NU SKIN ENTERPRISES INC
Form 10-K/A
April 29, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K/A

(Amendment No. 1)

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2007

OR

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

Commission file number: 001-12421

NU SKIN ENTERPRISES, INC.

(Exact name of registrant as specified in its charter)

Delaware	**87-0565309**
(State or other jurisdiction of incorporation)	(IRS Employer Identification No.)

75 West Center Street
Provo, UT 84601

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (801) 345-1000

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

Title of each class	Name of exchange on which registered
Class A common stock, $.001 par value	New York Stock Exchange

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes ¨ No x

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨(Do not check if a smaller reporting company)	Smaller Reporting Company ¨

Based on the closing sales price of the Class A common stock on the New York Stock Exchange on June 30, 2007, the aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately $832 million. All executive officers and directors of the Registrant have been deemed, solely for the purpose of the foregoing calculation, to be affiliates of the Registrant.

As of February 15, 2008, 63,410,845 shares of the Registrant s Class A common stock, $.001 par value per share, and no shares of the Registrant s Class B common stock, $.001 par value per share, or preferred stock were outstanding.

Documents incorporated by reference. None.

Explanatory Note

This Amendment No. 1 to Form 10-K (the Amendment) amends Nu Skin s (the Company) Annual Report on Form 10-K for the fiscal year ended December 31, 2007, originally filed with the Securities and Exchange Commission on February 29, 2008 (the Original Filing). We are refiling Part III to include information required by Items 10, 11, 12, 13 and 14 because our definitive proxy statement containing such information will not be filed within 120 days after the end of our fiscal year ended December 31, 2007. In addition, we are including information in Item 9B regarding the revised deadline for submitting stockholder proposals to be included in our proxy statement for our annual meeting in 2008. In addition, in connection with the filing of this Amendment and pursuant to the rules of the Securities and Exchange Commission, we are including with this Amendment certain currently dated certifications. Accordingly, Item 15 of Part IV has also been amended to reflect the filing of these currently dated certifications.

Except as described above, no other changes have been made to the Original Filing. This Amendment continues to speak as of the date of the Original Filing and we have not updated the disclosures contained therein to reflect any events that occurred subsequent to the date of the Original Filing. The filing of this Form 10-K/A is not a representation that any statements contained in items of Form 10-K other than Part II, Item 9B and Part III, Items 10 through 14 are true or complete as of any date subsequent to the Original Filing.

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PART II

Item 9B. Other Information

On February 25, 2008 and February 29, 2008, Nu Skin Enterprises, Inc. (the Company) executed amendments (collectively, the Amendments) to the following loan and credit agreements (collectively, the Credit Agreements): (i) Note Purchase Agreement dated October 12, 2000 between the Company and The Prudential Insurance Company of America, as amended; (ii) Private Shelf Agreement dated as of August 26, 2003 between the Company and Prudential Investment Management, Inc., as amended (the Private Shelf Agreement); and (iii) Credit Agreement dated as of May 10, 2001 among the Company, various financial institutions and the Bank of America, N.A., as Administrative Agent, as amended. The Amendments provide that for purposes of calculating the minimum Fixed Charges Coverage ratio the amount of Consolidated Net Income Available for Fixed Charges for the fiscal quarter ended December 31, 2007 shall be increased by $15 million.

The date of the Company s Annual Meeting of Stockholders will be June 25, 2008. As a consequence of having advanced the date of the Annual Meeting of Stockholders by more than 30 days from the date of the previous annual meeting, the deadline for the Company s receipt of stockholder proposals for inclusion in the proxy statement and for a stockholder proposal to be raised at this year's annual meeting was December 26, 2007.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Directors and Executive Officers

The information for our executive officers is contained in Part I, Item 1 of our Form 10-K. Set forth below are the name, age, and business experience of each of our directors, listed in alphabetical order:

Daniel W. Campbell, 53, has served as a director of our company since March 1997 and currently serves as our Lead Independent Director. Mr. Campbell has been a Managing General Partner of EsNet, Ltd., a privately held investment company, since 1994. From 1992 to 1994, Mr. Campbell was the Senior Vice President and Chief Financial Officer of WordPerfect Corporation, a software company, and prior to that was a partner of Price Waterhouse LLP. He currently serves as a director of The SCO Group, Inc., a provider of software solutions for businesses. He received a B.S. degree from Brigham Young University.

Christine Day, 46, has served as a director since May 2007. Ms. Day was recently appointed to serve as the Chief Executive Officer of Lululemon Athletica, a marketer of athletic and casual wear, beginning in June. She was serving as the Executive Vice President of Lululemon Athletica, a position she has held since January 2008. Ms. Day previously served as President of the Asia Pacific Group for Starbucks Coffee from January 2004 to February 2007. Prior to her role as president of the Asia Pacific Group, Ms. Day served in a variety of positions with Starbucks since 1986, including senior vice president of Starbucks Coffee International, senior vice president of North American finance and administration, and senior vice president of North American strategic business systems. She currently serves as a member of the board of directors of Select Comfort (NASDAQ: SCSS). She graduated from Central Washington University with a bachelor of arts in Administration and is a graduate of Harvard Business School s Advanced Management Program. Ms. Day has notified the Company that she will not be standing for re-election at the Company s annual meeting of shareholders this year.

Jake Garn, 75, has served as a director of our company since March 1997. Senator Garn served as a Managing Director of Summit Ventures, LLC, a lobbying firm, from 2000 to 2004, when he retired. He currently serves on the boards of directors of Franklin Covey Co., a provider of time management seminars and products and Headwaters, Inc., a provider of products, technologies and services to the energy, construction and home improvement industries. From 1974 to 1993, Senator Garn was a member of the United States Senate and served on numerous Senate Committees. He received a B.S. degree from the University of Utah.

M. Truman Hunt, 49, has served as our President since January 2003 and our Chief Executive Officer since May 2003. He has also served as a director of our company since May 2003. Mr. Hunt joined Nu Skin International, Inc. (NSI) (which we acquired in 1998) in 1994 and has served in various positions with NSI and our company, including Vice President and General Counsel from May 1998 to January 2003 and Executive Vice President from January 2001 until January 2003. Prior to 1994, Mr. Hunt served as President and Chief Executive Officer of Better Living Products, Inc., an NSI affiliate involved in the manufacture and distribution of houseware products sold through traditional retail channels and he was a securities and business attorney in private practice. He received a B.S. degree from Brigham Young University and a J.D. degree from the University of Utah.

Andrew D. Lipman, 56, has served as a director of our company since May 1999. Mr. Lipman is a partner and head of the Telecommunications, Media and Technology Group of Bingham McCutchen LLP, an international law firm. Mr. Lipman previously held a similar position from 1988 with Swidler Berlin, LLP, which mergered with Bingham and McCutchen in 2006. He also currently serves as a member of the boards of directors of Sutron Corporation, a provider of hydrological and meteorological monitoring products, and The Management Network Group, Inc., a telecommunications-related consulting firm. He received a B.A. degree from the University of Rochester and a J.D. degree from Stanford Law School.

Steven J. Lund, 55, has served as a director and Vice Chairman of our company since September of 2006. Prior to this, he was on a three-year leave of absence serving on a church assignment in Georgia. Mr. Lund served as President, Chief Executive Officer, and a director of our company from its inception in 1996 until his 2003 leave of absence. Mr. Lund was a founding shareholder of Nu Skin International, Inc. (NSI) (which we acquired in 1998) and served as the Executive Vice President of NSI until the Company s acquisition of NSI. Mr. Lund previously worked as an attorney in private practice. He received a B.A. degree from Brigham Young University and a J.D. degree from Brigham Young University s J. Reuben Clark Law School.

Patricia Negrón, 41, has served as a director of our company since June 2005. Ms. Negrón is currently an independent business consultant, author and advisor to Goode Partners, LLC. In 1999, Ms. Negrón launched the financial advisory group at Breakaway Solutions, an internet consulting firm, which she managed until 2001. Ms. Negrón previously worked as a research analyst at the investment banking firm of Adams Harkness & Hill. She received a B.S. degree from Armstrong Atlantic State University and a Certificate of Special Studies in Administration and Management from Harvard University Extension School.

Blake M. Roney, 50, has served as Chairman of the Board since our inception in 1996. Mr. Roney was a founder of NSI in 1984 and served as its Chief Executive Officer and President until our acquisition of NSI in March 1998. Since our acquisition of NSI, Mr. Roney has retained his position as Chairman of the Board of our company. He received a B.S. degree from Brigham Young University.

Sandra N. Tillotson, 51, has served as a director of our company since its inception in 1996 and as Senior Vice President since May 1998. Ms. Tillotson was a founding shareholder of NSI and served as a Vice President of NSI from its formation until our acquisition of NSI in 1998. She earned a B.S. degree from Brigham Young University.

We are not aware of any family relationships among any of our directors or executive officers. Our Certificate of Incorporation contains provisions eliminating or limiting the personal liability of directors for violations of a director s fiduciary duty to the extent permitted by the Delaware General Corporation Law.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act), requires our officers and directors and persons who own beneficially more than 10% of a registered class of our equity securities to file with the Securities and Exchange Commission and the New York Stock Exchange initial reports of ownership and reports of changes in ownership of our equity securities. Officers, directors, and greater than 10% beneficial owners are required to furnish us with copies of all Section 16(a) reports they file. Based solely upon a review of the copies of such reports furnished to us or written representations that no other reports were required, we believe that during the fiscal year ended December 31, 2007, all officers, directors, and greater than 10% beneficial owners complied with all applicable Section 16(a) filing requirements, except for the following: Each of Mr. Joe Chang and Mr. Dan Chard filed one late report on Form 4 related to one transaction and Ms. Melisa Quijano filed a late report on Form 3. In addition, Andrew Fan filed one late report with respect to one transaction by his wife.

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Code of Conduct

We have adopted a code of conduct that applies to all of our employees, officers and directors, including our subsidiaries. This code is available on our website at http://ww.nuskinenterprises.com. In addition, any substantive amendments we make to this code, and any material waivers we grant (including implicit waivers) to our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions will be disclosed on our website.

Audit Committee

The audit committee currently consists of Daniel Campbell (its chair), Christine Day and Patricia Negrón, each of whom is independent within the meaning of the listing standards of the New York Stock Exchange. The Board of Directors has determined that Daniel Campbell is an audit committee financial expert as such term is defined in Item 407(d)(5) of Regulation S-K promulgated by the Securities and Exchange Commission. The Audit Committee s responsibilities include, among other things:

- selecting our independent registered public accounting firm;
- reviewing the activities and the reports of the independent registered public accounting firm;
- reviewing our quarterly and annual financial statements and our significant accounting policies, practices and procedures;
- approving in advance the audit and non-audit services provided by the independent registered public accounting firm; and
- reviewing the adequacy of our internal controls and internal auditing methods and procedures.

Item 11. Executive Compensation

Compensation Discussion and Analysis

Overview

Our Compensation Committee is responsible for establishing and administering our executive compensation program, which consists of a variety of components, including base salary, cash incentive bonuses, equity awards, and retirement benefits. This compensation and discussion analysis is intended to provide more information regarding:

- our compensation objectives;
- the various components of our compensation program and how they relate to our objectives;
- the factors taken into consideration in establishing the levels of compensation or participation in these various components; and
- the compensation decisions during the year related to the compensation of the Chief Executive Officer, the Chief Financial Officer, and the other executive officers listed in the summary compensation table (the Named Officers) and factors and analysis related to such decisions.

Objectives

The primary objectives of our compensation program are to:

- successfully recruit and retain experienced and talented executives;

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- provide competitive compensation arrangements that are linked to corporate and individual performance; and
- align the financial interests of our executives with those of our stockholders.

The following table identifies each of the key components of our compensation program and the primary objectives that each of the components is designed to accomplish:

Component of Compensation Program	Primary Objective
Base Salary	Retention
Discretionary Bonuses	Retention Pay-for-Performance
Cash Incentive Plan	Pay-for-Performance Stockholder Alignment
Equity Incentive Plan	Pay-for-Performance Stockholder Alignment Retention
Retirement and Deferred Compensation Plans	Retention
Severance Arrangements	Retention

We also provide perquisites and other personal benefits to executive officers that represent a very small portion of their overall compensation.

Process for Determining Compensation

Role of Compensation Committee and Chief Executive Officer

The Compensation Committee is responsible for evaluating the performance of the Chairman and the Chief Executive Officer relative to their performance goals and targets and for setting their compensation. The Compensation Committee has given the Chief Executive Officer the responsibility of evaluating the performance of the other executive officers and discussing the evaluations with the Compensation Committee. The Chairman and Chief Executive Officer can also make recommendations to the Compensation Committee with regard to the compensation packages for new executive officers and/or adjustments in compensation for other executive officers. The Compensation Committee reviews any such recommendations and has the authority to approve, revise, or reject such recommendations.

Use of Compensation Consultants and Survey Data

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The Compensation Committee has retained the services of Frederic W. Cook & Co. as its independent compensation consultant to assist the Compensation Committee in the review of our executive compensation program, to provide compensation data and alternatives to the Committee, and to provide advice to the Committee as requested. The compensation consultant engaged by the Compensation Committee generally does not perform any work for our company outside of the services it performs for the Compensation Committee. We utilized the compensation data and alternatives provided by the compensation consultant to analyze compensation decisions in light of current market rates and practices, and to help ensure that our compensation decisions are competitive in the market and economically defensible. We compare the compensation proposals for our Named Officers to the compensation practices of a peer group of publicly-traded companies that compete in our industry or are similar in size to us. The competitive cash compensation data provided by Frederic W. Cook & Co. includes limited use of national survey data calibrated for all industries for companies with similar revenue levels as us. The group is reviewed and updated by the Compensation Committee from time to time to insure we are utilizing an appropriate group in terms of size and relevance. The group was most recently reviewed and revised in November 2007 by the Compensation Committee taking into account the input and recommendations of Fredric W. Cook & Co. The Compensation Committee determined that it was appropriate to expand the group to include consumer product companies with market capitalizations in the range of 1/3rd to 3 times our market capitalization. The three companies removed from the previous peer group had market capitalizations outside this range. The revised peer group was used in analyzing the special equity grant in December 2007 as discussed below. Our company is at the median of this group with respect to revenue and market capitalization. Peer group information and other data is only one factor used by the Committee in making decisions. The following table indicates the companies that are included in the revised peer group as well as the companies that were included in the previous peer group.

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Current Peer Group	**Previous Peer Group**
Bare Escentuals	Alberto Culver

Blyth	Blyth
Chattern	Church and Dwight
CSS Industries	Elizabeth Arden
Elizabeth Arden	Herbalife
Gaiam	NBTY
Herbalife	Perrigo
Inter Parfums	Playtex Products
NBTY	Sensient Tech
Perrigo	Tupperware
Playtex Products	USANA Health Sciences
Prestige Brands	Weight Watchers
Sensient	
Tupperware Brands	
Usana Health Sciences	

Mix of Compensation

When we review the compensation for an executive, we do not use a specific formula or allocation targets to establish the level or mix of compensation. Rather, we exercise judgment in determining a mix of compensation that we believe is appropriate to accomplish our compensation objectives under the circumstances applicable to the executive. We also take into consideration the relative mix of compensation provided by other companies and try to make sure each component is competitive. When reviewing one component of compensation, we will consider the compensation paid under other components. For example, in the past we took into consideration the value of Mr. Hunt s initial unvested restricted stock grant when considering his salary level, which has resulted in his salary being below the median of our peer group. Historically, a majority of target compensation is typically tied to corporate performance in the form of our cash incentive plans and our equity incentive plans.

Components of Compensation

Base Salaries

In establishing and approving base salaries, we consider various factors including:

current market practices and salary levels;

the nature of each executive officer's responsibilities and capabilities;

individual performance and the performance of our company;

the overall total direct compensation of an executive officer, consisting of base salary, targeted cash incentive payments and other cash payments, and equity incentive awards;

competitive offers made to executive officers and the level of salary that may be required to recruit or retain our executive officers; and

the recommendations of the Chairman of the Board and the Chief Executive Officer for officers other than themselves.

Base salaries are typically reviewed annually during our evaluation period in February and March and changes are typically made effective for the first pay period ending in April. We do not assign any specific weights to the factors identified above, but emphasize establishing base salaries that are competitive with the salaries paid by other companies in order to enable us to attract and retain qualified and effective executive officers. In order to remain competitive, we use the median level for base salaries from our peer group and industry surveys as a guideline, except for our key performers, which include our Named Officers, where we use the 75^{th} percentile as a guideline. We use a higher threshold for our key performers because we believe that maintaining a higher salary level for key performers will increase retention. However, these levels are merely guidelines, and we set salaries above and below these guidelines depending on various factors, including corporate and individual performance, experience in the position, the uniqueness of the position and responsibility, levels of other compensation components, and level of retention risk.

The salaries of Mr. Hunt and all other executive officers were reviewed in the first quarter of 2007. Based on the decrease in operating income in 2006 and the efforts to control costs, no increases were approved for the Named Officers, except for the contractual increase of $25,000 that Mr. Chard was entitled to under the terms of his employment agreement. Mr. Hunt unilaterally reduced his own base salary in 2006 from $665,000 to $550,000. Mr. Sumihiro s base salary was approved in connection with the employment agreement offered to him to accept a position as the head of our Japan operations. Based on Mr. Sumihiro s years of experience at Amway Japan, including his position as chief operating officer and the limited pool of qualified candidates with high level management experience in direct selling in Japan, we believe the approved salary level was appropriate. Mr. Sumihiro s base salary also includes a $100,000 foreign service premium related to his position as an expatriate (a foreign service assignment).

Cash Incentive Bonuses

Consistent with our objective to tie a significant portion of the executive officers compensation to our financial performance, we utilized a cash incentive plan that paid incentive bonuses based on our performance in quarterly and semi-annual incentive periods in 2007. The plan was designed to motivate executive officers and reward them for meeting their short-term operating targets. We used revenue and operating income as the two performance targets in 2007, with 70% of the bonus tied to revenue targets and 30% of the bonus tied to operating income targets. We have historically elected to allocate a larger portion of the bonus to revenue because we believe that revenue growth is critical to our long-term success. However, we also include operating income targets so that revenue growth does not come at the expense of the bottom line. If the minimum operating target is not achieved, we do not pay a bonus even if the associated revenue target is met. Because our executive officers cannot control foreign currency fluctuations, we have eliminated the impact of foreign currency fluctuations on the performance targets by using fixed foreign currency exchange rates in calculating targets and actual performance. We establish our revenue and operating targets for the first two quarters of the year and the first semi-annual period at the beginning of the year. We establish targets for the last two quarters and second semi-annual period in the middle of the year, generally following completion of the second quarter. The bonus amounts payable for the quarterly periods are paid at half the rate of the semi-annual period bonuses.

Bonuses are computed based upon the degree to which the targeted performance measures were met or exceeded. We establish incentive targets at three levels, referred to as Minimum, Budget, and Stretch targets. If Budget targets are met for a particular incentive period, a participant will receive a bonus amount equal to the pre-established percentage of salary (the Target Bonus). If a Budget target is not met, the bonus amount decreases linearly until reaching 50% of the Target Bonus at the Minimum target level. No bonus is paid if Minimum operating income targets are not met. To the extent actual revenue or operating income measures exceed Budget level, the bonus amount increases linearly above the Target Bonus until reaching 200% of the Target Bonus at the Stretch level. If performance exceeds the Stretch level, the bonus amount increases in proportion to the extent to which Stretch targets are exceeded, but may not exceed $3 million under the terms of our incentive plan. The Compensation Committee has the discretion to exclude extraordinary, infrequent or non-operational items or amounts from the calculations to the extent it determines appropriate. During the last three years, bonuses at the corporate level have been earned for six of the 12 quarterly incentive periods, and three of the six semi-annual periods. Approximately half of the bonuses were paid out below target bonus level. Based on our review of our incentive plan, our performance compared to our peer group, and the relative level of bonuses earned by our executives compared to our peer group, we believe that the level of bonuses paid under our incentive plan has been reflective of and consistent with corporate performance. For example, the level of bonuses paid to our executives was below the median and consistent with our performance as compared to our peer group.

We set the targeted level of bonuses (the Target Bonus Percentages) based on an executive officer s position and responsibility and market practices. The target levels are intended to tie a meaningful portion of an executive officer s total cash compensation to our performance. We have set Mr. Hunt s target bonus percentage at 100%, which is in line with the market practices of our peer group. Because we believe that our other top corporate executives should work as a team and share the responsibility to support the goals and performance of our company, we have typically structured our cash incentives for these executives to be similar in size and composition. The target bonuses for our Chairman, Mr. Roney, and the Named Officers serving on our executive committee (Mr. Chang, Mr. Chard, and Mr. Wood) are set at 60% and are tied to the same targets as Mr. Hunt s. Because Mr. Sumihiro is the President of our operations in Japan, his bonus is tied to revenue and operating profit in Japan. His target bonus percentage is set at 50%, which is consistent with the bonus percentages of our regional heads who are not on our executive management committee.

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Incentive Plan Targets

The table below sets forth the operating income and revenue targets for the incentive periods in 2007, the actual performance both in amount and as a percentage of the target performance, and the percentage of the target bonus that was earned.* The total dollar amount of the bonuses earned is set forth in the Summary Compensation Table.

(dollar amounts expressed in thousands)

	Q1 2007	Q2 2007	H1 2007	Q3 2007	Q4 2007	2H 2007
Revenue						

Budget Target	$277,385	$297,294	$574,679	$295,304	$304,365	$599,669
Actual	$272,250	$290,339	$562,589	$288,032	$296,828	$584,860
% of Target	98%	98%	98%	98%	98%	98%
% of Target Bonus	76%	70%	73%	0%	0%	0%
Operating Profit						
Budget Target	$ 19,000	$ 25,900	$ 44,900	$ 23,700	$ 33,000	$ 56,700
Actual	$ 17,682	$ 25,229	$ 42,911	$ 18,672	$ 23,709	$ 42,381
% of Target	93%	97%	96%	79%	72%	75%
% of Target Bonus	67%	82%	75%	0%	0%	0%

* We establish targets and determine bonus payouts based on pre-established, fixed currency exchange rates. Differences between actual results reported in the table above and results reported in our audited financial statements are a result of the difference between the fixed currency rates established for bonuses and actual foreign currency exchange rate fluctuations during the period. In addition, we also excluded the following charges in determining actual performance: (a) fourth quarter restructuring charges of $17.0 million; and (b) second quarter expenses of $2.8 million related to closing operations in Brazil. We believe it was appropriate to exclude the charges so that management would not be penalized for making decisions to improve profitability and based on the understanding that targets for the second half of 2007 would be adjusted to reflect anticipated cost savings with respect to closing Brazil, and targets for 2008 would reflect the anticipated cost savings with respect to the actions taken in the fourth quarter.

As indicated above, Mr. Sumihiro s bonus targets were based on Japan s operating results, and no bonuses were earned under the plan based on these results in Japan during the year.

For 2008, we have made several changes to increase the alignment of our cash incentive plan to the interests of our stockholders. First, 50% of the target bonus will be tied to meeting annual incentive targets rather than semi-annual targets. Second, payment of bonuses will be tied to meeting earnings per share targets rather than operating income targets. Third, for corporate officers, 50% of the target bonus will now be tied to operating income as opposed to 30%. Finally, performance will not be calculated using fixed foreign currency exchange rates, but will based on our actual financial results except as described below. We believe these changes will better align the efforts our management team with the interests of our stockholders and help focus their efforts on annual results. The measurement of actual performance will be adjusted, however, to eliminate the impact of foreign currency swings if the Yen moves outside of a pre-established range. In addition, a bonus can be reduced by up to 10% for corporate officers (Mssrs. Hunt, Chang, Chard and Wood) or 20% for the heads of key regions and markets (Mr. Sumihiro) if individual performance goals are not met. In 2008, no changes were made to the target bonus percentages of the Named Officers.

Other Bonus

We retain the right to make discretionary bonuses to executive officers for excellent performance and other factors. We believe that it is appropriate to reward for superior individual performance in exceptional circumstances. However, we have generally only approved discretionary bonuses in limited circumstances. No discretionary bonuses were paid to the Named Officers in 2007.

We have also historically made a year-end holiday gift payment to all corporate employees, including the Named Officers, in the form of a gift certificate or similar merchant credit arrangement or cash in an amount equal to a percentage of each employee s base salary (typically approximately two-week s salary). The amount of the year-end holiday gift we paid to the Named Officers is included in the bonus column of the Summary Compensation Table and represents the same percentage of pay as was provided to other corporate employees.

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We have occasionally agreed to pay retention or guaranteed bonuses when we have determined it was necessary to attract or retain a key executive. We believe a retention bonus paid at the end of an agreed upon employment period can provide a greater incentive to remain employed than an equivalent increase in salary because the salary is paid pro rata throughout the period and the retention bonus is only paid if the employee remains employed at the end of the employment period. In 2007, a retention bonus of $200,000 was paid to Mr. Chang pursuant to the terms of Mr. Chang s compensation package that was negotiated in 2006 in light of other opportunities available to Mr. Chang. Under the terms of such arrangement, Mr. Chang received retention bonuses at the end of 2006 and 2007 and is entitled to receive retention bonuses at the end of each of the next two years in the amount of $300,000 and $400,000, respectively, if he is still employed by us at such time. The retention bonus is back-end weighted so that the majority of the bonus will be received at the end of the later years. We felt that this retention bonus was an appropriate mechanism to incentivize Mr. Chang to remain with our company based on Mr. Chang s contributions in our product development area, his experience in the industry, his value as a spokesperson to our global distributor force, and the other opportunities available to him.

In connection with the negotiation of a compensation package for Mr. Sumihiro, we agreed to pay Mr. Sumihiro a signing bonus of $100,000 and to guarantee payment of $150,000 in bonuses in 2007 and 2008. In the event the amount of incentive bonuses earned by Mr. Sumihiro is less than $150,000 in 2007 or 2008, then we must pay Mr. Sumihiro the difference between $150,000 and the amount of his cash incentive awards in that year. Mr. Sumihiro received a $150,000 discretionary bonus in March 2008 based on this contract provision. Based on the factors discussed above concerning the determination of Mr. Sumihiro salary, as well as the compensation opportunity at his prior employer, we believed it was necessary to offer these guaranteed bonuses and the signing bonus in order to get Mr. Sumihiro to accept the position.

Annual Equity Grants

Aligning the interest of our executive officers with those of our stockholders in order to encourage our executive officers to manage like a company owner is an important objective of our compensation program. In order to accomplish this objective, we have tied a significant portion of the total compensation of executive officers to our long-term stock performance through the grant of equity awards and the adoption of our Stock Ownership Guidelines. We also believe that equity compensation helps retain executives who may have significant value tied up in unvested equity awards.

Based on our review of our compensation program in 2006, we determined that stock options should still be a major component of equity compensation for our Chief Executive Officer and each of the members of the executive management committee because of the strong performance nature of stock options (i.e., they only have value if the stock price increases). We also determined that shifting a portion of the annual grant to restricted stock units would provide greater retention incentives to employees, help compensate for volatility in the stock price, and make our overall grants more cost-effective. Accordingly, we made the following changes to our equity grant practices in 2006:

- shifted from stock options to restricted stock units for most employees;
- allocated equity awards to non-executive management committee members equally between stock options and restricted stock units;
- provided members of the executive management committee with the election to shift 30% of their future stock options to restricted stock units; and
- used an approximate 3.5 to 1 ratio to convert stock options to restricted stock units for those employees who will be receiving restricted stock units in lieu of stock options.

As indicated above, we make semi-annual grants of equity awards as well as a limited number of special equity grants. We periodically review the level of our semi-annual equity awards and make adjustments to those levels when we determine it is appropriate. We do not use a fixed formula or criteria in determining whether to adjust the level of semi-annual awards, but make a subjective evaluation that may take into consideration a variety of factors including:

- the practices of other companies;
- the degree of responsibility for overall corporate performance;
- overall compensation levels;
- changes in positions and/or responsibilities;
- individual and corporate performance;
- potential dilution of our overall equity grants;
- the associated expense of such awards; and
- recommendations of the Chairman of the Board and Chief Executive Officer with respect to the other executive officers.

We believe that our Chief Executive Officer should have a significant portion of his total compensation in the form of equity to align his management of the Company with the interests of the stockholders. We had previously established Mr. Hunt s semi-annual stock option grant level at 100,000 options. In 2006, Mr. Hunt unilaterally reduced his semi-annual stock option grant level to 25,000 stock options. Because we believe our other senior executive officers should manage the business as a team, we have typically structured our equity incentives to be similar in size and composition. We have generally provided a similar level of equity awards in our semi-annual grants to each of the members of our executive management committee, which is the key management group responsible for our strategy and operations. While we generally have not given significant consideration to the value of existing equity awards as we want to encourage stock ownership and the retention of equity awards for long periods, we do review and consider the value of existing awards (inclusive of sales proceeds over the previous three years) of our executive officers in connection with our review of equity compensation practices. In 2007, the semi-annual grant levels for stock options remained as follows:

Name	**Semi-Annual Number of Options**
Truman Hunt	25,000
Ritch Wood	22,500
Joe Chang	17,500
Dan Chard	17,500

Mr. Sumihiro s semi-annual grant was set at 17,500 shares and he received an initial equity grant of 100,000 stock options when he joined our company. The factors considered in setting these grant levels were the same factors described above regarding his salary and bonus guarantee. Mr. Chard elected to take 30% of his semi-annual grants in the form of restricted stock units in 2007 (adjusted at a 3.5 to 1 ratio). We have historically not made equity grants to Mr. Roney because of his significant equity interest in our company.

Special Equity Grants

In 2007, management was successful in renewing revenue growth, with revenue growing approximately 4% compared to 2006 despite challenges in China and Japan. In 2006, we experienced a revenue decline of 6%. However, because we were not achieving the desired level of earnings growth, additional steps were taken in the fourth quarter of 2007 to improve earnings. One of these steps was to provide an attractive special incentive to a key group of 22 officers and key managers to align their efforts to significantly improve earnings per share and motivate them to improve earnings. To accomplish this, we determined that the best approach would be to provide these key managers with performance stock options that would only vest if meaningful earnings per share targets were achieved. As a result, we made a special grant of performance stock options to these key employees, 50% of which would vest when earnings per share reach $1.50 for any 12 month period (determined on a quarterly basis) and 50% of which would vest when earnings per share reaches $2.00 per share. If these targets are not achieved based on performance through December 2012, the options are forfeited. For reference, our earnings per share in 2007 were $0.67 (inclusive of $0.17 per share of restructuring charges (net of taxes)).

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In determining the appropriate number of shares to grant, the Compensation Committee engaged the services of its compensation consultant to review the proposal, provide a comprehensive review of total direct annual compensation (total cash and equity compensation), and advise the committee. In considering the grant, we reviewed and considered various factors including:

- the average equity grant over the last three years compared to our peers;
- the value of the total holdings of the Named Officers;
- the carried-ownership interest (number of shares and options owned by the executive as a percentage of the outstanding shares) of the Named Officers;
- the potential financial statement expenses associated with such a grant;
- the potential dilution of such grants with respect to the outstanding shares; and
- the semi-annual equity grants in 2007.

For purposes of this analysis, we treated one performance option as the equivalent of 0.5 time vested options, based on our valuation of the options. We also spread the grant over the five-year performance period for purposes of analyzing the grant and making comparisons to the equity grant practices of our peer group of companies and industry surveys. Officers with similar level of responsibility were generally granted similar numbers of performance options with various exceptions. Although the grants would increase our overall equity expense and usage rate above historical levels, the Compensation Committee determined the grant would be appropriate based on various factors including the fact that the options would not vest unless significant earnings per share growth occurred and the grant would help unify management in achieving improved earnings growth.

Based on this analysis, we granted 120,000 performance options to each of Mssrs. Wood, Chang and Chard, who are members of our executive committee. Mr. Sumihiro received 50,000 performance options, which was less than other regional mangers received based on the fact that he had received a 100,000 share option grant earlier in the year. Mr. Hunt and Mr. Roney did not receive options at this time. The Committee elected to address Mr. Hunt s compensation at a future time as they considered other potential changes to his compensation. As indicated above, Mr. Roney has not been granted options because of his large equity position in our company. Because the approved grants would only become exercisable if earnings per share grow significantly, the Committee was willing to consider grants that would result in some officers having equity grants levels at the 75th percentile or higher compared to our peer companies. However, based on its determination that the grants would result in the annual grant levels of Mssrs. Wood, Chard and Chang being above the 75th percentile of the peer comparisons, the Committee elected not to grant these individuals the regular time-vested options they would have otherwise received in the second half of 2007. Mr. Hunt and Mr. Sumihiro did receive their regular time vested options of 25,000 options and 17,500 options, respectively, for the second half of the year.

Our equity awards contain forfeiture provisions that allow the Compensation Committee to recover the gains from the exercise or vesting of any equity awards if an executive engages in misconduct including the commission of an act of fraud, intentional misrepresentation, and violation of non-compete and non-solicitation covenants. In such event, we may terminate the outstanding awards of such executive and recover any gains from the exercise or vesting of equity awards during the twelve months preceding the act or anytime thereafter.

Timing of Equity Grants

We make semi-annual equity grants to our executive officers and key employees. These grants generally take place at or near the end of February and August each year. Generally, the grant date is the date that the members of the Compensation Committee are able to meet at or near the end of February and August. The exercise price of the options is set at the closing price of our stock on the date of grant. We use two semi-annual grants for stock options rather than one annual grant in order to minimize the impact of stock volatility on the exercise price during the year. For consistency purposes, we also make grants of restricted stock units on these dates so that the Compensation Committee is reviewing the entire equity grant at the same time. The Compensation Committee generally meets on the proposed grant date where they review the award list and approve the grant. In 2007, the grant to our executive officers was delayed until December 2007 for several reasons including a review by the Compensation Committee of our equity grant practices based on market conditions and performance as well the consideration of a special performance option grant. We also grant a limited number of equity awards at times other than on the general semi-annual grant date. These awards are generally related to new hires, promotions, changes in job responsibilities, and new compensation packages.

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Dividend Equivalent

We provide Mr. Hunt with a payment equal to the dividend that would be paid on 250,000 shares. We believe this provides Mr. Hunt with additional alignment with our stockholders return on investment by tying a portion of his compensation to the dividends that are paid to our stockholders.

Equity Retention Guidelines

In January 2005, we established equity retention guidelines for our executive officers to motivate our executive officers to consider the long-term consequences of business strategies and to provide for a level of long-term performance risk with respect to our compensation programs. These guidelines provide that executive officers and directors must retain 50% to 75% of the net shares (after payment of the exercise price and related taxes) with respect to any equity award unless the individual holds a number of shares equal to designated levels set forth in the guidelines. The designated levels for executive officers are phased in over a five-year period. Outstanding options and restricted stock units are not counted in determining whether a director or officer holds shares equal to or greater than the designated level. At the end of the five-year phase-in period, the designated ownership levels are set at 100,000 shares for our Chief Executive Officer, 20,000 shares for members of our executive management committee, and 10,000 shares for our other executive officers. With the exception of Mr. Roney, Mr. Hunt and Mr. Chang, the Named Officers are subject to the retention requirement because their ownership levels are below the applicable designated levels.

Retirement and Other Post-Termination Benefits

Our executive officers do not participate in any pension or defined benefit plan. We believe it is important for retention purposes to provide executives with a meaningful opportunity to accumulate savings for their retirement. To accomplish this we maintain both a tax-qualified 401(k) plan and a non-qualified deferred compensation plan. Under our non-qualified deferred compensation plan, our highly compensated employees (as defined by the Internal Revenue Code) may elect to defer up to a maximum of 100% of their compensation. We do not make any matching contributions, but we do make discretionary contributions to the plan for select employees ranging from 3% of salary to 10% of salary. In order to provide an incentive for our key employees to remain with us for the long-term, the discretionary contributions do not vest until the participant has 20 years of service. Amounts deferred are credited to accounts that track investment accounts offered through variable insurance products and earnings are tied to the earnings on these investment accounts. Because earnings are not above market, the earnings on the deferred compensation plan are not included in the Summary Compensation Table, although they are included in the Aggregate Earnings in Last Fiscal Year column of the Nonqualified Deferred Compensation table on page 25.

The employment agreement entered into by Mr. Hunt when he was appointed President and Chief Executive Officer in 2003 contains certain severance and change of control benefits. These benefits provide for acceleration of his equity awards immediately prior to the announcement of a change of control and a lump sum severance benefits in the event his employment is terminated within two years following a change of control. We believe these benefits help to ensure that Mr. Hunt will remain employed and actively engaged in the event of a potential change of control. We believe these benefits are reasonable. We have also agreed to certain severance payments for Mr. Hunt if he is terminated without cause, which we believe are reasonable and necessary in order to attract and retain a qualified Chief Executive Officer. Mr. Chang is also entitled to have his stock options vest in the event of a change of control and is also entitled to certain severance benefits. We also have a severance arrangement with Mr. Chard. The benefits were negotiated in order to retain the services of these employees. These change of control and severance benefits are described and quantified below under the section entitled Employment Agreements and in the table below entitled Potential Payments Upon Termination or Change of Control . We are in the process of reviewing our change in control and severance benefits.

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Our current equity awards for all key employees also provide for accelerated vesting upon a change of control if an employee is terminated within two-years following such change of control. We believe this double trigger acceleration is a reasonable way to protect employees who may be terminated following a change of control. It also assists Nu Skin with retaining their services in the event of a potential change of control and thereafter. We believe such arrangements are in the best interests of the company and our stockholders if they are reasonable in amount and scope, because they can help to retain key employees during a change of control process.

Perquisites and Other Personal Benefits

We also provide our executive officers and other key employees with various other benefits. These consist of, among other things, payments for term life insurance, use of recreational equipment and properties, sporting event tickets, security and free company product. We generally pay the income taxes associated with the use of these perquisites. These benefits represent a very small portion of the executive officer s overall compensation. We review these benefits on a regular basis and believe these benefits are rsize:10pt;">3)

Includes 661 shares held by Mr. Bugher’s spouse through an IRA.

4) Includes 4,916 shares held by spouses of the group.

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5) Information based on two Schedule 13Gs filed with the SEC on February 14, 2013 by Wellington Management Company, LLP and Wellington Trust Company, NA. Wellington Management Company, LLP is an investment adviser and may be deemed to beneficially own 300,000 shares which are held of record by its clients. Those clients have the right to receive, or the power to direct the receipt of, dividends from, or the proceeds from the sale of, such securities. No such client is known to have such right or power with respect to more than five percent of this class of securities, except Wellington Trust Company, NA, which is an investment adviser and may be deemed to beneficially own 300,000 shares which are held of record by its clients. Those clients have the right to receive, or the power to direct the receipt of, dividends from, or the proceeds from the sale of, such securities. No such client is known to have such right or power with respect to more than five percent of this class of securities. The business address for Wellington Management Company, LLP and Wellington Trust Company, NA is 280 Congress Street, Boston, MA 02210.

6) Information based on Schedule 13G filed with the SEC on February 11, 2013 by Banc Fund VI L.P. ("BF VI"), an Illinois limited partnership, Banc Fund VII L.P. ("BF VII"), an Illinois limited partnership, and Banc Fund VIII L.P. ("BF VIII"), an Illinois limited partnership, all of which may be deemed to beneficially own 290,000 shares. The general partner of BF VI is MidBanc VI L.P. ("Midbanc VI"), whose principal business is to be a general partner of BF VI. The general partner of BF VII is MidBanc VII L.P. ("MidBanc VII"), whose principal business is to be a general partner of BF VII. The general partner of BF VIII is MidBanc VIII L.P. ("MidBanc VIII"), whose principal business is to be a general partner of BF VIII. MidBanc VI, MidBanc VII, and MidBanc VIII are Illinois limited partnerships. The general partner of MidBanc VI, MidBanc VII, and MidBanc VIII is The Banc Funds Company, L.L.C., ("TBFC"), whose principal business is to be a general partner of MidBanc VI, MidBanc VII, and MidBanc VIII. TBFC is an Illinois corporation whose principal shareholder is Charles J. Moore. Mr. Moore has been the manager of BF VI, BF VII and BF VIII since their respective inceptions. As manager, Mr. Moore has voting and dispositive power over the securities of the Company held by each of those entities. As the controlling member of TBFC, Mr. Moore will control TBFC, and therefore each of the partnership entities directly and indirectly controlled by TBFC. The business address is 20 North Wacker Drive, Suite 3300, Chicago, IL 60606.

7) Information based on Schedule 13G filed with the SEC on February 8, 2013 by M3 Funds, LLC which stated that, as of December 31, 2012, all 281,352 of the reported shares were owned directly by M3 Partners, L.P. ("M3 Partners"), whose general partner is M3 Funds, LLC (the "General Partner") and whose investment adviser if M3F, Inc. (the "Investment Adviser"). The General Partner and the Investment Adviser could each be deemed to be indirect beneficial owners of the reported shares, and could be deemed to share such beneficial ownership with M3 Partners. Jason A. Stock and William C. Waller are the managers of the General Partner and the managing directors of the Investment Adviser, and could be deemed to share such indirect beneficial ownership with the General Partner, the Investment Adviser and M3 Partners. The business address of M3 Funds, LLC is 10 Exchange Place, Suite 510, Salt Lake City, UT 84111.

DIRECTOR COMPENSATION

In 2012, each director of the Company, who was not an executive officer of the Company, received an annual retainer of $20,000. The Chair of the Board of the Company received an additional annual retainer of $25,000. The Chair of the Compensation Committee and the Chair of the Corporate Governance and Nominating Committee received additional annual retainers of $3,000, while the Chair of the Audit Committee received an additional annual retainer of $5,000. All Board and committee members, except those serving as executive officers of the Company, were paid $750 for each Board and committee meeting attended in person or via teleconference. All director and committee fees were paid in cash.

Name	Fees earned or paid in cash ($) (1)	All other compensation ($) (2)	Total ($)
Mark D. Bugher	32,750	0	32,750
Jan A. Eddy	38,750	0	38,750
John J. Harris (3)	32,000	0	32,000
Gerald L. Kilcoyne	64,790	0	64,790
John M. Silseth (4)	51,025	0	51,025
Jerome J. Smith	64,000	66,149	130,149
Barbara H. Stephens (4)	30,500	0	30,500
Dean W. Voeks	40,750	0	40,750
Gary E. Zimmerman (5)	13,750	0	13,750

(1) Includes Company subsidiary board of directors and committee fees.
(2) Mr. Smith’s total includes $64,222 of employment compensation for services as an employee. Mr. Smith’s total also includes $1,927 of employer 401(k) match.
(3) Appointed effective January 30, 2012.
(4) Ms. Stephens received $750 for her service as Chair of the Compensation Committee beginning in the fourth quarter of 2012. Mr. Silseth stepped down as Chair of the Compensation Committee after the third quarter of 2012 and received $2,250 in 2012 for his service as Chair of this committee.
(5) Retired effective May 14, 2012.

EXECUTIVE COMPENSATION

The Company maintains a comprehensive compensation program that is designed to attract and retain key employees, motivate the key employees to achieve strategic objectives and reward key employees for superior performance. Our compensation programs support a pay for performance culture. The success of the Company and its executives is measured by the financial success of our shareholders. Our compensation plans are designed to preserve and grow book value, support sound business practices and credit quality, and maintain and increase shareholder value.

The Compensation Committee has overall responsibility for evaluating the compensation plans, policies and programs relating to the executive officers of the Company. The Company's Chief Executive Officer conducts annual performance reviews for the executive officers, and the Compensation Committee considers the Chief Executive Officer's assessment of each executive officer's individual performance and his salary recommendations for the other executive officers in determining executive officer compensation. The Compensation Committee evaluates the Chief Executive Officer's performance and establishes his compensation. The Chief Executive Officer does not participate in Compensation Committee discussions or decisions relating to his compensation.

The Compensation Committee has the authority to retain inside advisors and has sole authority to retain and pay outside advisors. In 2012, the Compensation Committee continued to work with Pearl Meyer & Partners ("PM&P"), one of the country's largest independent compensation consulting firms addressing executive and director compensation, on a variety of executive compensation matters. The Compensation Committee has reviewed and considered information provided to it by PM&P, the Compensation Committee members and the Company's executive officers, and based on its review and such factors as it deemed relevant, the Compensation Committee has concluded that the advice it receives from PM&P is objective and that PM&P's work did not raise any conflict of interest.

With respect to the Named Executive Officers, the compensation program includes the following: salary, annual cash incentive bonus, long-term incentive compensation (which is delivered primarily through equity awards) and other benefits and perquisites. The compensation program is administered by the Compensation Committee.

Compensation Philosophy

In accordance with its written charter, the Compensation Committee carries out its responsibilities as authorized by the Board with respect to the compensation of the Company's executive officers. The Compensation Committee makes compensation decisions for the Company's executive officers based on the Company's compensation philosophy and the following guiding principles:

- Base salaries are determined with consideration to a number of factors including the positions' roles and responsibilities, competitive market data for similar positions and pay levels for peer positions within the Company.

- A significant portion of our executive officers' compensation is directly and materially linked to operating performance. In particular, annual cash incentive bonus payments are heavily dependent on meeting or exceeding Company performance goals as well as objective and subjective criteria related to the executive officers' areas of responsibility.

- The Company's equity incentive plans are an important component of executive officer compensation. The plans are intended to advance the interest of the Company and its shareholders by encouraging executive officers and other key employees to own Company stock. Through equity grants, the long-range interests of executive officers and other key employees are linked with those of shareholders as they accumulate meaningful stakes in the Company.

- In general, the Company only provides perquisites to executive officers if there is a meaningful benefit to the Company in doing so.

Assessment of Compensation Risk

The Compensation Committee believes that a sensible approach to balancing risk-taking and rewarding the achievement of reasonable, but not necessarily easily attainable, goals is a key component of its overall assessment of the compensation plans, programs and arrangements it has put in place for the Company's Named Executive Officers and all employees. As a publicly-traded financial institution, the Company must contend with several often overlapping layers of regulations when considering and implementing compensation-related decisions. These regulations do not set specific parameters within which compensation decisions must be made, but do require the Company and the Compensation Committee to be mindful of the risks that often go hand-in-hand with compensation programs designed to incentivize the achievement of better than average performance. While the regulatory focus on risk assessment has been heightened over the last several years, the incorporation of general concepts of risk assessment in our compensation decisions is not a recent development.

The Compensation Committee annually reviews the Company's compensation plans and has made all reasonable efforts to ensure that these plans do not encourage the Named Executive Officers or employees to take unnecessary and excessive risks or risks that would adversely affect the Company's performance or long-term value.

Conclusion

Through the leadership of the Company's executive management team we were able to achieve the following in 2012:

- Successfully closed a public offering of $29.1 million in common equity.
- Achieved record net income of $8.9 million, up 6% from the prior year.
- Reached record core earnings of $18.5 million, up 12% from the prior year.[1]
- Achieved return on average assets of 0.75% and return on average equity of 12.65%.
- Reported record average in-market deposits of $649 million, up 25% from the prior year.
- Decreased non-performing assets by $8.3 million, or 35%, over the prior year.

After considering all components of the compensation paid to the Named Executive Officers and the accomplishments described above, the Compensation Committee and the Board believe 2012 was a success for the Company; the Company's achievement of financial results relative to the broader financial services industry is noteworthy and the Named Executive Officer compensation appropriately reflects the Company's compensation philosophy and aligns with the Company's success in meeting its strategic, operating and financial goals.

[1]Core earnings is a non-GAAP financial measure comprised of pre-tax income plus provision for loan and leases losses, other identifiable costs of credit and other discrete items that are unrelated to the Company's core business activities. The presentation of core earnings provides for an assessment of the growth of the Company's core business without the volatility that is associated with costs of credit and other discrete items that are unrelated to its core business. A reconciliation of core earnings to net income before taxes, the most directly comparable GAAP financial measure, can be found on page 32 of the Company's Annual Report on Form 10-K, filed with the SEC on March 8, 2013.

SUMMARY COMPENSATION TABLE

The following table sets forth for each of the Named Executive Officers: (1) the dollar value of base salary during the years ended December 31, 2011 and 2012; (2) the dollar value of the compensation cost of all outstanding stock awards recognized over the requisite service period, computed in accordance with FASB Accounting Standards Codification (ASC) Topic 718 (without reduction for estimated forfeitures); (3) the dollar value of earnings for services pursuant to awards granted during these years under non-equity incentive plans; (4) all other compensation for these years; and (5) the dollar value of total compensation for these years. The Named Executive Officers are Corey A. Chambas, President and Chief Executive Officer of the Company, Michael J. Losenegger, Chief Credit Officer of the Company and Mark J. Meloy, President and Chief Executive Officer of First Business Bank.

Name and Principal Position	Year	Salary ($)	Stock awards ($) (1)	Non-equity incentive plan compensation ($) (2)	All other compensation ($) (3)	Total ($)
Corey A. Chambas	2012	302,000	123,709	192,012	25,382	643,103
President & Chief Executive Officer	2011	290,949	98,890	147,598	22,700	560,138
Michael J. Losenegger	2012	205,107	51,758	78,146	27,685	362,696
Chief Credit Officer	2011	201,085	57,118	69,837	23,271	351,311
Mark J. Meloy	2012	190,216	48,045	87,595	23,571	349,427
Chief Executive Officer First Business Bank	2011	185,577	52,429	51,887	18,949	308,842

1) The value of the restricted stock award is computed by multiplying the number of shares granted by the market value on the grant date. See “Outstanding Equity Awards at December 31, 2012.”

2) The amounts reported in the “Non-equity incentive plan compensation” column were calculated under the Annual Incentive Bonus Program in the calendar year reported. The Board defined specific threshold, target, and superior award opportunities as a percentage of salary for each named executive officer. The specific percentages were based on the individual executive’s position and competitive market data for similar positions. The 2012 awards were contingent primarily on performance relative to goals for return on assets, core earnings growth, and core deposit growth. The performance criteria were equally weighted and reflect the Company’s strategic objectives.

3) The Company provided a 3.0% 401(k) match and a 5.0% discretionary 401(k) profit sharing contribution in 2012 for each of the Named Executive Officers as follows: Mr. Chambas, $7,500 and $12,500; Mr. Losenegger, $7,500 and $12,500; and Mr. Meloy, $7,264 and $12,107. Mr. Chambas and Mr. Losenegger have the use of vehicles owned by the Company. The other compensation listed is the value of their personal mileage, included as a “taxable fringe” on their respective W-2’s. Mr. Meloy receives a $350 per month automobile allowance.

LONG TERM INCENTIVE PLANS

2012 Equity Incentive Plan

The Company adopted the 2012 Equity Incentive Plan (“Plan”) during the quarter ended June 30, 2012. The Plan was established to advance the interests of our shareholders by enhancing the Company’s ability to attract, retain and motivate persons who make or are expected to make important contributions to the Company by providing such persons with equity ownership opportunities and equity-based incentives, thereby aligning the interests of such persons with those of our shareholders. The Plan is administered by the Compensation Committee of the Board and provides for the grant of equity ownership opportunities through incentive stock options and nonqualified stock options, restricted stock, restricted stock units, dividend equivalent units, and any other type of award permitted by the Plan. Shares previously available for grant under the 2006 Equity Incentive Plan were transferred to the Plan. As of December 31, 2012, 218,115 shares were available for future grants under the Plan.

401(k) Retirement Savings Plan

A “tax-qualified” Section 401(k) plan has been adopted by the Board of the Company. All employees who are 21 years old or older and who are projected to work over 1000 hours per year are eligible to begin salary deferrals on the first day of the month following 90 days of employment. Employees may annually contribute the maximum allowed by the Internal Revenue Code. The Company provides a discretionary matching contribution of up to 3.0% of the employee's gross wages. To qualify for the employer match, employees must work over 1000 hours in their first anniversary year, have continuous employment during the year and attain at least age 21. The Company, in its sole discretion, can contribute an additional profit sharing contribution, based on Company performance. Employees are eligible to receive a profit sharing contribution after one year of employment. Employees must be employed on the last day of the plan year and have worked 1000 hours during the plan year to receive the discretionary contribution.

OUTSTANDING EQUITY AWARDS AT DECEMBER 31, 2012

The following table sets forth information on outstanding option and stock awards held by the Named Executive Officers at December 31, 2012, including the number of shares underlying both exercisable and unexercisable portions of each stock option, and the expiration date of each outstanding option.

	Option Awards				Stock Awards		
Name and Principal Position	Number of securities underlying unexercised options (#) exercisable	Number of securities underlying unexercised options (#) unexercisable	Option exercise price ($)	Option expiration date (1)	Grant date (2)	Number of shares or units of stock that have not vested (#)	Market value of shares or units of stock that have not vested ($) (3)
Corey A. Chambas	10,000	0	22.00	1/27/2013			
Chief Executive Officer	10,000	0	24.00	10/18/2014			
	7,000	0	25.00	2/17/2015			
					11/16/2010	4,225	96,964
					8/16/2011	4,350	99,833
					8/16/2012	5,330	122,324
Michael J. Losenegger	5,000	0	22.00	2/17/2013			
Chief Credit Officer	2,500	0	22.00	10/20/2013			
	5,000	0	24.00	10/18/2014			
	5,000	0	25.00	2/17/2015			
					11/16/2010	2,438	55,952
					8/16/2011	2,513	57,673
					8/16/2012	2,230	51,179
Mark J. Meloy	6,500	0	22.00	1/27/2013			
Chief Executive Officer	9,984	0	15.33	1/14/2014			
First Business Bank					11/16/2010	2,263	51,936
					8/16/2011	2,307	52,946
					8/16/2012	2,070	47,507

1) All option grants vested at 25% per year for four years from the grant date. All option grants are fully vested.
2) All restricted stock grants vest at 25% per year for four years from the grant date. The unvested restricted stock will vest as follows. For the grant dated 11/16/2010 to Mr. Chambas: 2,112 will vest on 11/16/2013 and 2,113 will vest on 11/16/2014. For the grant dated 8/16/2011 to Mr. Chambas: 1,450 will vest on 8/16/2013, 1,450 will vest on 8/16/2014 and 1,450 will vest on 8/16/2015. For the grant dated 8/16/2012 to Mr. Chambas: 1,332 will vest on 8/16/2013, 1,333 will vest on 8/16/2014, 1,332 will vest on 8/16/2015, and 1,333 will vest on 8/16/2016. For the grant dated 11/16/10 to Mr. Losenegger: 1,219 will vest on 11/16/13 and 1,219 will vest on 11/16/14. For the grant dated 8/16/2011 to Mr. Losenegger 838 will vest on 8/16/2013, 837 will vest on 8/16/2014 and 838 will vest on 8/16/2015. For the grant dated 8/16/2012 to Mr. Losenegger: 557 will vest on 8/16/2013, 558 will vest on 8/16/2014, 557 will vest on 8/16/2015, and 558 will vest on 8/16/2016. For the grant dated 11/16/10 to Mr. Meloy: 1,131 will vest on 11/16/13 and 1,132 will vest on 11/16/14. For the grant dated 8/16/2011 to Mr. Meloy 769 will vest on 8/16/2013, 769 will vest on 8/16/2014 and 769 will vest on 8/16/2015. For the grant dated 8/16/2012 Mr. Meloy: 517 will vest on 8/16/2013, 518 will vest on 8/16/2014, 517 will vest on 8/16/2015, and 518 will vest on

8/16/2016.

3) Market value is based on the closing price of our stock on December 31, 2012, which was $22.95.

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DISCLOSURE REGARDING TERMINATION AND CHANGE IN CONTROL PROVISIONS

Corey A. Chambas

Effective January 1, 2005, First Business Bank amended and restated an agreement with Corey Chambas, President and Chief Executive Officer of the Company and former President and Chief Executive Officer of First Business Bank. The agreement provides Mr. Chambas with retirement and death benefits as well as certain change in control benefits as outlined below. For purposes of the definition of “Company” under certain provisions of this agreement, Company means First Business Financial Services, Inc. or First Business Bank.

Mr. Chambas is entitled to a change in control benefit if, within two years after the change in control, one of the following occurs:

i) the Company terminates Mr. Chambas' employment without cause;
ii) Mr. Chambas terminates his employment within three months after being demoted or moved outside Milwaukee, Ozaukee, Waukesha, or Dane counties;
iii) Mr. Chambas terminates his employment within three months after his salary is reduced by 10% or more without his agreement; or
iv) Mr. Chambas voluntarily terminates his employment within three months of the change in control.

If Mr. Chambas’ employment is terminated pursuant to (i), (ii), or (iii), then the amount of the change in control benefit payable to Mr. Chambas will be equal to the aggregate of the fair value of Mr. Chambas’ unvested restricted shares issued by the Company, which will be immediately vested, calculated as of the date of his termination or separation from employment, plus such additional amount as will, when added to any parachute payment, as defined in Section 280G of the Internal Revenue Code, made to Mr. Chambas contingent upon the change in control, be equal to 2.99 times his salary (referred to as the “allowable amount”). In the event the amount is greater than the allowable amount, Mr. Chambas will be paid the lesser amount. If Mr. Chambas’ employment is terminated pursuant to (iv), then the change in control benefit payable to Mr. Chambas will be equal to two times his salary, unless such amount will be greater than the allowable amount, in which event Mr. Chambas will be paid the allowable amount.

Under the agreement, Mr. Chambas is prohibited from competing with the Company or any of its affiliates for a period of two years after the termination of his employment.

A “change in control” of the Company will be deemed to have occurred if: (i) any person becomes the beneficial owner of securities of the Company representing at least fifty percent of the combined voting power of the Company’s then outstanding securities; (ii) during any twelve consecutive months, individuals who, at the beginning of the twelve month period constitute the Board of the Company, cease for any reason to constitute a majority of the Board of the Company; provided, however, a change in control shall not occur pursuant to this provision, if a new director is approved by a vote of at least a majority of the directors serving on the Board of the Company, and these directors either were directors at the beginning of the twelve month period or whose election or nomination for election was so approved; or (iii) the shareholders of the Company approve: (A) a plan of complete liquidation of the Company; (B) an agreement for the sale or disposition of all or substantially all of the Company’s assets; or (C) a merger, consolidation, or reorganization of the Company with or involving any other corporation, other than a merger, consolidation, or reorganization that would result in the voting securities of the Company outstanding prior thereto continuing to represent at least fifty percent of the combined voting power of the voting securities of the Company (or such surviving entity) outstanding immediately after or within one year following such merger, consolidation, or reorganization.

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The following table describes the potential payments upon termination or a change in control for Mr. Chambas. The table assumes that his employment was terminated on December 31, 2012, and the price per share was $22.95, the closing price of the Company's Common Stock on December 31, 2012.
Corey A. Chambas

Executive Benefits and Payments upon:	Termination by Company for Cause or by Executive ($)	Termination by Company Not for Cause ($)	Death ($)	Change in Control ($)	Termination by Company not for Cause or by Executive for Good Reason Following Change in Control ($) (1)	Voluntary Termination by Executive Within Three Months of a Change in Control ($) (1)
Compensation						
Severance	0	850,225	0	0	720,418	720,418
Consulting Fees	0	10,000	0	0	10,000	10,000
Restricted Stock Unvested & Accelerated	0	0	319,120	319,120	0	0
Benefits and Perquisites						
Supplemental Retirement Benefits	0	0	1,500,000	0	0	0
Total	0	860,225	1,819,120	319,120	730,418	730,418

1) The total benefit to Mr. Chambas excludes the value received through the acceleration of unvested restricted stock because the value is transferred upon the occurrence of a change in control and is not contingent upon a separation from the Company.

Mr. Chambas' other potential benefits do not become vested either partially or completely until December 1, 2016.

The agreement also provides that, in the event Mr. Chambas dies while in the employ of the Company, the Company shall pay to his designated beneficiary or to his estate, the sum of $1,500,000. This supplemental retirement benefit as described above is paid over a period of ten years beginning on the 15th day of the month immediately following Mr. Chambas' death. Under normal circumstances, the death benefit is paid in lieu of, rather than in addition to the retirement benefit. If, however, the amount of normal or early retirement benefit Mr. Chambas would be entitled to on the day of his death exceeds the amount of the death benefit, then the retirement benefit shall be paid as a replacement for the death benefit.

If Mr. Chambas is terminated for a reason other than cause prior to a change in control or more than two years after a change in control, then he will be entitled to a severance benefit equal to the greater of two times his salary (defined above) or the amount of any early or normal retirement benefit. If Mr. Chambas is terminated for cause, all of the Company's obligations to pay any benefit under the agreement shall immediately become null and void.

"Cause" shall be determined by the Board of the Company, in the exercise of good faith and reasonable judgment, and shall generally mean any of the following:

i) the willful, intentional, and continued failure by Mr. Chambas to substantially perform his duties to the best of his ability after a written demand for performance is delivered by the Board of the Company to Mr. Chambas that identifies the failure to perform such duties if such failure is not remedied within ninety calendar days after receipt of the written demand by Mr. Chambas; or

ii) the occurrence of Mr. Chambas' conviction for committing an act of fraud, embezzlement, theft or other act constituting a felony substantially related to the circumstances of his duties; or material breach by Mr. Chambas of the banking laws of Wisconsin or the United State or any regulation issued by a state or federal regulatory authority having jurisdiction over the banking affairs of FBB, or any of its subsidiaries, parent or affiliated organizations; or an act that disqualifies Mr. Chambas from serving as an officer or director of a bank under Wisconsin or federal banking laws.

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Michael J. Losenegger

Effective August 6, 2007, the Company entered into an Executive Change in Control Severance Agreement with Michael J. Losenegger, Chief Credit Officer of the Company. The agreement is triggered by a change in control of the Company and requires the Company to make payment of severance benefits to Mr. Losenegger if any event defined as a “qualifying termination” occurs. A qualifying termination is defined as:

i) separation from service with the Company due to the Company’s involuntary termination of Mr. Losenegger’s employment without cause; or

ii) separation from service with the Company due to Mr. Losenegger’s termination of employment for good reason, meaning any one or more of the following:

- a material reduction of Mr. Losenegger's authorities, duties, or responsibilities as Chief Credit Officer;
- a requirement that Mr. Losenegger move to a location in excess of one hundred miles from his principal job location;
- a reduction in Mr. Losenegger's base salary in effect at the time of the change in control;
- the failure of the Company to continue Mr. Losenegger's participation in employee benefit programs, non-equity incentive programs, or other compensation arrangements then in effect;
- the failure of the Company to obtain a satisfactory agreement from any successor to the Company to perform the Company's obligations under this agreement; or
- a material breach of the agreement by the Company that is not remedied within ten business days of receipt of a written notice of the breach delivered to the Company by Mr. Losenegger.

Under the agreement, Mr. Losenegger is prohibited from competing with the Company or any of its affiliates for a period of two years after the termination of his employment.

The following table describes the payments that would be made to Mr. Losenegger if a qualified termination had occurred on December 31, 2012. The table assumes that his employment was terminated on December 31, 2012, and the price per share was $22.95, the closing price of the Company’s Common Stock on December 31, 2012.

Michael J. Losenegger

Executive Benefits and Payments upon :	Change in Control Resulting in a Qualified Termination ($)
Compensation	
Severance	461,491
Restricted Stock Unvested & Accelerated	164,804
Benefits and Perquisites	
Health Benefits	18,343
Total	644,638

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If Mr. Losenegger becomes entitled to severance benefits, then the Company would be obligated to pay to and provide him with:

i) a lump sum cash amount equal to Mr. Losenegger's unpaid base salary, accrued vacation pay, and unreimbursed business expenses from the most recently completed fiscal year;
ii) any amount payable to Mr. Losenegger under the non-equity incentive compensation plan then in effect;
iii) a cash amount equal to two times Mr. Losenegger's annual base salary;
iv) a lump sum cash amount equal to the greater of (a) Mr. Losenegger's then-current target incentive compensation opportunity established under any annual non-equity incentive plan; or (b) his target incentive compensation opportunity in effect prior to the change in control; and
v) the continuation of Mr. Losenegger's health insurance coverage for eighteen months from the effective date of termination.

Subject to certain exceptions, a "change in control" will occur if any of the following events occur:

i) the acquisition by any individual, entity, or group, of beneficial ownership of more than fifty percent of the combined voting power of the Company's outstanding securities with respect to the election of directors of the Company;
ii) the consummation of a reorganization, merger or consolidation of the Company or sale or other disposition of all or substantially all of the assets of the Company (a "Corporate Transaction"); excluding, however a Corporate Transaction pursuant to which all or substantially all of the individuals or entities who are the beneficial owners of the Company immediately prior to the Corporate Transaction will beneficially own, directly or indirectly, more than fifty percent of the outstanding shares of common stock of the resulting entity and of the combined voting power of the outstanding securities entitled to vote for the election of directors of such entity; or
iii) during any period of not more than twelve consecutive months, individuals who at the beginning of such period constitute the Board of the Company, and any new director whose election by the Board of the Company or nomination for election by the Company's shareholders was approved by a vote of at least a majority of the directors then still in office who either were directors at the beginning of the period or whose election or nomination for election was previously so approved, cease for any reason to constitute a majority.

Mark J. Meloy

Effective August 6, 2007, First Business Bank, entered into an Executive Change in Control Severance Agreement with Mark J. Meloy, President and Chief Executive Officer of FBB. The agreement is triggered by a change in control of FBB or the Company and requires FBB or the Company to make payment of severance benefits to Mr. Meloy if any event defined as a qualifying termination occurs. A qualifying termination is defined as:

i) separation from service with FBB or the Company due to FBB's or the Company's involuntary termination of Mr. Meloy's employment without cause; or
ii) separation from service with FBB or the Company due to Mr. Meloy's termination of employment for good reason, meaning any one or more of the following:
- a material reduction of Mr. Meloy's authorities, duties, or responsibilities as President and CEO;
- a requirement that Mr. Meloy move to a location in excess of one hundred miles from his principal job location;

- a reduction in Mr. Meloy’s base salary in effect at the time of the change in control;
- the failure of FBB or the Company to continue Mr. Meloy’s participation in employee benefit programs, non-equity incentive programs, or other compensation arrangements then in effect;
- the failure of FBB or the Company to obtain a satisfactory agreement from any successor to the Company to perform the Company’s obligations under the agreement; or
- a material breach of this agreement by FBB or the Company that is not remedied within ten business days of receipt of a written notice of the breach delivered to FBB or the Company by Mr. Meloy.

Under the agreement, Mr. Meloy is prohibited from competing with the Company or any of its affiliates for a period of two years after the termination of his employment.

The following table describes the payments that would be made to Mr. Meloy if a qualified termination had occurred on December 31, 2012. The table assumes that his employment was terminated on December 31, 2012, and the price per share was $22.95, the closing price of the Company’s Common Stock on December 31, 2012.

Mark J. Meloy

Executive Benefits and Payments upon :	Change in Control Resulting in a Qualified Termination ($)
Compensation	
Severance	427,986
Restricted Stock Unvested & Accelerated	152,388
Benefits and Perquisites	
Health Benefits	18,343
Total	598,717

If Mr. Meloy becomes entitled to severance benefits, the Company or FBB is obligated to pay to and provide him with:

i) a lump sum cash amount equal to Mr. Meloy’s unpaid base salary, accrued vacation pay, and unreimbursed business expenses from the most recently completed fiscal year;
ii) any amount payable to Mr. Meloy under the non-equity incentive compensation plan then in effect;
iii) a cash amount equal to two times Mr. Meloy’s annual base salary;
iv) a lump sum cash amount equal to the greater of (a) Mr. Meloy’s then-current target incentive compensation opportunity established under any annual non-equity incentive plan; or (b) his target incentive compensation opportunity in effect prior to the change in control; and
v) the continuation of Mr. Meloy’s health insurance coverage for eighteen months from the effective date of termination.

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Subject to certain exceptions, a "change in control" will occur if any of the following events occur, provided that, for purposes of this definition, "Company" includes both First Business Bank and First Business Financial Services, Inc.:

i) the acquisition by any individual, entity, or group, of beneficial ownership of more than fifty percent of the combined voting power of the Company's outstanding securities with respect to the election of directors of the Company;

ii) the consummation of a Corporate Transaction; excluding, however a Corporate Transaction pursuant to which all or substantially all of the individuals or entities who are the beneficial owners of the Company immediately prior to the Corporate Transaction will beneficially own, directly or indirectly, more than fifty percent of the outstanding shares of common stock of the resulting entity and of the combined voting power of the outstanding securities entitled to vote for the election of directors of such entity; or

iii) during any period of not more than twelve consecutive months, individuals who at the beginning of such period constitute the Board of the Company, and any new director whose election by the Board of the Company or nomination for election by the Company's shareholders was approved by a vote of at least a majority of the directors then still in office who either were directors at the beginning of the period or whose election or nomination for election was previously so approved, cease for any reason to constitute a majority.

ITEM 2 – NON-BINDING ADVISORY PROPOSAL ON EXECUTIVE COMPENSATION

Section 14A of the Exchange Act, as created by Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), and the rules and regulations promulgated thereunder by the SEC, require publicly traded companies, such as the Company, to conduct a separate shareholder advisory vote to approve the compensation of the registrant's executive officers, as disclosed pursuant to the SEC's compensation disclosure rules, commonly referred to as a "say-on-pay" vote. In accordance with these requirements, we are providing shareholders with an advisory vote on the compensation of our Named Executive Officers.

The overall objectives of the Company's compensation programs have been to align executive officer compensation with the success of meeting annual and long-range strategic operating and financial goals. The Compensation Committee and our Board believe that the Company's policies and procedures are effective in implementing our compensation philosophy and achieving our goals, and that the compensation of our Named Executive Officers in 2012 reflects and supports these compensation policies and procedures.

In accordance with the requirements of the Dodd-Frank Act and the rules and regulations promulgated thereunder, the following resolution is submitted for shareholder approval:

"RESOLVED, that First Business Financial Services, Inc.'s shareholders approve, on an advisory basis, the compensation of the Company's Named Executive Officers, as described in the Company's proxy statement dated March 28, 2013."

Approval of this resolution requires that the number of votes cast in favor of the resolution at the Annual Meeting exceed the number of votes cast against it. While this say-on-pay vote is required, as provided in Section 14A of the Exchange Act, it is not binding on the Compensation Committee or our Board and may not be construed as overruling any decision by the Compensation Committee or our Board. However, the Compensation Committee will take into account the outcome of the vote when considering future compensation arrangements. Abstentions and broker non-votes will not affect the voting results for this proposal.

THE BOARD RECOMMENDS SHAREHOLDERS VOTE TO APPROVE THE OVERALL COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS, AS DESCRIBED IN THIS PROXY STATEMENT, BY VOTING "FOR" THIS PROPOSAL. SHARES OF COMMON STOCK REPRESENTED BY EXECUTED BUT UNMARKED PROXIES WILL BE VOTED "FOR" THIS PROPOSAL.

ITEM 3 – NON-BINDING ADVISORY VOTE ON FREQUENCY OF SHAREHOLDER VOTES ON EXECUTIVE COMPENSATION

Section 14A of the Exchange Act, as created by Section 951 of the Dodd-Frank Act, and the rules and regulations promulgated thereunder require publicly traded companies, such as the Company, to provide a separate shareholder vote on the frequency with which shareholders shall conduct an advisory say-on-pay vote on executive compensation, such as the proposal above. In accordance with these requirements, we are providing shareholders with an advisory vote on the frequency with which our shareholders will vote on a say-on-pay proposal.

The advisory vote on the frequency of say-on-pay votes is a non-binding vote as to how often say-on-pay votes should occur: every year, every two years, or every three years. In addition to those choices, shareholders may also abstain from voting. Section 14A of the Exchange Act requires us to hold an advisory vote on the frequency of say-on-pay votes at least once every six years.

After careful consideration, our Board recommends that future shareholder say-on-pay votes be conducted annually. The Board values and encourages constructive input from our shareholders regarding the Company’s compensation philosophy, policies and practices, and believes it is important that such policies and practices are aligned with the best interests of our shareholders. An annual say-on-pay vote will provide the Board and Compensation Committee with useful information on shareholder sentiment about these important matters on the most frequent and consistent basis.

Although the Board recommends a say-on-pay vote every year, shareholders are not voting to approve or disapprove the Board’s recommendation. Rather, shareholders are being asked to vote on the following resolution:

“RESOLVED, that the shareholders of First Business Financial Services, Inc. determine, on an advisory basis, that the frequency with which the shareholders shall have an advisory vote on executive compensation set forth in the Company’s proxy statement for its annual meeting of shareholders, beginning with the 2013 Annual Meeting of Shareholders, is (i) every year, (ii) every two years, or (iii) every three years.”

The choice which receives the highest number of votes will be deemed the choice of the shareholders.

While this advisory vote is required, as provided in Section 14A of the Exchange Act, it is not binding on our Compensation Committee or Board of Directors and may not be construed as overruling any decision by the Compensation Committee or the Board. However, the Compensation Committee will take into account the outcome of the vote when determining the frequency of future say-on-pay votes. Abstentions and broker non-votes will not affect the voting results for this proposal.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE “EVERY YEAR” FREQUENCY ALTERNATIVE. SHARES OF COMMON STOCK REPRESENTED BY EXECUTED BUT UNMARKED PROXIES WILL BE VOTED FOR THE “EVERY YEAR” FREQUENCY ALTERNATIVE.

SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires the Company's directors, executive officers and holders of 10% or more of the outstanding Common Stock to file reports concerning their ownership of Company equity securities with the SEC. Based solely upon a review of such reports, the Company believes that during the fiscal year ended December 31, 2012, all of its directors and executive officers complied with the Section 16(a) filing requirements except that one de minimis recurring stock purchase as part of a stock purchase plan was filed late on a Form 4 for Mark D. Bugher and one purchase was filed late on a Form 4 for Joan A. Burke.

RELATED PARTY TRANSACTIONS

Under its written charter, the Audit Committee is responsible for reviewing related party transactions and potential conflicts of interest. The Audit Committee is also responsible for reviewing, on an annual basis, a report prepared by management summarizing the Company's compliance with the Federal Reserve System's Regulation O and the FR Y-6 Report filed with the Federal Reserve Bank. The Company's executive officers and directors and their associates have been, and the Company anticipates that they will continue to be, clients of the Company's subsidiary banks, First Business Bank and First Business Bank-Milwaukee (the "Banks") in the ordinary course of business, which includes maintaining deposit, trust and other fiduciary accounts and obtaining loans. The Banks have granted various types of loans to the Company's executive officers and directors, and to entities controlled by them. As of December 31, 2012, such loans: (i) were made consistent with similar practices in the banking industry generally; (ii) were made in the ordinary course of business and on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with the Bank's other clients; (iii) did not involve more than the normal risk of collectability or present other unfavorable features; (iv) and were subject to and made in accordance with the Federal Reserve System's Regulation O. All extensions of credit made to the Company's directors are approved by the Banks' boards of directors as insider loans under Regulation O requirements.

MISCELLANEOUS

Independent Registered Public Accounting Firm

KPMG LLP acted as the Company's independent registered public accounting firm for its fiscal year ended December 31, 2012. The Audit Committee is solely responsible for the selection, retention, oversight and, when appropriate, termination of the Company's independent registered public accounting firm. Representatives of KPMG LLP are expected to be present at the Annual Meeting with the opportunity to make a statement if they so desire. Such representatives are also expected to be available to respond to appropriate questions.

The fees to KPMG LLP for the fiscal years ended December 31, 2012 and 2011 were as follows:

	2,012	2,011
Audit Fees[(1)]...	$363,188	$163,700
Audit-Related Fees..	--	--
Tax Fees..	--	--
All Other Fees..	--	--
Total..	$363,188	$163,700

(1) Audit fees consist of fees incurred in connection with the audit of annual financial statements, the review of interim financial statements included in the quarterly reports on Form 10-Q, the issuance of consents, the issuance of comfort letters, assistance with and review of documents filed with the SEC and reports on internal controls. The primary reason for the increase is due to the service provided for, and in relation to, the Company's equity offering completed in December 2012.

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Audit Committee Pre-Approval Policy

The Audit Committee has established pre-approval policies and procedures with respect to audit and permitted non-audit services to be provided by its independent registered public accounting firm. Pursuant to these policies and procedures, the Audit Committee may form, and delegate authority to, subcommittees consisting of one or more members when appropriate to grant such pre-approvals, provided that decisions of such subcommittee to grant pre-approvals are presented to the Audit Committee at its next scheduled meeting. The Audit Committee's pre-approval policies do not permit the delegation of the Audit Committee's responsibilities to management. During 2012, approximately $1,500 of fees to the independent registered public accounting firm were approved pursuant to the de minimis exception under the SEC’s rules, representing 0.4% of the amount paid by the Company to KPMG LLP.

ITEM 4 – RATIFICATION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee has selected KPMG LLP as the Company’s independent registered public accounting firm for the year ending December 31, 2013. Although not required to be submitted to a shareholder vote, the Board believes it appropriate to obtain shareholder ratification of the Audit Committee’s action in appointing KPMG LLP as the Company’s independent registered public accounting firm. Should such appointment not be ratified by the shareholders, the Audit Committee will reconsider the matter. The Audit Committee expects that the Board will ratify the appointment of KPMG LLP as the Company’s independent registered public accounting firm at their first meeting after the Annual Meeting. Unless shareholders otherwise specify, the shares represented by the proxies received will be voted “FOR” the ratification of the appointment of KPMG LLP as the Company’s independent registered public accounting firm. The affirmative vote of a majority of the votes cast in person or by proxy at the Annual Meeting will be required to ratify the appointment of KPMG LLP as the Company’s independent registered public accounting firm. Abstentions and broker non-votes will not affect the voting results for this proposal.

THE BOARD RECOMMENDS THE RATIFICATION OF THE AUDIT COMMITTEE’S APPOINTMENT OF KPMG LLP AS THE COMPANY’S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE YEAR ENDING DECEMBER 31, 2013 AND THAT EACH SHAREHOLDER VOTE “FOR” SUCH RATIFICATION. SHARES OF COMMON STOCK REPRESENTED BY EXECUTED BUT UNMARKED PROXIES WILL BE VOTED “FOR” THE RATIFICATION OF THE AUDIT COMMITTEE’S APPOINTMENT OF KPMG LLP AS THE COMPANY’S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM.

OTHER MATTERS

Shareholder Proposals

Proposals that shareholders of the Company intend to include in the Company’s proxy statement for the 2014 annual meeting and present at the 2014 annual meeting pursuant to SEC Rule 14a-8 must be received by the Company by the close of business on November 29, 2013. In addition, a shareholder who otherwise intends to present business at the 2014 annual meeting (including nominating persons for election as directors) must comply with the requirements set forth in the Company’s Amended and Restated Bylaws. Among other things, to bring business before an annual meeting, a shareholder must give written notice thereof, complying with the Amended and Restated Bylaws, to the Corporate Secretary of the Company not less than 60 days and not more than 90 days prior to the anniversary date of the previous year’s annual meeting (subject to certain exceptions if the annual meeting is advanced or delayed a certain number of days). Under the Amended and Restated Bylaws, if the Company does not receive notice of a shareholder proposal submitted otherwise than pursuant to Rule 14a-8 (i.e., proposals shareholders intend to present at the 2014 annual meeting but do not intend to include in the Company’s proxy statement for such meeting) after February 19, 2014 and before March 21, 2014, then the notice will be considered untimely and the Company will not be required to present such proposal at the 2014 annual meeting. If the Board chooses to present such proposal at the 2014 annual meeting, then the persons named in proxies solicited by the Board for the 2014 annual meeting may exercise discretionary voting power with respect to such proposal.

Other Matters

The cost of soliciting proxies will be borne by the Company. In addition to soliciting proxies by mail, proxies may be solicited personally and by telephone by certain directors, officers and employees of the Company, who will receive no extra compensation for their services. The Company will reimburse brokers and other nominees for their reasonable expenses in communicating with the persons for whom they hold Common Stock.

Pursuant to the rules of the SEC, services that deliver the Company's communications to shareholders that hold stock through a bank, broker or other holder of record may deliver to multiple shareholders sharing the same address a single copy of the Company's annual report to shareholders and proxy statement. Upon written or oral request, the Company will promptly deliver a separate copy of the annual report to shareholders and/or proxy statement to any shareholder at a shared address to which a single copy of each document was delivered. Similarly, if shareholders sharing an address wish to receive a single copy of future notices, proxy statements or annual reports, the Company will comply upon receipt of such request. Shareholders may notify the Company of their requests by writing Barbara M. Conley, SVP, General Counsel and Corporate Secretary, First Business Financial Services, Inc., 401 Charmany Drive, Madison, Wisconsin 53719 or calling her at 608-238-8008.

By Order of the Board of Directors
FIRST BUSINESS FINANCIAL SERVICES, INC.
/s/ Barbara M. Conley
Barbara M. Conley
SVP, General Counsel and Corporate Secretary

March 28, 2013

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