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First Business Financial Services, Inc.

Earnings Conference Call - Second Quarter 2025

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CORPORATE SPEAKERS:

Corey Chambas
First Business Financial Services, Inc.; Chief Executive Officer
David Seiler
First Business Financial Services, Inc.; President and Chief Operating Officer
Brian Spielmann
First Business Financial Services, Inc.; Chief Financial Officer

PARTICIPANTS:

Jeff Rulis
D.A. Davidson; Analyst
Daniel Tamayo
Raymond James; Analyst
Damon Del Monte
KBW; Analyst
Nathan Race
Piper Sandler; Analyst
Brian Martin
Janney; Analyst

PRESENTATION:

Operator^ Good afternoon. Welcome to the First Business Bank Earnings Conference Call second quarter 2025. (Operator Instructions) Please note that this event is being recorded. I would now like to turn the conference over to First Business Financial Services Inc CEO, Corey Chambas. Please go ahead.

Corey Chambas^ Good afternoon, everyone.
Thank you for joining
us.
We appreciate your time and your interest in First Business Bank. Joining me today is our President and Chief Operating Officer, Dave Seiler, and our CFO, Brian Spielmann. Today we'll discuss our financial performance, followed by a Q&A session.

First Business Financial Services, Inc.

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I'd like to direct you to our second quarter earnings release and supplemental earnings call slides which are available through our website at ir.firstbusiness.bank.
We
encourage you to review these along with our other investor materials.

Before we begin, please note, this call may include forward-looking statements and the company's actual results may differ materially from those indicated in any forward-looking statements.

Important factors that could cause actual results to differ materially from those indicated in the forward-looking statements are listed in the earnings release and the company's most recent annual report Form 10-K and as may be supplemented from time to time in the company's other filings with the SEC, all of which are expressly incorporated herein by reference.

There you can also find information related to any non-GAAP financial measures we discuss on today's call including reconciliations of such measures.
We
are pleased to report another outstanding quarter.

As you know we work to achieve a five-year strategic plan that is built to drive double-digit growth on an annual basis. Results for our second quarter and first half of 2025 show that strategic plan at work.

During the quarter, our team again produced double-digit core deposit growth that outpaced our robust expansion of loans.

We also maintained a strong net interest margin and saw a decline in net charge-offs. Private Wealth assets expanded significantly and fees grew.
Operating
revenue was solid even with some expected variability in our fee income sources, showing the value of our revenue diversification strategy.

This drove pretax pre-provision adjusted earnings up 13% over last year's second quarter and EPS up 10%. ROA matched the linked quarter and year ago quarters, showing great consistency. Most importantly, tangible book value growth is a significant driver of stock valuation gains, and we grew tangible book value per share an impressive 14% from a year ago.

Before I hand it over to Dave, I want to acknowledge our recent announcement of my planned retirement and Dave's succession to CEO, effective next May 2026. You are all very familiar with Dave and we're grateful for his outstanding leadership and his commitment to the future of First Business Bank. Dave?

First Business Financial Services, Inc.

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David Seiler^ Thank you, Corey. Balance sheet growth was a clear highlight again this quarter. You can see the quarterly highlights on Slide Three of the earnings call slides.

We continue to see exceptional growth with core deposits increasing $70 million or 11% annualized from the first quarter and up 10% from last year's second quarter. Another indicator of our great success in core deposit gathering is service charges on deposits, which grew 16% from last year's second quarter.

I'll note that our growth trajectory has been outstanding, but as a business-only bank with larger average client balances, normal daily balance fluctuations can make a significant difference to period-end growth rates.

We prioritize developing long-term relationships and that requires a long sales cycle.

So, we intend to evaluate our success over a rolling four-quarter view rather than period-to-period.

Loan balances grew about $267 million over the same period last year. That's up about 9%. You can see our quarterly deposit and loan growth trends on Slide Four.
We
 continue to see solid demand for our conventional and niche C&I products. Total C&I balances expanded $30 million or 10%, annualized.

This included growth within asset-based lending up $13 million, floor plan financing, up $10 million and equipment finance, up $7 million. Activity levels in our asset-based lending group continue to exceed what we've seen in the last two years.

We attribute this to current market dynamics and our new leader in asset-based lending, who is off to a great start.
We are positioned to capture growth opportunities in this
space.
Our
 Floorplan Financing team also continues to see nice demand and extremely high client satisfaction results, which has led to a significant number of referrals.

On revenue, I'll cover a few areas quickly. Private Wealth is a true highlight for us. The consistency of its revenue generation, relationship development and capital efficiency are extremely valuable to our company.

Private Wealth assets under management grew an incredible 36% annualized during the quarter and were up 15% from a year ago. Approximately 63% of our growth in assets under management during the past 12 months was from transfers from our new and existing clients.

Obviously there is a market component to this business that can drive variability, but as a revenue annuity stream, it is exceptional and growing.

We also saw a decrease in SBA loan sale premiums and fee income. Like several of our fee income items, individual contribution levels can vary quarter-to-quarter. This quarter, the timing of closings and loans fully funding was a factor.

Additionally, we've closed a higher proportion of SBA construction loans which has lengthened our overall timeline between loan closing and loan sales. Pricing is extremely competitive right now but we have a very strong team in place, and we continue to win deals.

On to asset quality.
We are very pleased with our low level of net charge-offs during the quarter, particularly the fact that they came from the Transportation and Logistics segment of our small ticket equipment finance portfolio, which was anticipated
 and is running off. The $4.6 million increase in NPAs was due to a single credit in the Transportation and Logistics sector of the conventional C&I portfolio.

In total, our exposure to this industry at June 30th was $75 million, $44 million in the conventional portfolio, and $31 million in the small ticket equipment finance portfolio. It is important to note that our exposure to this industry in the conventional portfolio is well collateralized.

As a reminder, we are no longer lending to the Transportation and Logistics industry in our small ticket equipment finance business. This gives us confidence that our overall loss risk is relatively low.

We continue to be pleased that our overall portfolio is performing as expected, and we have no areas of particular concern. Now I'll hand it off to Brian.

Brian Spielmann^ Thanks, Dave. The second quarter margin of 3.67% reflects our continued strong balance sheet management. You can see a breakdown of this on Slide Six of our earnings supplement.

Our margin includes fees in lieu of interest, which refers to the recurring, variable amount of interest income we earned from items like prepayment fees and asset-based loan fees. These declined by $379,000 from Q1.

This contributed 18 basis points to reported margin in Q2 compared to 23 basis points in Q1 and 27 basis points in Q4 of ‘24. Excluding these and other variable items, our adjusted net interest margin rose 1 basis point to 3.47% for the quarter compared to both linked and prior year quarters.

We’re very pleased with our ability to maintain a strong and stable margin in this environment. In the last month of the quarter, we added multiple meaningful new deposit relationships, which enabled us to let some wholesale funding mature without the need to replace it.

A few additional notes on fee income.

In the other line, we saw a decrease of $369,000 in SBIC fee income in Q2. We expect this fee income should improve in the second half of the year as existing funds mature, though variability is always expected.

We also expect to invest in additional SBIC funds going forward as a long-term revenue catalyst and effective use of capital. The same is true for BOLI, which has favorable taxable equivalent yields and tax implications.

One administrative item as a reminder: last quarter, we reclassified certain types of C&I loan fees from noninterest income to fees in lieu of interest in our net interest income line.

For the second quarter, this reclassification was approximately $567,000 and it was $500,000 in Q1. This affects year-over-year comparisons for net interest income and fee income, but has no impact to total revenue.

Quarterly variability in specific line items reinforces the value of the fee income diversification we’ve worked hard to produce.
We
continue to expect total fee income to grow in our long-term target rate of 10% annually going forward.

Our expenses were well contained in Q2. I’ll reiterate that when we think about expenses, our primary objective is achieving annual positive operating leverage. That is, annual expense growth at some level below our targeted level of 10% annual revenue growth.

On taxes, our year-to-date effective tax rate of 15.8% is right around the lower end of our expected range of 16% to 18%.
We continue to believe this range is appropriate
.

Finally, our strong earnings are generating more than enough capital to facilitate our expected organic growth and we continue to feel good about our capital levels. And now I'll hand it back over to Corey.

Corey Chambas^ Thank you, Brian. We're very pleased to report this strong quarter, but I hope we've continued to make it clear that we take a longer view.

So it's helpful to draw your attention to our year-to-date performance, which is outstanding. Compared to the same period of 2024, in the first six months of 2025 we've delivered 10% growth in operating revenue, 18% growth in pretax pre-provision earnings, 17% growth in net income, and 14% growth in tangible book value.

We're very optimistic about 2025 and beyond and we believe our focus on strategic initiatives will continue to serve us well into the future. I want to thank you for taking time to join us today. We're happy to take your questions now.

Operator^ (Operator Instructions) Your first question comes from the line of Jeffrey Rulis from D.A. Davidson.

Jeff Rulis^ I wanted to check in on the loan growth side. It sounds like you -- some constructive comments, there's some optimism and I guess the goal of 10%, and I appreciate Corey, you look from a longer-term basis.

But I guess as we look for the year, going to be kind of a stretch to get 10%?
Or
is there some seasonality or some tailwinds that second half might kick in a little stronger?

Brian Spielmann^ Yes. I would say we're not far away Jeff. We're running in the 8s.

So we do some larger deals, and it can move around quarter-to-quarter.

So we're still feeling like that's well in sight, not really a seasonal thing. Dave?

David Seiler^ Brian, I'd just add to the last four quarters, we've been at about 8.9%. Again that's a deal or two away from 10%.
We've
had pretty broad-based growth in our conventional markets.

We've seen growth particularly in our Southeast, which is our Milwaukee market, and Northeast market.
Then we've seen some nice growth in some of our specialty
areas.

So there’s nothing we are seeing in our pipelines right now that would have us back off of that.

Jeff Rulis^ Okay. I may have worded that poorly. I guess just kind of you put up decent growth given a year-to-date disruption macro-wise, I guess trying to look for -- of late, are you getting indications of increased comfortability from your business borrowers further away from tariff noise?

And is there some I guess some more wind at the back type of -- is kind of what I’m getting at, does second half shape up any greater?
Or
 is it pretty steady state?

Corey Chambas^ I think it’s a pretty steady state, Jeff. The disruptions and on again off again things that have gone on have caused folks to be concerned, cautious maybe a little bit.
I
 think things have calmed some and economies continue to move forward in a strong way.

So I think some of that uncertainty hesitation is dying down a bit.

So our borrowers are really not showing us any indication that they’re going to do anything different than business as usual.

Jeff Rulis^ Got you. And my other question, I just wanted to hop on the funding side and more deposits. The last few times we’ve chatted deposit competition has heated up, and we’ve seen a little pickup in the deposit costs.

Does that give you any pause or any threat to that kind of terminal net interest margin in the 3.60% to 3.65%?
Do you feel like that’s shaking out where deposit pricing is becoming more challenging and as a threat to that
level?
Or
 I guess expectations about deposit costs and margins combined.

Brian Spielmann^ Yes.
On the deposit cost front, it’s not always -- it’s been a challenge of label. We’ve
 always paid at the top tier of the market to be competitive and build relationships.

And so we’re just seeing that higher rates sticking for longer now.

So while we're going to pay that rate, we don't think it has negative implications on our go-forward look under interest margin for that 3.60% to 3.65% long-term target.

Operator^ Your next question comes from the line of Daniel Tamayo from Raymond James.

Daniel Tamayo^ Thanks.

So I guess -- yes. Just first on the -- I appreciate all the color on the increase in the NPAs on the specific transportation C&I loan that you had. Just to be clear, that was the full amount of the increase in NPAs.

I don't know if you guys gave the amount of that loan?
I
know you gave the buckets, which I appreciate on the C&I and the small ticket side, but the specific loan that caused the increase in the NPAs, what was the amount of that?

Brian Spielmann^ About $6 million, net increase (Multiple Speakers) $6 million.

Daniel Tamayo^ Got it.
What's
the -- where does that loan stand now as it relates to reserves versus kind of the total loan?

Brian Spielmann^ Well it's -- we went through an impairment analysis and it's specifically reserved for.

So we think to the point that it's at right now it's fully collateralized.

Daniel Tamayo^ All right. Helpful I got and then just a follow-up, but unrelated on the SBA loan sale gains you talked about some of that in the prepared remarks.

But just curious, given the increase in competition in the area, if you have any -- I can't remember if you gave any specific guidance on where you think that line shakes out. I know it's volatile on a quarterly basis, but maybe on an annual basis, where you think that may shake out for the year?

Corey Chambas^ So yes, I mean as we've talked over the past few quarters, it does bounce around a little bit. I think Q1 was a little higher than we were expecting originally. Q2 is down, and we expect it to kind of bounce back closer to Q1, I think for the remainder of the year.

Operator^ Your next question comes from the line of Damon DelMonte from KBW.

Damon Del Monte^ Just to circle back on the transportation portfolio. I guess how are you feeling about the remainder of the portfolio?
Are
there any other early signs or building signs of more degradation in that portfolio?

Corey Chambas^ Well I think we look at the two pools of that, right?
One is our equipment finance transportation loans, which continue to run
off.
Those
things were -- we stopped lending in that area in May I believe, of ‘23.

So those things are -- the loans that our left are becoming fairly seasoned.

So we would like to think that the number of nonperformers from that group is going to continue to decrease.

On the conventional side, things seem to be holding okay. The difference between the conventional side and the equipment finance side is that the conventional side generally has much stronger collateral coverage.

Damon Del Monte^ Got it.
Okay. That’s
helpful.
Then
with regards to kind of the outlook here for expenses, Brian, do you think you kind of just show modest growth off of like this quarter’s level?
Or kind of how
do you feel like the back half of the year is shaping up?

Brian Spielmann^ Yes. I would say typical modest growth. We’re going to continue to hire where we need to. We’ll have the seasonal loss of those social security expenses going down.

We’re at a point now with some of our technology spend that’s being capitalized and more of just a lower run rate there.

So feel good about our ability to drive positive operating leverage on an annual basis here, still in ‘25.

Damon Del Monte^ Okay. Great.
Then
I guess just lastly on the provision outlook. Absent any other loans moving into nonperformance

that we just kind of think about it just from enough to support growth and kind of keep the reserve level flat with modest charge-offs. Is that a fair way to characterize it and look at it?

Brian Spielmann^ Yes. It's a fair way to characterize it, I would say in the last three quarters have been in that $2.5 million to $2.7 million.
That run rate seems realistic or reasonable for what we're
seeing for growth.

Charge-offs were down a little bit this quarter.
So that was a good indicator on a go-forward
basis.
The thing we can't control really is some of the inputs into the CECL model relative to the economic forecast go-forward
forecast.
So
that's always a bit of a wildcard for all the banks, as you well know.

Operator^ Your next question comes from the line of Nathan Race from Piper Sandler.

Nathan Race^ Curious, just as you're thinking about opportunities to grow core deposits, I know that pipeline isn't as visible in terms of maybe what you have coming on, on the commercial side of things.

But just curious kind of how you guys see core deposit growth trending, excluding brokered and CDs in the back half of this year. And just maybe any targets over the next year or so in terms of where you'd like to see wholesale funding get down to?
I
know wholesale funding is a part of the model in terms of how you match fund some of your commercial real estate growth, but would appreciate any thoughts along those lines?

Corey Chambas^ I'll go to the back half of your question there, Nate, to begin.
Our
goal from our strategic plan is to be about 75% for in-market, 25% wholesale funding.
That's
kind of a plus/minus maybe 5percentage points, because it really depends on our match funding needs and what our borrowers are doing on term financing.
If
they're using swaps, we don't need as much if they want just a fixed rate, we need a little bit more.

So kind of really anywhere in that range is -- works well for our neutral balance sheet, which as you know we kind of pride ourselves on and stick to strategically.

So
 that 75 plus/minus is the range that we'd like to strive for as far as pipelines and growth going forward. Dave, do you want to take that?

David Seiler^ Sure.
As far as pipelines and growth in the back half, I don't think I'd expect anything different than the front
half.
We
 try to do the same thing.

We try to be outbound -- our treasury management people are outbound active calling. Again we look at -- we like to look at our service charges on deposits, which have grown 16% over the past year, I believe.

And that just shows us -- that shows us that there's good, consistent calling and new accounts being added.

So we expect to keep doing the same thing and deposits are a bit lumpy.

So you're going to see them grow a little higher in one quarter than the next.
But
 overall, we think we can match the pace of our loan growth.

Corey Chambas^ Yes.
So
 big picture, Nate, I'd say net-net, if we're going to grow our loans 10%, we've got to grow our deposits quarter-to-quarter, that 10% might be a little more wholesale one quarter, a little more in market one quarter, but that will equalize out. And again why we kind of look at a rolling four quarter basis, on that as well.

Nathan Race^ Okay. Great. That's really helpful. And Brian, you mentioned you guys are going to obviously remain competitive driving core deposit growth going forward.

But just curious what you're seeing from a competitive perspective these days among some of both the larger and smaller institutions that you compete with, are you seeing any more rational pricing or any notable changes from a competitive perspective within the last 90 days or so?

Brian Spielmann^ I would say it's competitive as ever.
So
 I think we -- whilst it's frustrating, I think we feel good about it for us because we can pay what we need to pay yet, we still have the ability to price our assets accordingly, especially in some of

those niche C&I lending areas where it gives us the ability to drive that 3.60% to 3.65% margin here going forward.
But
yes, it's just as competitive as this has been.

Corey Chambas^ Yes.
I'll just tack on to
that.
As
Brian said, the C&I growth is faster than the CRE growth over the last couple of years. That continues to be our strategy, and that plays well with the need to be able to have a bit higher yield which we do on the C&I book overall to 200 basis points or so higher than the CRE book.
It's
a good thing that we've been growing that.

And continue to expect to do that because deposits are just more expensive for everyone.
If you're a growth-oriented company like we are, we've
got to bring in new deposit relationships.

If you're a bank that's just kind of stagnant and not really growing, you don't really have to do that.
But fortunately, our model is such that we're able to do it and maintain
the margin.

Nathan Race^ Right. Appreciate that. Maybe one last one. Brian, can you just update us in terms of kind of the margin sensitivity to short-term rates in terms of maybe what we could expect from a margin impact if we do get a Fed cut at some point in the back half of this year?

Brian Spielmann^ Yes, happy to.

So we're just slightly -- well remind we want to try to be neutral. We're just slightly asset sensitive as of Q2, but that's really more just a function of some of that short-term cash we have on the balance sheet.

We plan to put that to work in the second half of the year.
Our
model is in the Q. We'll indicate some downward sensitivity on the up 100s and 200s, but very immaterial, and that's the instantaneous shocks as well.

So, we feel really comfortable about our ability, given our neutrality, to manage deposit betas if and when they start cutting rates to, again, drive towards that or drive / maintain that 3.60% to 3.65% which we're running a little higher than that right now.

So there's a little bit of a few basis points of compression built into that assumption.

Nathan Race^ Okay.
But
it sounds like once that cash is redeployed, the beta should be pretty well matched on both sides of the balance sheet.

Brian Spielmann^ Correct.

Operator^ Your next question comes from the line of Brian Martin from Janney.

Brian Martin^ I'm not sure who, but just -- I think you guys talked about some wholesale funds maturing this quarter. Just wondering what the implications on the near-term margin given that -- I don't know when that occurred in the quarter, but just trying to understand the impact that may be having given that later in the quarter?

David Seiler^ Yes. Good question.
So basically, it was a function, and this is what we always
do.
We
tend to have some shorter-term wholesale funding we roll in one week advances as we're looking to place funds out on the curve for our match funding or waiting for core deposits to come in.

And that was the case this quarter where we had roughly $100 million of short-term advances floating and rolling every week and that was then swapped out with the $100 million plus of core deposits.

The weighted average rate of those is pretty consistent, given some of the duration we had in the CDs.
So really, what we're seeing is a push on net interest margin, given that mix change even given the size of
it.
So
good about our ability to, again, maintain that margin target.

Brian Martin^ Got you.

Okay.
Then just your point earlier, I don't know who said it, but the mix of the loans. I'm
just wondering what the -- how the specialty trends were this quarter versus the traditional?

And
just kind of where you see that trending to the next 12 to 18 months, if you will.

And I thought last quarter it was around the low 20s in terms of percentage, but just how was the mix this quarter and just your outlook there would be helpful.

Corey Chambas^ Yes. We've -- we'd like to see that mix move up a little bit.
On some of the niche lending areas, we've
seen really good activity in ABL, as Dave mentioned.

So we expect that to continue.
We
would look for our Floorplan business, it continued to grow.

That's been a really steady and growing business for us. Those would probably be the two areas that we'd be looking for the most growth in the near term.

Brian Martin^ Got you. And as far as just longer term, like a longer-term target on the percentage of where you think that kind of shakes out where you'd like to see that be if it's in the low 20s today that's trending towards a 30% type of level?
Is
that too aggressive in terms of where you want to get to over time?

Corey Chambas^ I think it's a little. Well, depends on what over the long / over time means.
But
I think over time yes, that makes sense, maybe that moves to 30%.

But the tricky part is, it's sort of chasing a runner with a head start because our commercial / standard commercial and our standard CRE business keeps growing.

So that's not standing still.

So to push that other percentage up, we've got to do even more.

So I would see that -- it's been as high as 26% is my recollection was the highest it's been.

We've had some softness in a couple of lines there in the last couple of years, particularly the ABL was soft for a while, and that's moving again.

So I think we closed that gap again.
I
would hope that, that's getting more towards 25% in the next year or so.

Then maybe moving up a little bit because I think when we were gaining ground on that percentage in our last strategic plan, we went from 16% at the beginning of that five-year plan up to 25%.

So we're -- at that point, we're moving along pretty good a couple of percentage points a year or so.
So that could be 1%, 2% a year if we're successful in growing those business lines, we'd like to.

Brian Martin^ Got you.
Those business lines, whether this quarter or just year-to-date, have they been pretty stable? I mean I guess they're just keeping pace. They have not really outgrown in the first half of this year relative to the other portfolios?

Corey Chambas^ Yes. I think that's a fair characterization. I'd say Floorplan's outgrown, but the other ones probably are pretty consistent and more in line, yes.

Brian Martin^ Yes.

Okay.
Then maybe just one last one for me. Just- I don't know when the Q comes out, just the trends in criticized loans or criticized and classified any -- outside of the one credit you've talked about, any changes to anything notable in those two numbers for the quarter?

Corey Chambas^ There's nothing material to note there that we're aware of.

In the Q you'll see those trends are pretty consistent.

Brian Martin^ Yes.
Okay. Just making sure.

Operator^ There are no further questions at this time. I will now turn the call over to Corey Chambas. Please continue.

Corey Chambas^ Thank you for joining us today.

We appreciate your time and your interest in First Business Bank, and we look forward to sharing our progress again next quarter. Have a great day.

Operator^ Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.