Live Oak Bancshares

CFO Highlights

CFO Highlights: Q4 2018

Our net income in the fourth quarter of 2018 totaled $10.5 million, or $0.26 per diluted share. For the full year of 2018, net income totaled $51.4 million, or $1.24 per diluted share. We exited 2018 at $3.67 billion in total assets with substantial loan and lease growth of $506.4 million compared to the prior year-end.

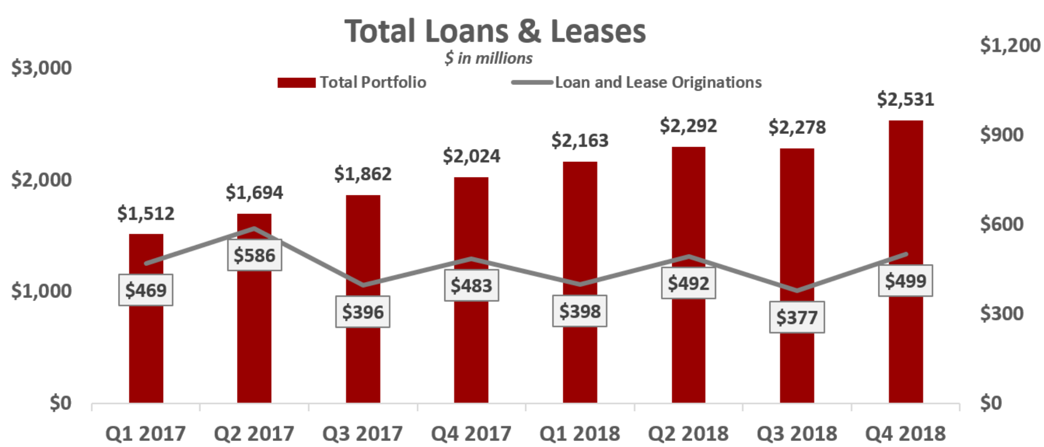
Revised Strategy

We initiated our business model pivot to retain a larger portion of our loans on balance sheet during the fourth quarter of 2018 in order to reduce earnings volatility and maximize long-term profitability with a more predictable earnings model. Consistent with our stated goal to hold 50% to 75% of loans that become eligible for sale, we sold $104.6 million compared to the approximate $240 million guaranteed loans that became eligible in the fourth quarter.

Fourth Quarter Highlights

- Loan and lease originations rose to $499 million
- Continued recurring revenue growth
- Improved net interest margin
- Lower gains on loan sales
- Lower noninterest expense
- Lower revaluation loss on servicing asset
- Net tax benefit of $3.0 million
- Increased provision for loan and lease losses

Loan & Lease Portfolio



Our total portfolio of loans and leases held for investment and held for sale increased by 25.0% over the prior year and grew 11.1% compared to the prior quarter. The increase in originations to $499 million during the fourth quarter of 2018 is primarily the result of loans in the renewable energy sector ramping up after the seasonal slowdown that typically occurs during the third quarter. Our loan and lease originations for the full year of 2018 totaled $1.77 billion. We anticipate our newer industry verticals, selective hiring of SBA Generalists, and the addition of new loan products will drive future originations.

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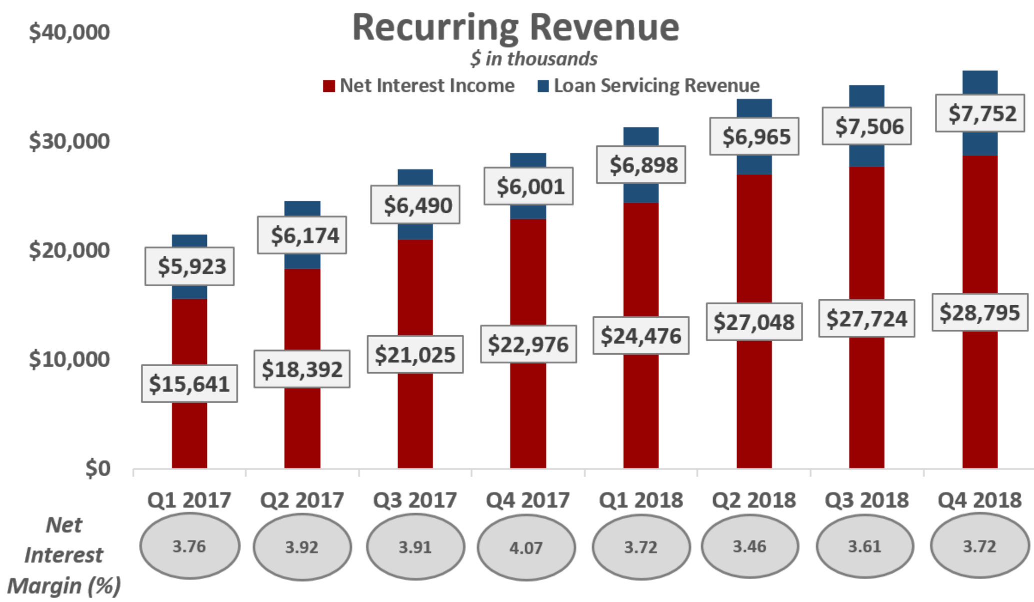
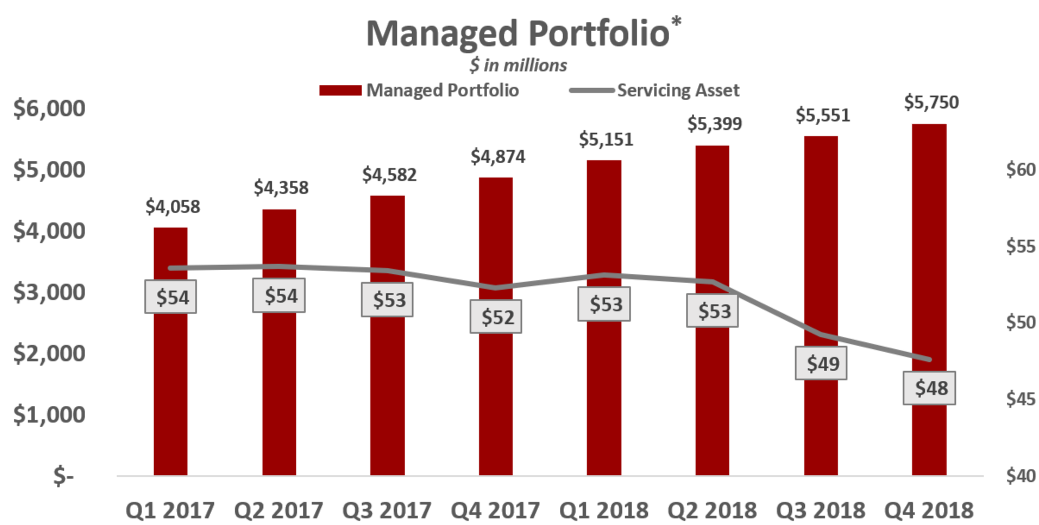
Sustained Recurring Revenue



The recurring revenue streams of net interest income and servicing revenue for our sold and serviced loan portfolio grew to $36.6 million for the fourth quarter of 2018, a 26.1% increase compared to the prior year's level, and represented 78.0% of total revenues. Net interest income increased in the fourth quarter to $28.8 million, a 25.3% increase over the prior year. On a linked quarter basis, the net interest margin rose 11 basis points to 3.72% and benefited from the variable-pricing nature of the loan portfolio. Servicing revenue on our sold and serviced loan portfolio increased to $7.8 million in the fourth quarter of 2018, an increase of 29.2% over the prior year. The managed portfolio, as defined below, at December 31, 2018, totaled $5.75 billion, a 18.0% 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 fourth quarter of 2018, the carrying value of the servicing asset amounted to $47.6 million. As the servicing asset valuation is influenced by current market pricing in the secondary market, the revaluation of the loan servicing asset for the fourth quarter of 2018 resulted in a net loss of $627 thousand, an improvement of $8.8 million compared to the prior quarter and reflecting the improved secondary market conditions.

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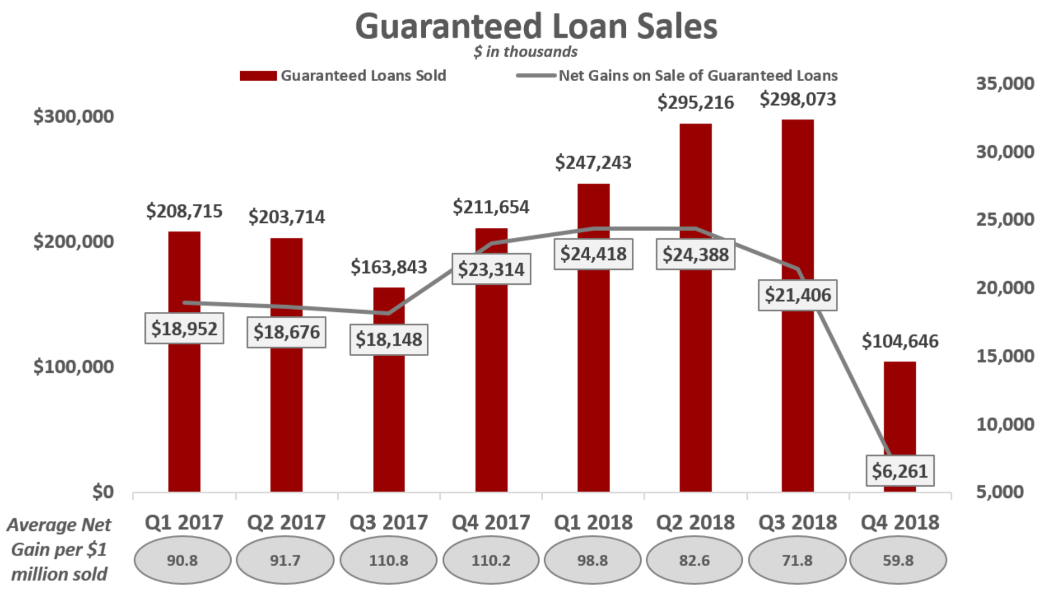
Secondary Market Sales



Loan sale volumes in the fourth quarter of 2018 decreased materially compared to historical quarters as we implemented our strategy to focus more on loan retention. Accordingly, gain on sale revenue for guaranteed loans decreased in the fourth quarter of 2018 to $6.3 million. Despite an improving secondary market for loan sales during the fourth quarter, the average net gain per $1 million sold decreased to $59.8 thousand compared to $71.8 million for the third quarter due to fair value fluctuations in exchange-traded interest rate lock commitments combined with strategically holding what we believe to be our most valuable loans.

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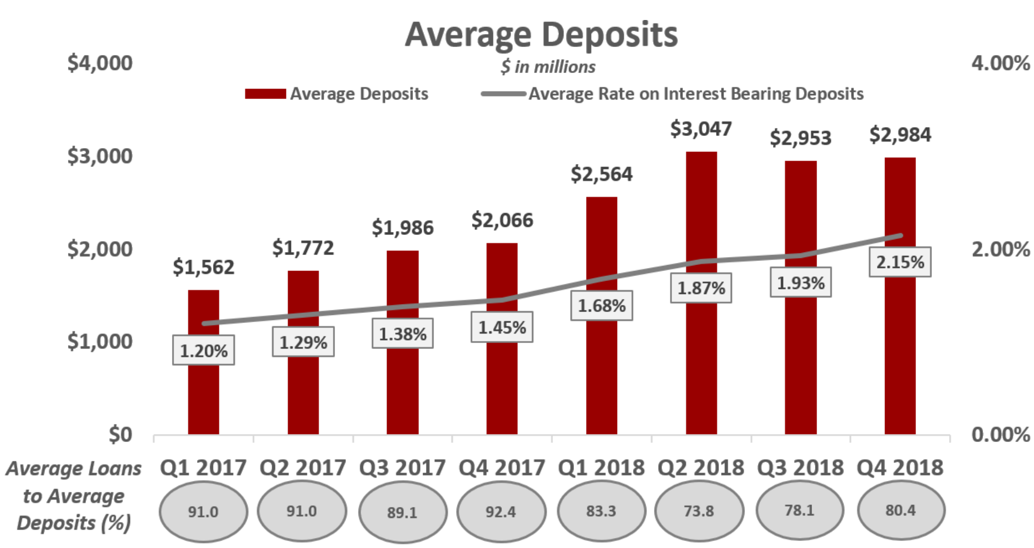
Funding Our Strategy



During the first half of 2018, we materially grew deposits to strengthen our liquidity position and reinvested excess funds to build a larger securities portfolio and cash position. Our recent business model shift to hold more loans on balance sheet results in stronger reliance on our deposit funding model. We continue to operate an efficient branchless model for deposit gathering which allows us to offer competitive rates. The average rate on interest bearing deposits increased 22 basis points from the prior quarter consistent with the higher rate environment.

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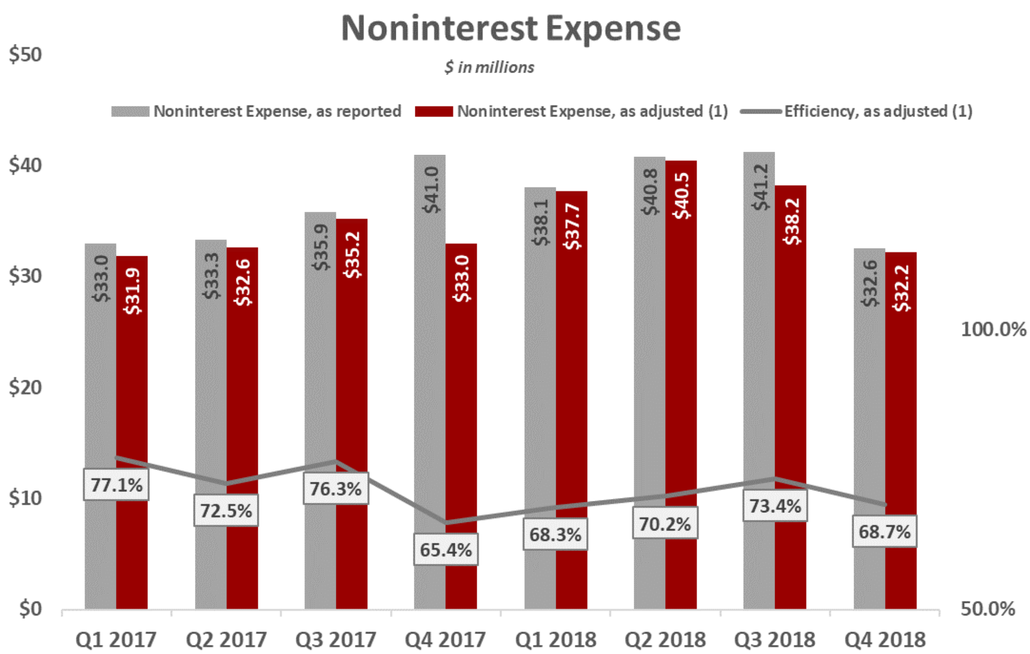
Scaling the Platform



Our non-GAAP noninterest expense[(1)] decreased to $32.2 million for the fourth quarter of 2018. The decrease from the prior quarter is primarily driven by the reversal of accrued incentive compensation for the year, due to not meeting budgeted performance metrics for 2018, combined with the exit from the title insurance business in August of 2018.

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

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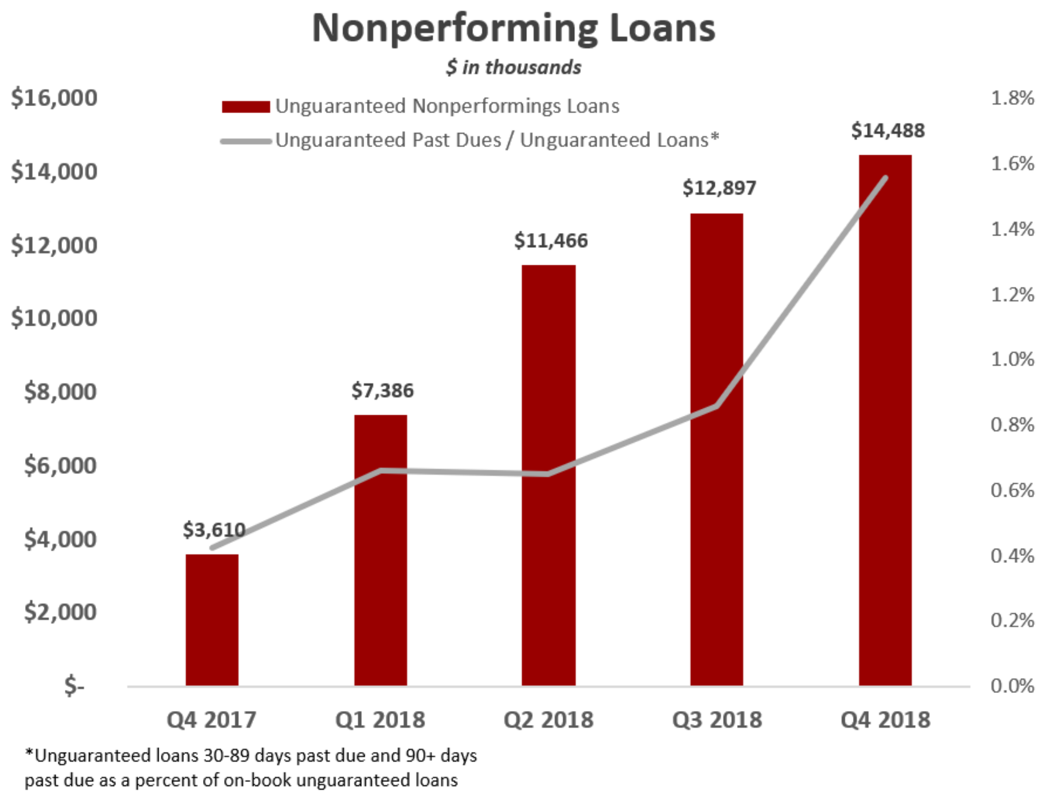
Credit Quality



Provision expense increased compared to the previous quarter and the fourth quarter of 2017, which was largely the result of growth in the loan and lease portfolio combined with increases in classified loans and past due trends over the past year. The loan and lease loss provision totaled $6.8 million for the fourth quarter of 2018, well above net charge-off levels. The allowance to loans and leases held for investment increased to 1.76% for the fourth quarter of 2018 compared to 1.64% for the prior quarter.

Income Tax Benefit: We experienced a net tax benefit for the fourth quarter of 2018 of $3.0 million and $5.4 million for all of 2018. The 2018 tax benefit is primarily the result of our continued investment in renewable energy assets for leasing activities which also generate investment tax credits.

Appendix
GAAP to Non-GAAP Reconciliation

	As of and for the three months ended							
	4Q 2018	3Q 2018	2Q 2018	1Q 2018	4Q 2017	3Q 2017	2Q 2017	1Q 2017
Noninterest income, as reported	$ 18,065	$ 24,331	$ 30,613	$ 30,756	$ 95,441	$ 25,060	$ 26,667	$ 25,753
Gain on contribution to equity method investment	—	—	—	—	(68,000)	—	—	—
Renewable energy tax credit investment income	—	—	—	—	20	—	(10)	(10)
Noninterest income, as adjusted	$ 18,065	$ 24,331	$ 30,613	$ 30,756	$ 27,461	$ 25,060	$ 26,657	$ 25,743
Noninterest expense, as reported	$ 32,558	$ 41,244	$ 40,830	$ 38,072	$ 41,024	$ 35,856	$ 33,300	$ 32,985
Stock based compensation expense	(360)	(360)	(357)	(352)	(360)	(286)	(378)	(346)
Merger costs associated with Reltco acquisition and Apiture investme	—	—	—	—	(1,718)	(390)	(250)	(516)
Trade-in loss on aircraft	—	—	—	—	—	—	—	(206)
Impairment expense on goodwill and other intangibles, net	—	(2,680)	—	—	(3,648)	—	—	—
Contract modification of Reltco	—	—	—	—	(1,600)	—	—	—
Renewable energy tax credit investment impairment and loss	—	—	—	—	(690)	—	(29)	(29)
Noninterest expense, as adjusted	$ 32,198	$ 38,204	$ 40,473	$ 37,720	$ 33,008	$ 35,180	$ 32,643	$ 31,888
Efficiency ratio:								
Noninterest expense, as adjusted (a)	$ 32,198	$ 38,204	$ 40,473	$ 37,720	$ 33,008	$ 35,180	$ 32,643	$ 31,888
Net interest income, as reported	28,795	27,724	27,048	24,476	22,976	21,025	18,392	15,641
Noninterest income, as adjusted	18,065	24,331	30,613	30,756	27,461	25,060	26,657	25,743
Less: gain (loss) on sale of securities	—	—	—	—	—	—	—	—
Adjusted operating revenue (b)	$ 46,860	$ 52,055	$ 57,661	$ 55,232	$ 50,437	$ 46,085	$ 45,049	$ 41,384
Efficiency ratio, as adjusted (a/b)	68.71%	73.39%	70.19%	68.29%	65.44%	76.34%	72.46%	77.05%

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.