Live Oak Bancshares

CFO Highlights

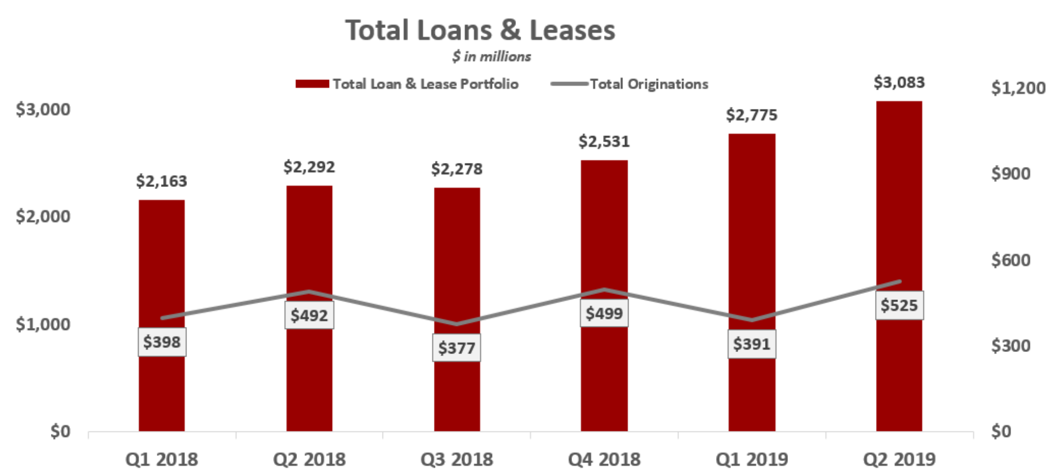
CFO Highlights: Q2 2019

Our net income in the second quarter of 2019 totaled $4.9 million, or $0.12 per diluted share. The loan and lease portfolio experienced 34.5% growth from the second quarter of 2018 and 11.1% from the prior quarter. Our recurring revenue streams of net interest income and servicing revenue rose to $41.0 million for the second quarter of 2019, which comprised 84.3% of our total revenue for the quarter, and fully covered our noninterest expense of $39.6 million.

During the second quarter, $238.4 million of guaranteed loans became eligible for sale and $71.9 million were sold, a 69.8% retention rate. This follows a 72.2% retention rate for the first quarter of 2019 and is above our long-term target of approximately 65%.

Success of Revised Strategy: The second quarter of 2019 validates the continued success of our business model pivot intended to reduce future earnings volatility and maximize long-term profitability with a more predictable earnings model by retaining a larger portion of loans eligible for sale on the balance sheet to drive recurring revenue growth. Evidence of the consistency in earnings from this strategic shift began to materialize more fully in the second quarter with healthy growth achieved in recurring revenue. At the same time, we continue to execute our more near-term goal of disciplined expense management as evidenced by the minimal growth in core expenses this quarter while we continue to invest in key growth initiatives.

Loan & Lease Portfolio



Our total portfolio of loans and leases held for investment and held for sale increased by $791.4 million over the same quarter a year ago to $3.08 billion and increased by $308.7 million compared to the prior quarter. The increase in originations to $525.1 million during the second quarter of 2019 arose from incremental increases in originations across many of our legacy and emerging industry verticals. Production volume also benefited from the ongoing selective hiring of experienced SBA lending generalists.

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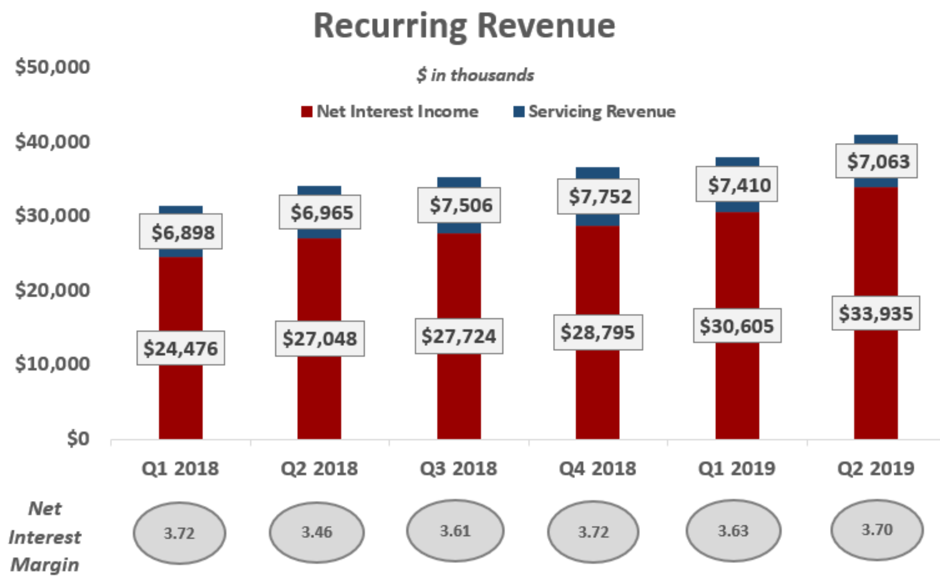
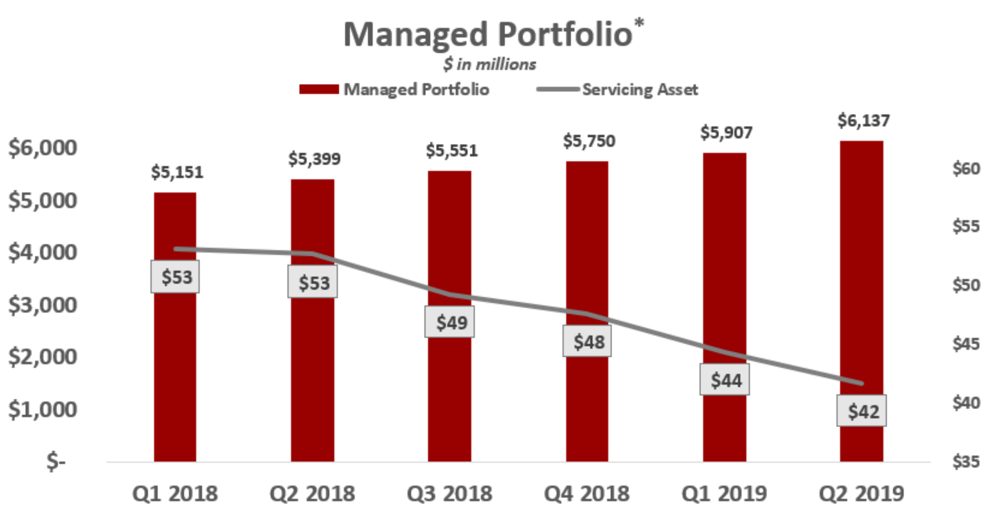
Sustained Recurring Revenue



The recurring revenue streams of net interest income and servicing revenue for our sold and serviced loan portfolio grew to $41.0 million for the second quarter of 2019, a 20.5% increase compared to the prior year, and represented 84.3% of total revenues for the second quarter of 2019 compared to 59.0% for the second quarter of 2018. Net interest income increased in the second quarter to $33.9 million, a 25.5% increase over the prior year attributable to much higher interest earning asset levels. On a linked quarter basis, the net interest margin rose 7 basis points to 3.70% as the increased yield on interest earning assets outpaced the increase in rates on interest bearing liabilities. The rate on interest bearing liabilities was relatively flat from the prior quarter, increasing 3 basis points. Servicing revenue on our sold and serviced loan portfolio amounted to $7.1 million during the second quarter of 2019, an increase of 1.4% over the prior year. Compared to the prior quarter, servicing revenue declined $347 thousand, or 4.7%, as the amortization of the serviced portfolio outpaced the addition of new loans to that portfolio driven by our strategic decision to sell fewer loans.

The managed portfolio, as defined below, at June 30, 2019, totaled $6.14 billion, a 13.7% 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 second quarter of 2019, the carrying value of the servicing asset amounted to $41.7 million, representing 8.0% of our total equity. The net loss arising from the revaluation of the loan servicing asset declined to $403 thousand in the second quarter of 2019 compared to a net loss of $2.25 million in the linked quarter and was primarily attributable to amortization of the serviced portfolio as the secondary market for loan sales has improved.

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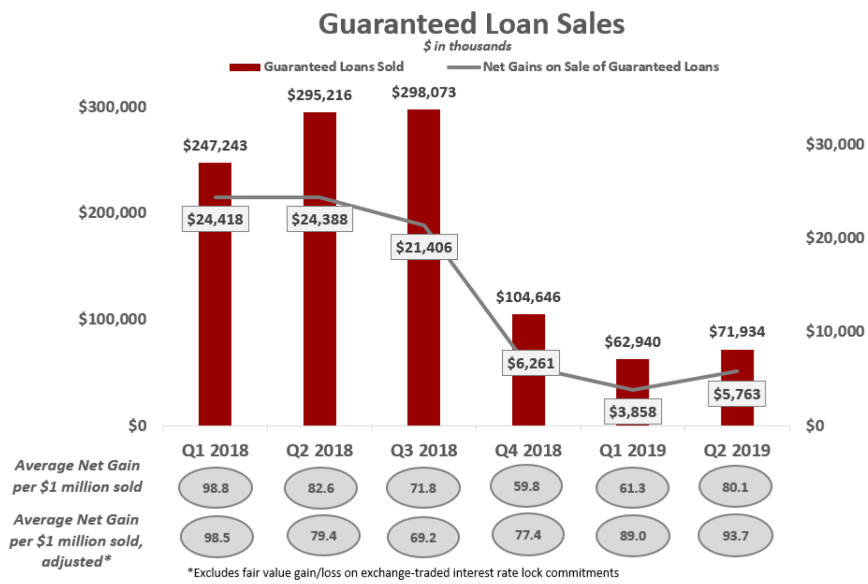
Secondary Market Sales



Loan sale volumes in the second quarter of 2019 decreased materially compared to the prior year as we continued to execute our strategy of loan retention. Accordingly, gain on sale revenue in the second quarter of 2019 amounted to $5.8 million. With the improving secondary market for loan sales during the second quarter, the average net gain per $1 million sold, excluding the fair value adjustment for exchange-traded interest rate lock commitments of $980 thousand, increased to $93.7 thousand compared to $89.0 thousand for the first quarter of 2019 also reflecting our selectivity in designating which loans to sell to maximize returns.

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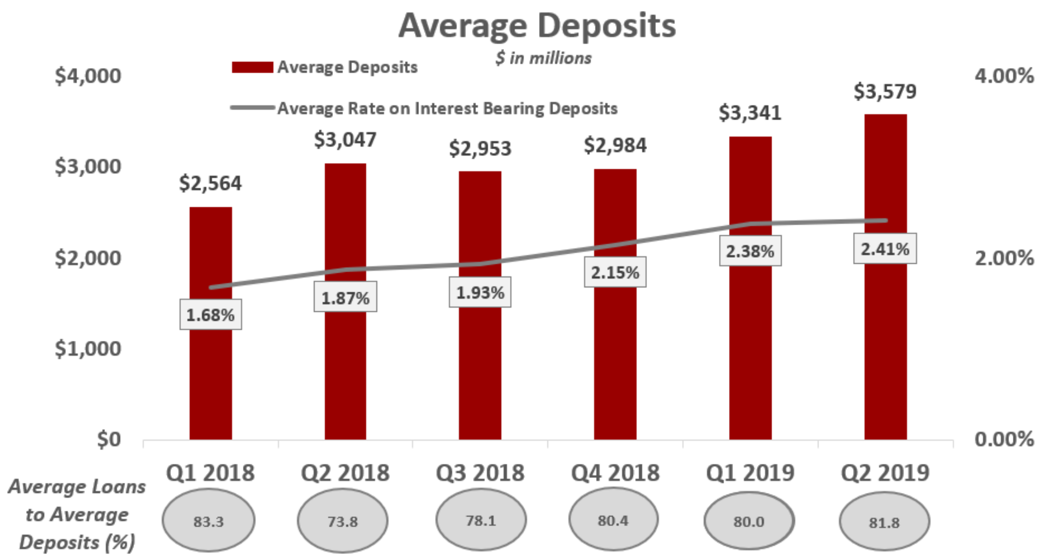
Funding Our Strategy



The average balance of deposits increased $238.7 million during the second quarter of 2019 compared to the prior quarter. We continue to operate an efficient branchless model for deposit gathering, at an incremental cost of 13 basis points for the second quarter of 2019, which allows us to offer competitive rates in an efficient manner. The average rate on interest bearing deposits increased by 3 basis points from the prior quarter. Our strategic repositioning to hold more loans on balance sheet has increased the importance of our deposit funding model.

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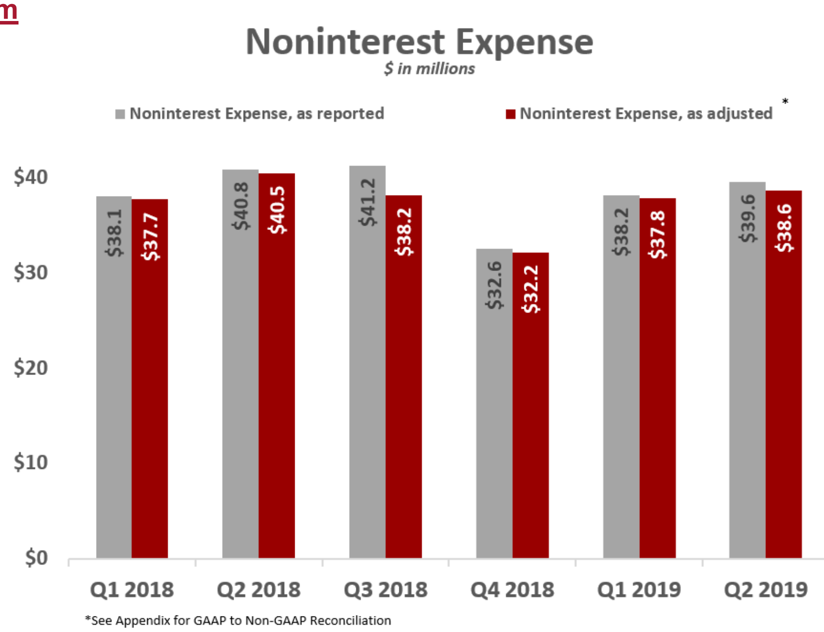
Scaling the Platform



Our non-GAAP noninterest expense, as adjusted*, totaled $38.6 million for the second quarter of 2019, an increase of 2.0% over the prior quarter and a 4.6% decrease from the same quarter one year ago due to a reduction in travel-related expense and the removal of certain operational expenses. The expiration of contract services for data processing and development activities provided by Apiture as part of the transition services agreement meaningfully contributed to the decline in noninterest expense from the prior year.

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Credit Quality

Our net charge-offs during the second quarter of 2019 totaled $526 thousand compared to $65 thousand in the prior quarter. Net charge-offs as a percentage of average held for investment loans and leases, annualized, for the second quarter of 2019 was 0.10% compared to 0.01% for the first quarter of 2019. The unguaranteed exposure of nonperforming loans decreased to $18.4 million, or 1.04% of total unguaranteed exposure, during the second quarter of 2019 compared to $20.2 million, or 1.22%, for the prior quarter. The percentage of the unguaranteed portion of classified loans and leases to total unguaranteed held for investment loans and leases decreased to 5.27% for the second quarter of 2019 compared to 5.39% for the prior quarter.

Provision expense of $3.5 million increased compared to the previous quarter as the loan and lease portfolio experienced meaningful growth while charge-offs remained relatively stable. The ratio of allowance for loans and lease losses to loans and leases held for investment was 1.71% as of June 30, 2019, compared to 1.75% for the prior quarter.

Income Tax Expense

We incurred a net income tax expense of $662 thousand which equates to an effective rate of 11.8%, in the second quarter of 2019 compared to $491 thousand in the second quarter of 2018 and $317 thousand for the prior quarter, or effective rates of 3.3% and 11.8%, respectively. 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					
	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019
Noninterest expense, as reported	$ 38,072	$ 40,830	$ 41,244	$ 32,558	$ 38,201	$ 39,576
Stock based compensation expense	(352)	(357)	(360)	(360)	(352)	(357)
Impairment expense on goodwill and other intangibles, net	—	—	(2,680)	—	—	—
Renewable energy tax credit investment impairment	—	—	—	—	—	(602)
Noninterest expense, as adjusted	$ 37,720	$ 40,473	$ 38,204	$ 32,198	$ 37,849	$ 38,617

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.