing
loans and leases,
interest of
which is
recognized on a
cash basis.

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

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The Corporation's net interest income between periods is derived from the interaction of changes in the volume of and rates earned or paid on interest-earning assets and interest-bearing liabilities. The dollar volume of loans, leases and investments compared to the dollar volume of deposits and borrowings, combined with the interest rate spread, produces the changes in net interest income between periods. The following tables show the relative contribution of the changes in average volume and average interest rates on changes in net interest income for both the three months ended March 31, 2005 and 2004 as well as the years ended December 31, 2004, 2003, and 2002. Information is provided with respect to (i) the effect on interest income attributable to changes in rate (changes in rate multiplied by prior volume), (ii) the effect on interest income attributable to changes in volume (changes in volume multiplied by prior rate) and (iii) the changes in rate/volume (changes in rate multiplied by changes in volume).

	Increase (Decrease) for the Three Months Ended March 31, 2005 Compared To 2004 (as restated)				2004 Compared To 2003 (as restated)			
	Rate	Volume	Rate/ Volume	Net (In Thousands)	Rate	Volume	Rate/ Volume	Net
Interest-Earning Assets								
Mortgage loans	\$271	\$253	\$ 18	\$ 542	\$(565)	\$465	\$(68)	\$(168)
Commercial loans	401	253	54	708	35	(63)	(1)	(29)
Leases	(48)	22	(3)	(29)	(51)			(51)
Consumer loans	13	(21)	(7)	(15)	(2)	9	(1)	6
Total loans receivable	637	507	62	1,206	(583)	411	(70)	(242)
Mortgage-related securities	23	175	9	207	(20)	127	(7)	100
Investment securities	(16)	(31)	7	(40)	(14)	31	(7)	10
Other investments	(8)	8	(1)	(1)	5	2		7
Fed funds sold		7	8	15	(1)	(5)	1	(5)
Interest bearing deposits			1	1				
Total net change in income on interest-earning assets	636	666	86	1,388	(613)	566	(83)	(130)
Interest-Bearing Liabilities								
NOW accounts	161	10	17	188	(26)	(4)	1	(29)
Money market	186	82	63	331	(55)	(36)	6	(85)
Certificates regular	247	218	32	497	(502)	334	(87)	(255)
Certificates large	74	(8)	(3)	63	(81)	9	(3)	(75)
Total deposits	668	302	109	1,079	(664)	303	(83)	(444)
Junior subordinated debentures/	1	7		8	(2)			(2)

Guaranteed trust preferred securities								
FHLB advances		(26)		(26)	(50)	33	(11)	(28)
Other borrowings	31	(13)	(5)	13	(5)	29	(3)	21
Total net change in expense on interest-bearing liabilities	700	270	104	1,074	(721)	365	(97)	(453)
Net change in net interest income	\$ (64)	\$396	\$ (18)	\$ 314	\$ 108	\$201	\$ 14	\$ 323

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	Increase (Decrease) for the Year Ended December 31, 2004 Compared To 2003 (as restated)				2003 Compared To 2002 (as restated)			
	Rate	Volume	Rate/ Volume	Net (In Thousands)	Rate	Volume	Rate/ Volume	Net
Interest-Earning Assets								
Mortgage loans	\$ (883)	\$ 1,027	\$ (57)	\$ 87	\$(1,725)	\$ 2,323	\$(259)	\$ 339
Commercial loans	(8)	627	(1)	618	(414)	(184)	9	(589)
Leases	(193)	98	(12)	(107)	(193)	157	(19)	(55)
Consumer loans	4	37	1	42	(14)	5	(1)	(10)
Total loans receivable	(1,080)	1,789	(69)	640	(2,346)	2,301	(270)	(315)
Mortgage-related securities	150	413	47	610	(628)	464	(176)	(340)
Investment securities	(37)	(76)	10	(103)	(106)	150	(52)	(8)
Other investments	(9)	17	(1)	7	13	42	7	62
Fed funds sold	(11)	(20)	8	(23)	(5)	(35)	3	(37)
Interest bearing deposits								
Total net change in income on interest-earning assets	(987)	2,123	(5)	1,131	(3,072)	2,922	(488)	(638)
Interest-Bearing Liabilities								
NOW accounts	52	(24)	(3)	26	(228)	36	(12)	(204)
Money market	(346)	7	(2)	(341)	(770)	(298)	99	(968)
Certificates regular	(744)	918	(94)	79	(3,049)	2,142	(735)	(1,642)
Certificates large	(110)	(10)	1	(118)	(494)	115	(43)	(422)
Total deposits	(1,148)	891	(98)	(354)	(4,541)	1,995	(691)	(3,236)
Junior subordinated debentures/ Guaranteed trust preferred securities	(16)	27	(1)	10	(16)			(16)
FHLB advances	(226)	134	(52)	(144)	(213)	58	(16)	(172)
Other borrowings	52	7	2	61	38	72	25	135
Total net change in expense on interest-bearing liabilities	(1,337)	1,059	(149)	(427)	(4,732)	2,125	(682)	(3,289)

Net change in net interest income	\$ 350	\$1,064	\$ 144	\$1,558	\$ 1,660	\$ 797	\$ 194	\$ 2,651
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Financial Condition

March 31, 2005

General. The total assets of FBFS increased \$34.7 million, or 6.2%, from \$563.0 million at December 31, 2004 to \$597.6 million at March 31, 2005. This increase was funded primarily by net increases in deposits of \$54.0 million. This growth is generally invested in loans and leases receivable.

Securities. Securities available-for-sale increased \$20.7 million from December 31, 2004 to March 31, 2005 as a net result of purchases of \$29.8 million net of maturities of \$9.1 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 \$14.7 million from \$469.9 million at December 31, 2004 to \$484.7 million at March 31, 2005. The activity in the loan and lease portfolio consisted of originations of \$58.3 million and purchases of \$5.1 million and offset by principal repayments of \$48.6 million and an increase in the allowance for loan and lease losses of \$69,000. Deferred loan fees declined from \$310,000 to \$273,000 from December 31, 2004 to March 31, 2005. 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 three months ended March 31, 2005 accompanied by increased payoff activity in the prior period as compared to the three months ended March 31, 2005. The increased payoff activity in the prior period resulted in accelerated deferred loan fee amortization for those loans that were paid off.

Non-performing Assets. Non-performing assets consists of non-accrual loans and leases of \$2.0 million as of March 31, 2005, or 0.34% of total assets, as compared to \$2.9 million, or 0.52% of total assets, as of December 31, 2004. This represents an decrease of \$880,000 in non-performing assets largely due to the cash sale of real estate owned of \$665,000. An immaterial gain was recognized on the sale of the property.

December 31, 2004

General. The total assets of FBFS increased \$44.5 million, or 8.0%, from \$518.5 million at December 31, 2003 to \$563.0 million at December 31, 2004. This increase was funded primarily by net increases in deposits of \$37.8 million. This growth is generally invested in loans and leases receivable.

Securities. Securities available-for-sale increased \$2.9 million from December 31, 2003 to December 31, 2004 as a net result of purchases of \$18.4 million and maturities of \$15.5 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 \$36.9 million from \$433.1 million at December 31, 2003 to \$470.0 million at December 31, 2004. The activity in the loan and lease portfolio consisted of originations of \$286.7 million, purchases of \$6.4 million and a reduction of the allowance for loan and lease losses of \$436,000 offset by sales of \$4.3 million and principal repayments of \$252.4 million.

Non-performing Assets. Non-performing assets consists of non-accrual loans and leases of \$2.3 million and foreclosed properties and repossessed assets of \$665,000 for a total of \$2.9 million as of December 31, 2004, or 0.52% of total assets, as compared to \$2.3 million, or 0.45% of total assets, as of December 31, 2003. This represents an increase of \$611,000 in non-performing assets largely due to the addition of a lease to a printer of \$1.1 million offset by a pay off of a lease to a specialty paper finisher and the pay down of a lease to a steel manufacturer. The lease to the printer is current as to all contractual payments. It is anticipated that the lessee, of the aforementioned newly added non-performing lease, will close production and successfully liquidate assets by mid 2005 and that all creditors will be made substantially whole. As of December 31, 2004, the Corporation does not anticipate any loss from this borrower.

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	At March 31, 2005	2004	2003	At December 31, 2002	2001	2000
				(Dollars in Thousands)		
Non-accrual loans	\$ 687	\$ 696	\$ 891	\$ 3,049	\$ 1,440	\$ 4
Non-accrual leases	1,360	1,566	717			
Total non-accrual loans and leases	2,047	2,262	1,608	3,049	1,440	4
Foreclosed properties and repossessed assets, net		665	708			
Total non-performing assets	\$ 2,047	\$ 2,927	\$ 2,316	\$ 3,049	\$ 1,440	\$ 4
Performing troubled debt restructurings	\$	\$	\$	\$	\$	\$
Total non-accrual loans and leases to total loans and leases	0.42%	0.47%	0.37%	0.73%	0.40%	0.00%
Total non-performing assets to total assets	0.34	0.52	0.45	0.64	0.35	0.00
Allowance for loan and lease losses to total loans and leases	1.31	1.34	1.55	1.42	1.55	1.51
Allowance for loan and lease losses to non-accrual loans and leases	314.79	281.83	423.57	192.69	383.54	93,575.00

As a matter of policy, the Corporation does not accrue income on loans or leases past due more than 90 days.

Allowance for Loan and Lease Losses. Management regularly reviews and revises its methodology to provide greater precision in its assessment of risks in the loan and lease portfolio and related evaluation of adequate allowance for loan and lease losses by incorporating historical charge-off migration analysis and an analysis of the current level and trend of factors felt indicative of loan and lease quality. The historical charge-off migration analysis utilizes the most recent five years of net charge-offs and traces the migration of the risk rating from origination through charge-off. The historical percentage of the amounts charged-off for each risk rating, for each subsidiary is averaged for the five year period giving greater weight in the calculation to the recent years. These percentages are then applied to the current loan and lease portfolio for this portion of the Allowance for Loan and Lease Losses. The other factors consider the risks inherent in the mix of the portfolio reflective of the weighting toward commercial and commercial real estate lending. The loan and lease portfolio is examined for any material concentrations and additional reserves have been established in an amount that, based on the experience of senior management, is adequate to cover concentration risk. These reserves are increased on a pro rata basis as the loan and lease portfolio grows. As a result of this review process, the improved historical trends in non-performing loans and charge-offs, and the improvement in

collateral value of three substandard loans and leases, the provision decreased \$740,000 from \$200,000 in 2003 to a negative \$540,000 in 2004 and resulted in the allowance for loan and lease losses as a percent of total loans to decrease from 1.55% to 1.34%. The relative improvement in the collateral value versus the carrying value was primarily due to updated appraisals from vendors that have experience in valuing the type of collateral combined with the continuation of payments which further reduced the carrying value of the loan and leases. As of March 31, 2005, the allowance for loan and lease losses has increased \$69,000 due to increased loan volume and classified assets offset by a decrease in non-accrual loans and leases. The evaluation process focuses on several factors including, but not limited to, management's ongoing review and risk rating of the portfolio, with particular attention paid to loans and leases identified by management as impaired and to potential impaired loans and leases based upon historical trends and ratios, the fair value of the underlying collateral, historical losses, changes in the size of the portfolio, trends in the level of delinquencies, concentrations of loans and leases to specific borrowers or industries and other factors which could affect potential credit losses.

To determine the level and composition of the allowance for loan and lease losses the portfolio is broken out by categories and risk ratings. Impaired loans and leases and potential impaired loans and leases are evaluated for a specific reserve based upon the estimated value of the underlying collateral for collateral-dependent loans, or alternatively, the present value of expected cash flows. Historical trends of

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the identified factors are applied to each category of loans that have not been specifically evaluated for the purpose of establishing the general reserve.

The Corporation reviews its methodology and periodically adjusts its allocation percentages based upon historical results. Within the specific categories certain loans or leases have been identified for specific reserve allocations as well as the whole category of that loan type or lease being reviewed for a general reserve based on the foregoing analysis of trends and overall balance growth within that category.

Foreclosed properties are recorded at the lower of cost or fair value. If, at the time of foreclosure, the fair value less cost to sell is lower than the carrying value of the loan, the difference, if any is charged to the allowance for loan losses prior to transfer to foreclosed property. The fair value is primarily based on appraisals, discounted cash flow analysis (the majority of which is based on current occupancy and lease rates) and verifiable offers to purchase. After foreclosure, valuation allowances or future write-downs to fair value less costs to sell are charged directly to expense.

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

	Three Months Ended March 31, 2005	2004	Year Ended December 31,			
			2003	2002	2001	2000
			(Dollars in Thousands)			
Allowance at beginning of year	\$ 6,375	\$ 6,811	\$ 5,875	\$ 5,523	\$ 3,743	\$ 3,092
Charge-offs:						
Mortgage					(48)	(82)
Commercial		(25)	(37)	(2,876)	(128)	
Lease				(480)		
Consumer		(6)		(2)		
Total charge-offs		(31)	(37)	(3,358)	(176)	(82)
Recoveries:						
Mortgage	1	9		96		
Commercial	3	4	773		16	
Lease		122				
Consumer						
Total recoveries	4	135	773	96	16	
Net recoveries (charge-offs)	4	104	736	(3,262)	(160)	(82)
Provision	65	(540)	200	3,614	1,940	733
Allowance at end of year	\$ 6,444	\$ 6,375	\$ 6,811	\$ 5,875	\$ 5,523	\$ 3,743
Net charge-offs to average loans	0.00%	0.02%	0.17%	(0.84)%	(0.05)%	(0.04)%

The Corporation's non-performing assets have historically fluctuated with both local and national trends. At March 31, 2005, the Banks had a total of \$6.3 million in classified assets as compared to \$5.5 million at December 31, 2004. This increase is primarily attributable to the addition of a commercial loan to a construction company with a net

carrying value of \$1.5 million which was classified substandard due to deterioration in the borrower's financial condition. This fluctuation in classified assets reflects current economic conditions and management believes the present level of the allowance for loan and lease losses to be prudent. Included in classified assets are non-performing loans and leases of \$2.0 million and \$2.3 million at March 31, 2005 and a foreclosed property with a net carrying value of \$665,000 at December 31, 2004. There is one lease on non-accrual with a net carrying value of greater than \$1.0 million. This \$1.1 million lease is secured by printing equipment. The lease is current as to all payments and has been placed on non-accrual because the lessee has informed FBFS that it expects to terminate the lease and sell the equipment. FBFS expects no loss on the lease termination. The above commercial loan to a construction company was the only loan classified as substandard as of March 31, 2005 with a net carrying value greater than \$1.0 million.

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Loan charge-offs were \$0 and \$31,000 for the three months ended March 31, 2005 and for the year ended December 31, 2004, respectively. Recoveries for the three months ended March 31, 2005 were \$4,000 and were \$135,000 for the year ended December 31, 2004.

The table below shows the Corporation's allocation of the allowance for loan and lease losses by loan and lease loss reserve category at the dates indicated.

	March 31, 2005		2004		2003		December 31, 2002		2001		2000	
	Percent of		Percent of		Percent of		Percent of		Percent of		Percent of	
	Allowance for Loan and Lease Losses	Allowance to Total Allowance	Allowance for Loan and Lease Losses	Allowance to Total Allowance	Allowance for Loan and Lease Losses	Allowance to Total Allowance	Allowance for Loan and Lease Losses	Allowance to Total Allowance	Allowance for Loan and Lease Losses	Allowance to Total Allowance	Allowance for Loan and Lease Losses	Allowance to Total Allowance
(Dollars in Thousands)												
Commercial												
real estate	\$2,957	45.89%	\$2,787	43.72%	\$1,709	25.09%	\$1,151	19.59%	\$1,216	22.02%	\$ 944	25.22%
Construction	480	0.07	461	7.23	314	4.61	189	3.22	159	2.88	228	6.09
Multi-family	244	0.04	187	2.93	135	1.98	134	2.28	62	1.12	131	3.50
1-4 family	295	0.05	311	4.88	166	2.44	71	1.21	69	1.25	169	4.52
Commercial	1,889	0.29	2,061	32.33	2,662	39.08	3,401	57.89	2,647	47.93	1,510	40.34
Lease												
receivables	444	0.07	445	6.98	887	13.02	281	4.78	392	7.10	277	7.40
Consumer												
and other	135	0.02	123	1.93	193	2.83	122	2.08	64	1.16	435	11.62
Unallocated		0.00		0.00	745	10.94	526	8.95	914	16.55	49	1.31
Total	\$6,444	100.00%	\$6,375	100.00%	\$6,811	100.00%	\$5,875	100.00%	\$5,523	100.00%	\$3,743	100.00%

Although management believes the allowance for loan and lease losses is adequate based on the current level of loan delinquencies, non-performing assets, trends in charge-offs, economic conditions and other factors as of March 31, 2005, there can be no assurance that future adjustments to the allowance will not be necessary. Management adheres to high underwriting standards in order to maintain strong asset quality and continues to pursue practical and legal methods of collection, repossession and disposal of any such troubled assets.

Deposits. As of March 31, 2005, deposits increased \$54.0 million to \$528.7 million from \$474.7 million at December 31, 2004. The increase during the three months ended March 31, 2004 was largely attributable to an increase in certificates of deposit of \$7.9 million accompanied by an increase of \$21.8 million in money market accounts and an increase of \$24.4 million in transaction accounts, respectively. The weighted average cost of deposits increased to 2.85% at March 31, 2005 from 2.33% at December 31, 2004.

Borrowings. The Corporation had borrowings of \$19.0 million as of March 31, 2005, largely consisting of FHLB advances of \$2.1 million which had a weighted average rate of 2.28%. Fed funds purchased and securities sold under agreement to repurchase totaled \$632,000 and had a weighted average rate of 2.03%. The Corporation also had a \$1.0 million line of credit with a weighted average rate of 4.38%, a \$5.0 million subordinated note payable which carried a weighted average rate of 4.96% and junior subordinated debentures of \$10.3 million with a weighted average rate of 8.85%. Borrowings decreased \$21.3 million during the three months ended March 31, 2005 largely due to the maturity of FHLB advances offset by 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 March 31, 2005, stockholders' equity was \$39.0 million or 6.5% of total assets. Stockholders' equity increased \$890,000 during the three months ended March 31, 2005 primarily as a result of comprehensive income of \$831,000, which includes net income of \$1.5 million partially offset by an increase in accumulated other comprehensive loss of \$694,000. Stock options

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exercised totaled \$62,000. As of December 31, 2004, stockholders' equity totaled \$38.1 million or 6.8% of total assets.

Liquidity and Capital Resources

During the three months ended March 31, 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 March 31, 2005 are the repayment of a short-term borrowing of \$1.0 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. See **Note 13** in Notes to Consolidated Financial Statements for the Corporation's comparative capital ratios and the capital ratios of its Banks.

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 \$246.7 million of deposits as of March 31, 2005. 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 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 customer relationships are established and as existing customers 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 regulators to maintain levels of liquid investments in qualified U.S. Government and agency securities and other investments which are sufficient to ensure the safety and soundness of operations. The regulatory requirements for liquidity are discussed in **Item 1** under **Regulation**.

During the three months ended March 31, 2005, operating activities resulted in a net cash inflow of \$1.2 million. Operating cash flows for the three months ending March 31, 2005 included earnings of \$1.6 million. Net cash provided from financing activities of \$32.8 million, which included an increase in deposits of \$54.0 million, was offset by net cash outflows of \$36.8 million in loan origination and investment activities. During the year ended December 31, 2004, operating activities resulted in a net cash inflow of \$4.3 million. Operating cash flows for the fiscal year included earnings of \$3.9 million. Net cash provided from financing activities of \$36.7 million, which included an increase in deposits of \$37.8 million, was offset by net cash outflows of \$44.8 million in loan origination and investment activities.

Table of Contents**Off-balance Sheet Arrangements**

As of March 31, 2005 the Corporation had outstanding commitments to originate \$154.6 million of loans and commitments to extend funds to or on behalf of customers pursuant to standby letters of credit of \$13.2 million. Commitments to extend funds typically have a term of less than one year; however the Banks have \$50.7 million of commitments which extend beyond one year. See **Note 13** to the Consolidated Financial Statements. 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 2b** and **Note 15** to the Consolidated Financial Statements. Management believes adequate capital and liquidity are available from various sources to fund projected commitments.

Contractual Obligations

The following table summarizes the Corporation's contractual cash obligations and other commitments at March 31, 2005 and December 31, 2004, respectively.

Contractual Obligations	Total	Payment Due by Period			More than 5 Years
		Less than	1-3	4-5	
		1 Year	Years	Years	
		(Dollars in Thousands)			
Operating lease obligations	\$ 5,632	\$ 551	\$ 1,094	\$ 1,094	\$ 2,892
Securities repurchase agreements	632	632			
Time deposits	315,375	195,959	76,383	32,703	10,330
Subordinated debt	5,000				5,000
Junior subordinated debentures	10,310				10,310
FHLB advances	2,051	506	1,029	11	505
Other long-term liabilities					
Total contractual obligations	\$ 339,000	\$ 197,648	\$ 78,506	\$ 33,808	\$ 29,037

Contractual Obligations	Total	Payment Due by Period			More than 5 Years
		Less than	1-3	4-5	
		1 Year	Years	Years	
		(Dollars in Thousands)			
Operating lease obligations	\$ 5,768	\$ 569	\$ 1,122	\$ 1,122	\$ 2,955
Securities repurchase agreements	678	678			
Time deposits	307,501	201,734	72,921	1,970	30,876
Subordinated debt	5,000				5,000
Junior subordinated debentures	10,310				10,310
FHLB advances	23,803	22,259	19	1,021	504
Other long-term liabilities					
Total contractual obligations	\$ 353,060	\$ 225,240	\$ 74,062	\$ 4,113	\$ 49,645

Table of Contents**Item 2a. Quantitative and Qualitative Disclosures About Market Risk**

Interest rate risk, or market risk, arises from exposure of the Corporation's financial position to changes in interest rates. It is the Corporation's strategy to reduce the impact of interest rate risk on 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 following table illustrates the potential impact of changing rates on the Corporation's net interest margin for the next twelve months, as of March 31, 2005.

	Change in interest rates in basis points (as restated)			
	-100	0	+100	+200
Impact on net interest income	1.07%		-1.11%	-2.22%

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 following table illustrates the Corporation's static gap position as of March 31, 2005, which is well within policy parameters.

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	Estimated maturity or repricing at March 31, 2005 (as restated)				
	Within 3 months	3 - 12 months	1 - 5 years	After 5 years	Total
	(In Thousands)				
Assets:					
Investment securities	\$ 6,562	\$ 10,772	\$ 61,074	\$ 9,951	\$ 88,360
Commercial loans	65,949	7,430	17,707	3,077	94,163
Real estate loans	156,145	27,689	122,199	23,931	329,963
Asset based loans	41,510				41,510
Lease receivables	1,760	5,144	15,326	1,738	23,968
Consumer loans	1,209	182	126		1,518
Total Earning Assets	\$ 273,135	\$ 51,218	\$ 216,433	\$ 38,697	\$ 579,482
Liabilities:					
Interest-bearing checking	\$ 54,606	\$	\$	\$	\$ 54,606
Money market accounts	110,734				110,734
Time deposits under \$100,000	67,567	85,135	102,938	10,300	265,940
Time deposits \$100,000 and over	18,089	29,200	2,146		49,435
Securities sold under agreements to repurchase	632				632
Federal Home Loan Bank advances	502	7	1,041	502	2,051
Short term borrowings	1,000				1,000
Long term debt	15,310				15,310
Interest rate swaps	(874)	128	746	0	
Total Interest-bearing Liabilities	\$ 267,566	\$ 114,470	\$ 106,870	\$ 10,802	\$ 499,708
Interest rate gap	\$ 5,569	\$ (63,252)	\$ 109,562	\$ 27,895	\$ 79,774
Cummulative interest rate gap	\$ 5,569	\$ (57,683)	\$ 51,879	\$ 79,774	
Cummulative interest rate gap to total earning assets	0.96%	(9.95)%	8.95%	13.77%	

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	Estimated maturity or repricing at December 31, 2004 (as restated)				
	Within 3 months	3 - 12 months	1 - 5 years	After 5 years	Total
	(In Thousands)				
Assets:					
Investment securities	\$ 5,442	\$ 8,768	\$ 48,987	\$ 3,249	\$ 66,445
Commercial loans	75,551	7,528	18,686	554	102,320
Real estate loans	149,628	32,256	105,773	16,158	303,815
Asset based loans	43,441				43,441
Lease receivables	1,575	4,725	19,283		25,583
Consumer loans	1,089	185	191		1,464
 Total Earning Assets	 \$ 276,726	 \$ 53,462	 \$ 192,919	 \$ 19,961	 \$ 543,068
 Liabilities:					
Interest-bearing checking	\$ 38,017	\$	\$	\$	\$ 38,017
Money market accounts	88,324				88,324
Time deposits under \$100,000	64,092	103,932	71,620	30,876	270,520
Time deposits \$100,000 and over	16,513	17,231	3,237		36,981
Securities sold under agreements to repurchase	678				678
Federal Home Loan Bank advances	11,001	507	1,040	505	13,053
Short term borrowings	10,750				10,750
Long term debt	15,310				15,310
Interest rate swaps	(917)	128	789	0	
 Total Interest-bearing Liabilities	 \$ 243,769	 \$ 121,798	 \$ 76,685	 \$ 31,381	 \$ 473,633
 Interest rate gap	 \$ 32,957	 \$ (68,336)	 \$ 116,234	 \$ (11,419)	 \$ 69,436
 Cumulative interest rate gap	 \$ 32,957	 \$ (35,379)	 \$ 80,855	 \$ 69,436	
 Cumulative interest rate gap to total earning assets	 6.07%	 (6.51)%	 14.89%	 12.79%	

Item 3. Properties

At March 31, 2005, the Banks conducted business from two offices located in Madison, Wisconsin at 401 Charmany Drive and in Brookfield, Wisconsin located at 18500 W. Corporate Drive. The Banks lease their full-service offices and these leases expire in 2016 and 2010, respectively. The Bank's two satellite offices in Chicago, Illinois and Mason, Ohio are leased under short-term lease agreements which have terms of less than one year. See **Note 9** to the Consolidated Financial Statements for more information regarding the premises and equipment.

Table of Contents**Item 4. Security Ownership of Certain Beneficial Owners and Management**

Beneficial Owners. As of March 31, 2005 First Business Financial Services, Inc. had 2,412,464 shares of Common Stock outstanding. The following table sets forth, as of July 21, 2005, the beneficial ownership of Common Stock by all persons and groups who are known by the Corporation to be the beneficial owners of more than five percent (5%) of the Common Stock. Other than as noted below, management knows of no person or group that beneficially owns more than five percent (5%) of the outstanding shares of Common Stock.

Name and Address of Beneficial Owner	Number of Shares Beneficially Owned	Percent of Common Stock Outstanding
Sam J. Jacobsen 3541 Bishops Way Middleton, WI 53562-2388	321,536	13.31%

Management. The following table sets forth, as of July 21, 2005, the number of shares of Common Stock beneficially owned by directors and executive officers of the Corporation.

Name of Beneficial Owner	Common Stock	Exercisable Stock Options	Percent of Total Common Stock
	Beneficially Owned Excluding Options		Beneficially Owned