
# Live Oak Bancshares

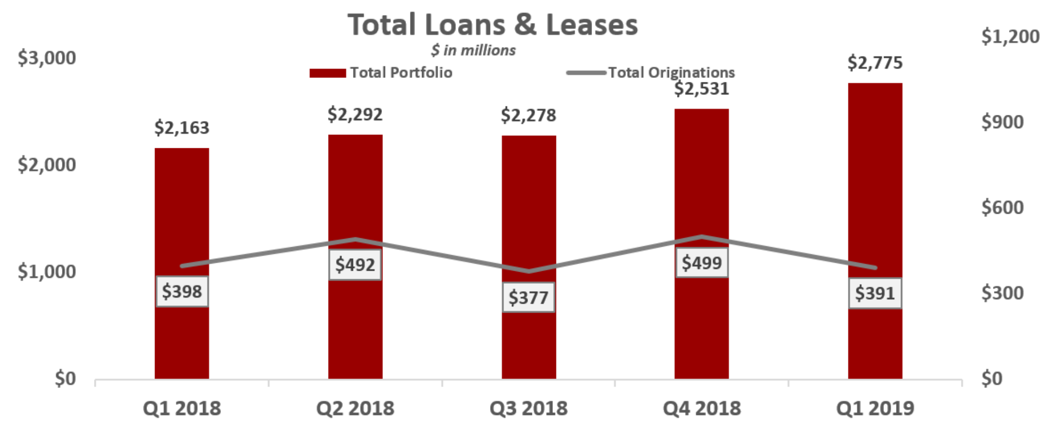
CFO Highlights

## CFO Highlights: Q1 2019

Our net income in the first quarter of 2019 totaled $2.4 million, or $0.06 per diluted share. Our recurring revenue streams of net interest income and servicing revenue rose to $38.0 million and comprised 87.1% of our total revenue for the quarter and nearly covered in full our noninterest expense $38.2 million.

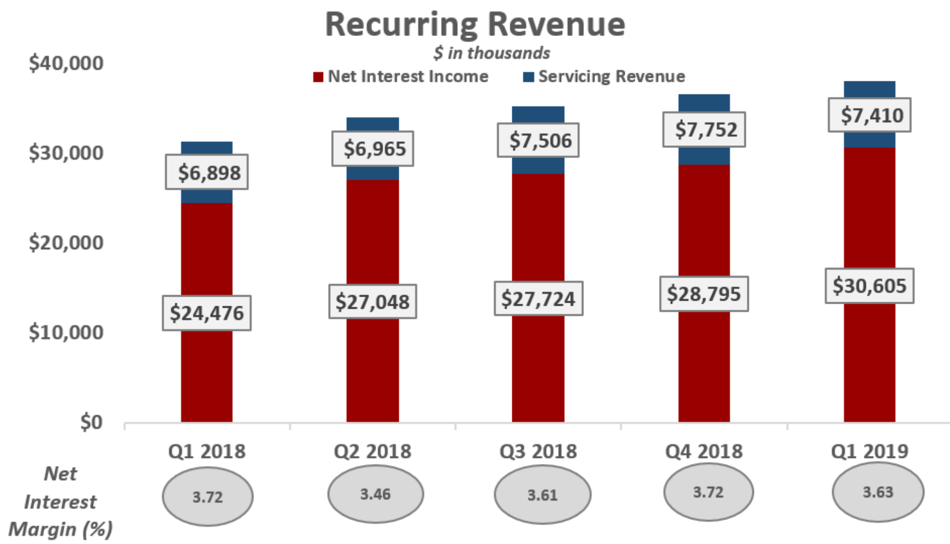
**Revised Strategy:** During the fourth quarter of 2018, we initiated our business model pivot to retain a larger portion of our loans eligible for sale on balance sheet intended to reduce future earnings volatility and maximize long-term profitability with a more predictable earnings model. During the first quarter, $226.7 million of guaranteed loans became eligible for sale and $62.9 were sold, a 72.2% retention rate. This percentage is consistent with our goal to hold 50% to 75% of loans that become eligible for sale with a long-term target of approximately 65%.

**Loan & Lease Portfolio**

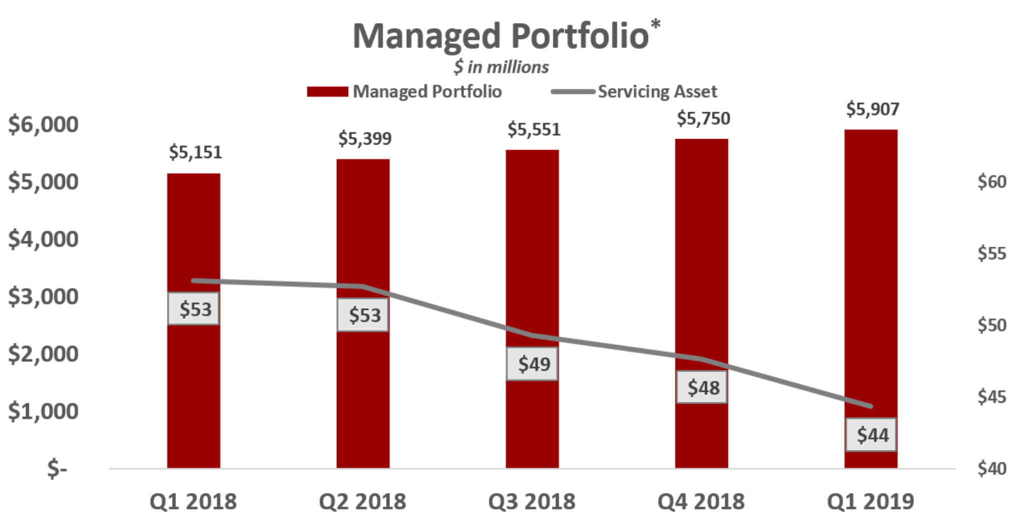



Our total portfolio of loans and leases held for investment and held for sale increased by 28.3% over the prior year and grew by 9.6% compared to the prior quarter. The decrease in originations to $390.9 million during the first quarter of 2019 is primarily the result of seasonality in loan demand that typically occurs during the first quarter of the year.

## Sustained Recurring Revenue




The recurring revenue streams of net interest income and servicing revenue for our sold and serviced loan portfolio grew to $38.0 million for the first quarter of 2019, a 21.2% increase compared to the prior year's level, and represented 87.1% of total revenues for the quarter. Net interest income increased in the first quarter to $30.6 million, a 25.0% increase over the prior year attributable to much higher earning asset levels. On a linked quarter basis, the net interest margin declined 9 basis points to 3.63% as the increasing rates for deposits due to competitive pressures outpaced the improving yield of the loan portfolio. Servicing revenue on our sold and serviced loan portfolio amounted to $7.4 million during the first quarter of 2019, an increase of 7.4% over the prior year. Compared to the prior quarter, servicing revenue declined $342 thousand, or 4.4%, as the amortization of the serviced portfolio outpaced the addition of new loans driven by our strategic decision to sell fewer loans. The managed portfolio, as defined below, at March 31, 2019, totaled $5.91 billion, a 14.7% increase over its level a year ago.

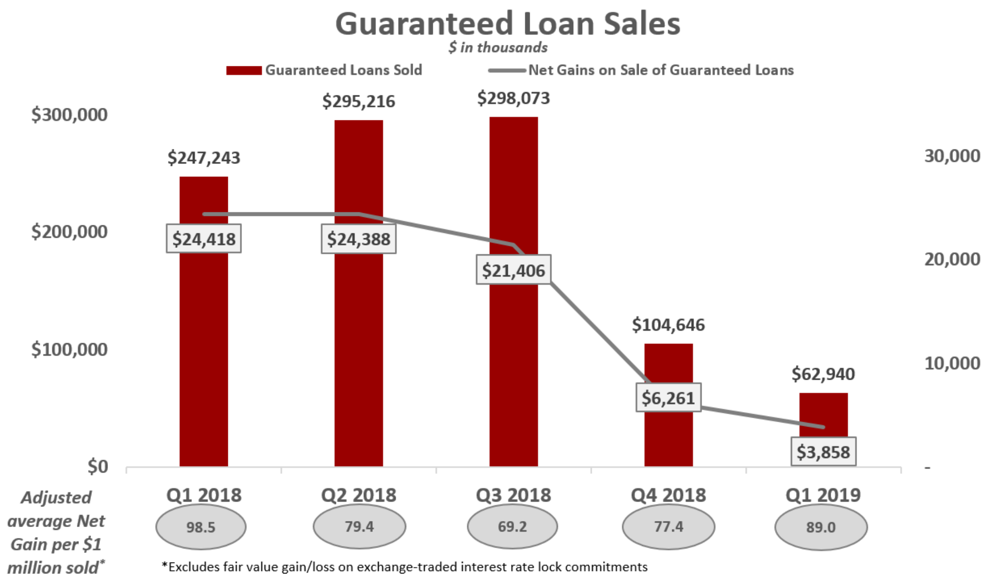



*Outstanding balance of sold and serviced loans plus loans and leases held for investment and held for sale.

At the end of the first quarter of 2019, the carrying value of the servicing asset amounted to $44.3 million, a decline of $3.3 million compared to the prior quarter as the serviced portfolio has declined.

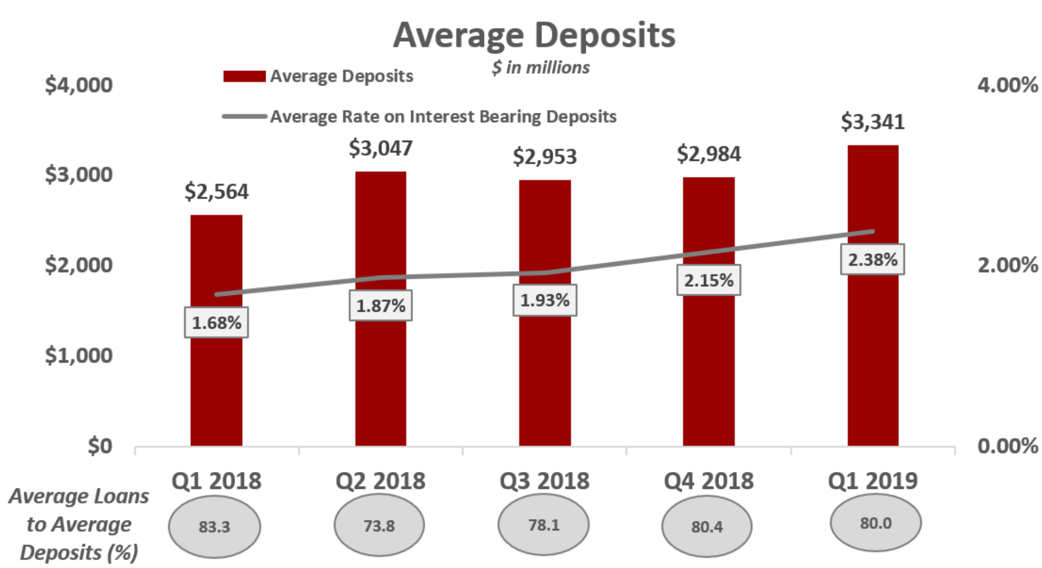
The revaluation of the loan servicing asset for the first quarter of 2019 resulted in a net loss of $2.2 million, which was primarily attributable to amortization of the serviced portfolio.

## Secondary Market Sales




Loan sale volumes in the first quarter of 2019 decreased materially compared to prior quarters as we continued our strategy to focus more on loan retention. Accordingly, gain on sale revenue for guaranteed loans decreased in the first quarter of 2019 to $3.9 million. With the improving secondary market for loan sales during the first quarter, the average net gain per $1 million sold, excluding the fair value adjustment for exchange-traded interest rate lock commitments, increased to $89.0 thousand compared to $77.4 thousand for the fourth quarter of 2018 reflecting our greater selectivity in designating loans to sell.

## Funding Our Strategy



The average balance of deposits increased $356.3 million during the first quarter of 2019 compared to the prior quarter. Our recent decision to hold more loans on balance sheet has increased the importance of our deposit funding model. We continue to operate an efficient branchless model for deposit gathering, at an incremental cost of 12 basis points for the first quarter of 2019, which allows us to offer competitive rates in an efficient manner. The average rate on interest bearing deposits increased 23 basis points from the prior quarter consistent with the higher rate environment and competitive pressures.

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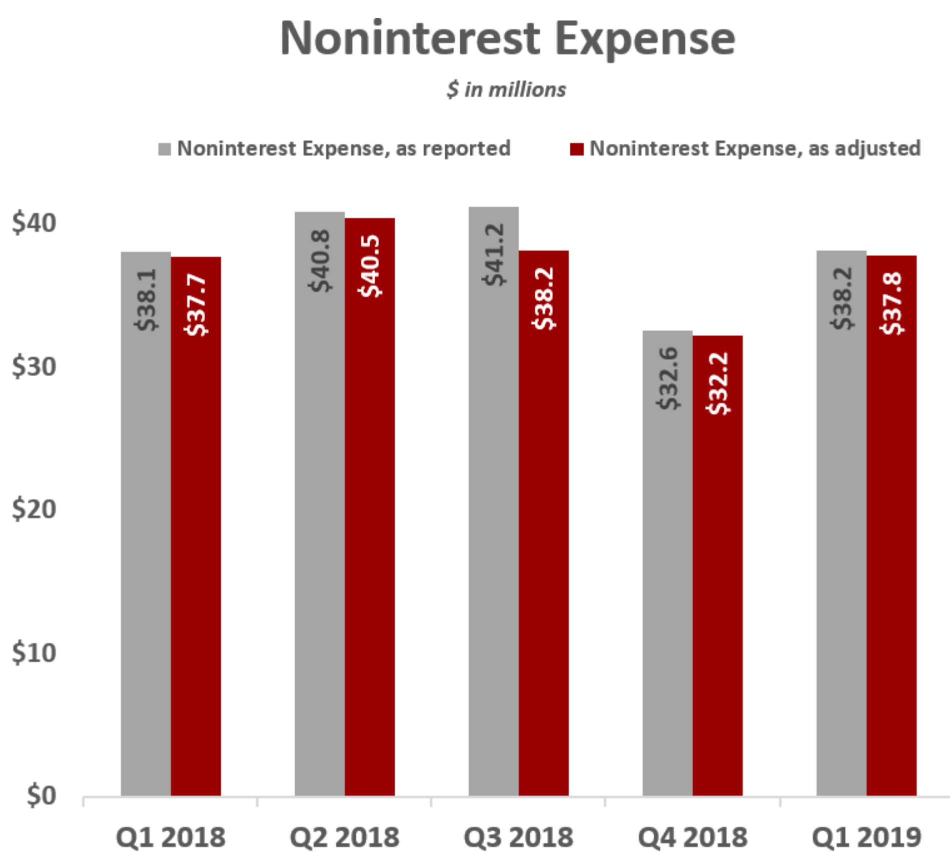
## Scaling the Platform




Our non-GAAP noninterest expense, as adjusted(1), totaled $37.8 million for the first quarter of 2019. The $5.6 million increase over the fourth quarter of 2018 is primarily the result of the $4.5 million reversal of accrued incentive compensation. Noninterest expense for the first quarter of 2019 was relatively flat compared to the same quarter one year ago. The first quarter of 2019 also benefited from the expiration of contract services for data processing and development activities provided by Apiture as part of the transition services agreement.

(1) See Appendix for GAAP to Non-GAAP Reconciliation

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## Credit Quality

Our net charge-offs during the first quarter of 2019 totaled $65 thousand compared to $1.2 million in the prior quarter. Net charge-offs as a percentage of average held for investment loans and leases, annualized, for the first quarter of 2019 was 0.01% compared to 0.28% for the fourth quarter of 2018. While net charge-offs decreased substantially compared to prior quarters, the unguaranteed exposure of nonperforming loans increased to $20.2 million, or 1.2% of total unguaranteed exposure, during the first quarter of 2019 compared to $14.5 million for the prior quarter. The percentage of the unguaranteed portion of criticized loans and leases to total unguaranteed HFI loans and leases increased to 5.39% for the first quarter of 2019 compared to 5.12% for the prior quarter.

Provision expense decreased compared to the previous quarter and the first quarter of 2018. This was the result of growth in the loan portfolio principally comprised of guaranteed loans combined with decreased levels of net charge-offs. The loan and lease loss provision totaled $2.7 million for the first quarter of 2019, well above net charge-offs. The allowance to loans and leases held for investment was 1.75% for the first quarter of 2019, similar to 1.76% for the prior quarter.

## Income Tax Expense

We incurred a net income tax expense of $317 thousand which equates to an effective rate of 11.8%, in the first quarter of 2019 compared to $315 thousand in the first quarter of 2018 and a net income tax benefit of $3.0 million in the fourth quarter of 2018. Our effective tax rate is heavily influenced by our continued investment in renewable energy assets for leasing activities which generate investment tax credits.

## Appendix

### GAAP to Non-GAAP Reconciliation

| | Three months ended | | | | |
|---|---|---|---|---|---|
| | **1Q 2018** | **2Q 2018** | **3Q 2018** | **4Q 2018** | **1Q 2019** |
| Noninterest expense, as reported | $ 38,072 | $ 40,830 | $ 41,244 | $ 32,558 | $ 38,201 |
| Stock based compensation expense | (352) | (357) | (360) | (360) | (352) |
| Impairment expense on goodwill and other intangibles, net | — | — | (2,680) | — | — |
| Noninterest expense, as adjusted | $ 37,720 | $ 40,473 | $ 38,204 | $ 32,198 | $ 37,849 |

## *Forward-Looking Statements*

Information in this document may contain "forward-looking statements" within the Private Securities Litigation Reform Act of 1995. These statements generally relate to our financial condition, results of operations, plans, objectives, future performance or business and usually can be identified by the use of forward-looking terminology such as "may," "will," "would," "should," "could," "expect," "anticipate," "estimate," "believe," "plan," "intend," "project," "goals," "outlook," or "continue," or the negative thereof or other variations thereof or comparable terminology. These statements represent our judgment concerning the future and are subject to business, economic and other risks and uncertainties, both known and unknown. These statements are based on current expectations, estimates and projections about our business, management's beliefs and assumptions made by management. These statements are not guarantees of our future performance and involve certain risks and uncertainties, which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in the forward-looking statements. These risks, uncertainties and assumptions include, without limitation:

- deterioration in the financial condition of borrowers resulting in significant increases in our loan and lease losses and provisions for those losses and other adverse impacts to results of operations and financial condition;
- changes in SBA rules, regulations and loan products, including specifically the Section 7(a) program, changes in SBA standard operating procedures or changes to Live Oak Banking Company's status as an SBA Preferred Lender;
- changes in rules, regulations or procedures for other government loan programs, including those of the United States Department of Agriculture;
- changes in interest rates that affect the level and composition of deposits, loan demand and the values of loan collateral, securities, and interest sensitive assets and liabilities;
- the failure of assumptions underlying the establishment of reserves for possible loan and lease losses;
- changes in loan underwriting, credit review or loss reserve policies associated with economic conditions, examination conclusions, or regulatory developments;
- a reduction in or the termination of our ability to use the technology-based platform that is critical to the success of our business model, including a failure in or a breach of our operational or security systems or those of its third party service providers;
- changes in financial market conditions, either internationally, nationally or locally in areas in which we conduct operations, including reductions in rates of business formation and growth, demand for our products and services, commercial and residential real estate development and prices, premiums paid in the secondary market for the sale of loans, and valuation of servicing rights;
- changes in accounting principles, policies, and guidelines applicable to bank holding companies and banking;
- fluctuations in markets for equity, fixed-income, commercial paper and other securities, which could affect availability, market liquidity levels, and pricing;
- the effects of competition from other commercial banks, non-bank lenders, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and mutual funds, and other financial institutions operating in our market area and elsewhere, including institutions operating regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone and the Internet;
- our ability to attract and retain key personnel;
- changes in governmental monetary and fiscal policies as well as other legislative and regulatory changes, including with respect to SBA lending programs and investment tax credits;
- changes in political and economic conditions;
- the impact of heightened regulatory scrutiny of financial products and services, primarily led by the Consumer Financial Protection Bureau;
- our ability to comply with any requirements imposed on us by our regulators, and the potential negative consequences that may result;
- operational, compliance and other factors, including conditions in local areas in which we conduct business such as inclement weather or a reduction in the availability of services or products for which loan proceeds will be used, that could prevent or delay closing and funding loans before they can be sold in the secondary market;
- the effect of any mergers, acquisitions or other transactions, to which we may from time to time be a party, including management's ability to successfully integrate any businesses that we acquire;
- other risk factors listed from time to time in reports that we file with the SEC, including in our Annual Report on Form 10-K; and
- our success at managing the risks involved in the foregoing.

Given these risks, uncertainties and other factors, you should not place undue reliance on these forward-looking statements. Moreover, these forward-looking statements speak only as of the date they are made and based only on information actually known to us at the time. We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. Except as otherwise disclosed, forward-looking statements do not reflect: (i) the effect of any acquisitions, divestitures or similar transactions that have not been previously disclosed; (ii) any changes in laws, regulations or regulatory interpretations; or (iii) any change in current dividend or repurchase strategies, in each case after the date as of which such statements are made.