

Live Oak Bancshares, Inc.
Form 10-Q
September 03, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2015

or

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

For the transition period from _____ to _____.

Commission file number: 001-37497

LIVE OAK BANCSHARES, INC.

(Exact name of Registrant as specified in its charter)

North Carolina
(State or other jurisdiction of
incorporation or organization)

26-4596286
(I.R.S. Employer
Identification No.)

1741 Tiburon Drive

Wilmington, North Carolina
(Address of principal executive offices)

28403
(zip code)

(910) 790-5867

(Registrant's telephone number, including area code)

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 NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer (Do not check if smaller reporting company)

Smaller Reporting Company

Indicate by check mark whether registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of September 2, 2015, there were approximately 29,442,615 shares of the registrant's voting common stock outstanding and approximately 4,723,530 shares of the registrant's non-voting common stock outstanding.

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Live Oak Bancshares, Inc. and Subsidiaries

Form 10-Q

For the Quarterly Period Ended June 30, 2015

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Table of Contents**PART I. FINANCIAL INFORMATION**

Item 1. Financial Statements

Live Oak Bancshares, Inc.**Consolidated Balance Sheets***As of June 30, 2015 (unaudited) and December 31, 2014**

(Dollars in thousands)

	June 30, 2015	December 31, 2014*
Assets		
Cash and due from banks	\$ 131,487	\$ 29,902
Certificates of deposit with other banks	10,000	10,000
Investment securities available-for-sale	50,719	49,318
Loans held for sale	356,481	295,180
Loans held for investment	237,612	203,936
Allowance for loan losses	(5,183)	(4,407)
Net loans	232,429	199,529
Premises and equipment, net	57,310	35,279
Foreclosed assets	34	371
Servicing assets	39,983	34,999
Investments in non-consolidated affiliates		6,345
Other assets	20,972	12,392
Total assets	\$ 899,415	\$ 673,315
Liabilities and Shareholders Equity		
Liabilities		
Deposits:		
Noninterest-bearing	\$ 15,749	\$ 14,728

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Interest-bearing	711,597	507,352
Total deposits	727,346	522,080
Short term borrowings		6,100
Long term borrowings	54,490	41,849
Other liabilities	14,198	11,472
Total liabilities	796,034	581,501
Shareholders equity		
Non-cumulative perpetual preferred stock (Series A), 6,800 shares authorized, issued and outstanding		
Preferred stock, no par value, 1,000,000 authorized, none issued or outstanding at June 30, 2015 and December 31, 2014		
Class A common stock, no par value, 100,000,000 shares authorized, 23,931,330 and 23,896,400, shares issued and outstanding at June 30, 2015 and December 31, 2014		
	49,122	48,657
Class B common stock, no par value, 10,000,000 shares authorized, 4,723,530 shares issued and outstanding at June 30, 2015 and December 31, 2014		
	50,015	50,015
Retained earnings (accumulated deficit)		
	4,206	(6,943)
Accumulated other comprehensive income		
	1	85
Total shareholders equity attributed to Live Oak Bancshares, Inc.	103,344	91,814
Noncontrolling interest	37	
Total equity	103,381	91,814
Total liabilities and shareholders equity	\$ 899,415	\$ 673,315

* Derived from audited financial statements.

See Notes to Consolidated Financial Statements 1

Table of Contents**Live Oak Bancshares, Inc.****Consolidated Statements of Income***For the three and six months ended June 30, 2015 and 2014 (unaudited)*

(Dollars in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
<i>Interest income</i>				
Loans and fees on loans	\$ 7,391	\$ 4,762	\$ 14,107	\$ 8,851
Investment securities, taxable	200	99	376	199
Other interest earning assets	70	41	136	64
Total interest income	7,661	4,902	14,619	9,114
<i>Interest expense</i>				
Deposits	1,801	1,131	3,277	2,229
Borrowings	444	204	885	357
Total interest expense	2,245	1,335	4,162	2,586
Net interest income	5,416	3,567	10,457	6,528
<i>Provision for loan losses</i>				
	50	475	1,127	899
Net interest income after provision for loan losses	5,366	3,092	9,330	5,629
<i>Noninterest income</i>				
Loan servicing revenue and revaluation	1,772	3,585	5,878	6,285
Net gains on sales of loans	15,719	12,326	31,180	22,357
Equity in loss of non-consolidated affiliates		(1,208)	(26)	(2,202)
Gain on sale of investment in non-consolidated affiliate			3,782	
Other noninterest income	644	405	1,376	873
Total noninterest income	18,135	15,108	42,190	27,313
<i>Noninterest expense</i>				

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Salaries and employee benefits	9,319	6,007	17,674	15,708
Travel expense	2,212	1,338	3,672	2,088
Professional services expense	624	671	1,532	1,606
Advertising and marketing expense	1,118	722	2,126	1,520
Occupancy expense	731	429	1,188	866
Data processing expense	722	628	1,615	1,057
Equipment expense	350	313	754	566
Other expense	1,724	1,431	2,927	2,572
Total noninterest expense	16,800	11,539	31,488	25,983
Income before taxes	6,701	6,661	20,032	6,959
Income tax expense	2,766		8,044	
Net income	3,935	6,661	11,988	6,959
Net loss attributable to noncontrolling interest			20	
Net income attributable to Live Oak Bancshares, Inc.	\$ 3,935	\$ 6,661	\$ 12,008	\$ 6,959
Basic earnings per share	\$ 0.14	\$ 0.31	\$ 0.42	\$ 0.33
Diluted earnings per share	\$ 0.13	\$ 0.31	\$ 0.41	\$ 0.33

See Notes to Consolidated Financial Statements 2

Table of Contents**Live Oak Bancshares, Inc.****Consolidated Statements of Comprehensive Income***For the three and six months ended June 30, 2015 and 2014 (unaudited)*

(Dollars in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net income	\$ 3,935	\$ 6,661	\$ 11,988	\$ 6,959
Other comprehensive income (loss) before tax:				
Net unrealized gain (loss) on investment securities arising during the period	(339)	98	(136)	203
Reclassification adjustment for (gain) loss on sale of securities available for sale included in net income				
Other comprehensive income (loss) before tax	(339)	98	(136)	203
Income tax expense	131		52	
Other comprehensive income (loss), net of tax	(208)	98	(84)	203
Total comprehensive income	\$ 3,727	\$ 6,759	\$ 11,904	\$ 7,162

See Notes to Consolidated Financial Statements 3

Table of Contents**Live Oak Bancshares, Inc.****Consolidated Statements of Changes in Shareholders' Equity***For the six months ended June 30, 2015 and 2014 (unaudited)*

(Dollars in thousands, except per share data)

	Common stock Shares		Amount	Retained earnings	Accumulated other	Non-	Total
	Class A	Class B		(accumulated deficit)	comprehensive income (loss)	controlling interest	
Balance at December 31, 2013	20,318,330		\$ 18,319	\$ 30,262	\$ (191)	\$	\$ 48,390
Net income				6,959			6,959
Other comprehensive income					203		203
Sales of common stock	45,440		200				200
Stock option exercises	174,990		152				152
Issuance of common stock grants	685,700		2,992				2,992
Stock option based compensation expense			79				79
Restricted stock expense			162				162
Dividends (distributions to shareholders)				(18,173)			(18,173)
Balance at June 30, 2014	21,224,460		\$ 21,904	\$ 19,048	\$ 12	\$	\$ 40,964
Balance at December 31, 2014	23,896,400	4,723,530	\$ 98,672	\$ (6,943)	\$ 85	\$	\$ 91,814
Net income (loss)				12,008		(20)	11,988
Other comprehensive loss					(84)		(84)
Consolidation of investment with non-controlling interest						35	35
Stock option exercises	34,930		154				154
Stock option based compensation expense			295				295
Restricted stock expense			16				16
Capital contribution from non-controlling interest						22	22
Dividends (distributions to shareholders)				(859)			(859)

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Balance at June 30, 2015	23,931,330	4,723,530	\$ 99,137	\$	4,206	\$	1	\$	37	\$ 103,381
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See Notes to Consolidated Financial Statements 4

Table of Contents**Live Oak Bancshares, Inc.****Consolidated Statements of Cash Flows***For the six months ended June 30, 2015 and 2014 (unaudited)*

(Dollars in thousands)

	Six Months Ended June 30,	
	2015	2014
<i>Cash flows from operating activities</i>		
Net income	\$ 11,988	\$ 6,959
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation and amortization	1,021	987
Provision for loan losses	1,127	899
Amortization of premium on securities, net of accretion	24	42
Amortization of discount on unguaranteed loans	1,313	(131)
Deferred tax expense	847	
Originations of loans held for sale	(472,413)	(295,281)
Proceeds from sales of loans held for sale	318,125	208,838
Net gains (losses) on sale of foreclosed assets	7	
Net increase in servicing assets	(4,984)	(4,128)
Net gains on sale of loans held for sale	(31,180)	(22,357)
Gain on sale of investment in non-consolidated affiliate	(3,782)	
Net loss on disposal of premises and equipment	16	
Stock option based compensation expense	295	79
Stock grants		2,992
Restricted stock expense	16	162
Equity in loss of non-consolidated affiliates	26	2,202
Changes in assets and liabilities:		
Accounts receivable and other assets	(3,192)	(1,636)
Accrued expenses and other liabilities	2,402	8,266
Net cash used by operating activities	(178,344)	(92,107)
<i>Cash flows from investing activities</i>		
Purchases of securities available-for-sale	(5,925)	
Proceeds from sales, maturities, calls, and principal paydowns of securities available-for-sale	4,364	1,203
Proceeds from sale of foreclosed assets	330	
Proceeds from sale of investment in non-consolidated affiliate	9,896	
Capital investments in non-consolidated affiliates		(250)

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Net cash acquired in consolidation of equity method investment	319	
Capital contribution from non-controlling interest	22	
Loan originations and principal collections, net	84,252	43,090
Purchases of premises and equipment, net	(23,068)	(8,603)
Net cash provided by investing activities	70,190	35,440

See Notes to Consolidated Financial Statements 5

Table of Contents**Live Oak Bancshares, Inc.****Consolidated Statements of Cash Flows (Continued)***For the six months ended June 30, 2015 and 2014 (unaudited)*

(Dollars in thousands)

	Six Months Ended June 30,	
	2015	2014
<i>Cash flows from financing activities</i>		
Net increase in deposits	205,266	69,937
Proceeds from long term borrowings	21,322	5,760
Repayment of long term borrowings	(8,681)	(131)
Proceeds from short term borrowings		6,000
Repayment of short term borrowings	(6,100)	
Stock option exercises	154	152
Sale of common stock, net		200
Shareholder dividend distributions	(2,222)	(8,086)
Net cash provided by financing activities	209,739	73,832
Net increase in cash and cash equivalents	101,585	17,165
<i>Cash and cash equivalents, beginning</i>	29,902	37,244
<i>Cash and cash equivalents, ending</i>	\$ 131,487	\$ 54,409
<i>Supplemental disclosure of cash flow information</i>		
Interest paid	\$ 4,152	\$ 2,561
Income tax	9,174	
<i>Supplemental disclosures of noncash operating, investing, and financing activities</i>		
Unrealized holding gains (losses) on available-for-sale securities, net of taxes	\$ (136)	\$ 203
Transfers of loans accounted for as secured borrowing collateral to other assets	4,575	
Dividends declared but not paid	169	3,414
Transfer of loans held for sale to loans held for investment	7,400	12,052
Transfer of loans held for investment to loans held for sale	4,514	3,830
Contingent consideration in acquisition of controlling interest in equity method of investment	170	
Non-cash dividend		9,514

See Notes to Consolidated Financial Statements

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Live Oak Bancshares, Inc.

Notes to Unaudited Consolidated Financial Statements

Note 1. Basis of Presentation

Nature of Operations

Live Oak Bancshares, Inc. (the Company or LOB) is a bank holding company headquartered in Wilmington, North Carolina incorporated under the laws of North Carolina in December 2008. The Company conducts business operations primarily through our commercial bank subsidiary, Live Oak Banking Company (the Bank). The Bank was established in May 2008 as a North Carolina-chartered commercial bank. The Bank specializes in providing lending services to small businesses nationwide in targeted industries. The Bank identifies and grows within credit-worthy industries through expertise within those industries. A significant portion of the loans originated by the Bank are guaranteed by the Small Business Administration (SBA) under the 7(a) program. In 2010, the Bank formed Live Oak Number One, Inc., a wholly-owned subsidiary, to hold properties foreclosed on by the Bank.

In addition to the Bank, the Company owns Independence Aviation, LLC, which was formed for the purpose of purchasing and operating aircraft used for business purposes of the Company, Government Loan Solutions, Inc. (GLS), a management and technology consulting firm that specializes in the settlement, accounting, and securitization processes for government guaranteed loans, including loans originated under the SBA 7(a) loan programs and USDA-guaranteed loans, and 504 Fund Advisors, LLC (504FA), formed to serve as the investment advisor to the 504 Fund, a closed-end mutual fund organized to invest in SBA section 504 loans.

The Company acquired control over 504FA, previously carried as an equity method investment, on February 2, 2015 by increasing its ownership from 50.0% to 91.3%. The acquisition of an additional 41.3% of ownership occurred in exchange for contingent consideration estimated to total \$170 thousand. With 8.7% of ownership remaining with a third party investor, amounts of earnings and equity in 504FA are now disclosed in the Company s financial statements as related to a noncontrolling interest.

The Company earns revenue primarily from the sale of SBA-guaranteed loans. This income is comprised of loan servicing revenue and revaluation and net gains on sales of loans. Net interest income is a secondary contributor to our earnings. Offsetting these revenues are the cost of funding sources, provision for loan losses, any costs related to foreclosed assets and other operating costs such as salaries and employee benefits, travel, professional services, advertising and marketing and tax expense.

General

In the opinion of management, all adjustments necessary for a fair presentation of the financial position and results of operations for the periods presented have been included, and all intercompany transactions have been eliminated in consolidation. Results of operations for the six months ended June 30, 2015 are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2015. The consolidated balance sheet as of December 31, 2014 has been derived from the audited consolidated financial statements contained in the Company s registration statement on Form S-1. A description of the significant accounting policies followed by the Company are as set forth in Note 1 of the Notes to Consolidated Financial Statements in the Company s registration statement on Form S-1.

The preparation of financial statements in conformity with United States generally accepted accounting principles, or GAAP, requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates.

All information in the Notes to Unaudited Consolidated Financial Statements has been presented in thousands, except percentage, time period, stock option, share and per share data.

Stock Split

On September 23, 2014, the Board of Directors declared a ten-for-one stock split of the Company's Class A and Class B common shares, which was effected in the form of a common stock dividend distributed on October 10, 2014. Except for the amount of authorized shares, all references to share and per share amounts in the consolidated financial statements and accompanying notes to the consolidated financial statements have been retroactively restated to reflect the stock split.

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Live Oak Bancshares, Inc.

Notes to Unaudited Consolidated Financial Statements

Note 1. Basis of Presentation (Continued)

Business Segments

Management has determined that the Company has one significant operating segment, which is providing a lending platform for small businesses nationwide. In determining the appropriateness of segment definition, the Company considers the materiality of a potential segment, the components of the business about which financial information is available, and components for which management regularly evaluates relative to resource allocation and performance assessment.

Note 2 - Recent Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board (FASB) issued ASU 2015-05, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40) Customer s Accounting for Fees Paid in a Cloud Computing Arrangement. ASU 2015-05 addresses accounting for fees paid by a customer in cloud computing arrangements such as (i) software as a service, (ii) platform as a service, (iii) infrastructure as a service and (iv) other similar hosting arrangements. ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. ASU 2015-05 will be effective for us on January 1, 2016 and is not expected to have a significant impact on our financial statements.

In May 2015, the FASB issued ASU 2015-07, Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or its Equivalent) (a Consensus of the Emerging Issues Task Force) . The new guidance eliminates the requirement to classify in the fair value hierarchy any investments for which fair value is measured at net asset value per share using the practical expedient. This guidance is effective for interim and annual periods beginning after December 15, 2015. The adoption of this guidance is not expected to be material to the consolidated financial statements.

Table of Contents**Live Oak Bancshares, Inc.****Notes to Unaudited Consolidated Financial Statements****Note 3. Earnings Per Share**

Basic and diluted earnings per share are computed based on the weighted average number of shares outstanding during each period. Diluted earnings per share reflects the potential dilution that could occur, upon the exercise of stock options or upon the vesting of restricted stock grants, any of which would result in the issuance of common stock that would then be shared in the net income of the Company.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Basic earnings per share:				
Net income available to common shareholders	\$ 3,935	\$ 6,661	\$ 12,008	\$ 6,959
Weighted-average basic shares outstanding	28,636,182	21,202,728	28,628,177	20,790,765
Basic earnings per share	\$ 0.14	\$ 0.31	\$ 0.42	\$ 0.33
Diluted earnings per share:				
Net income available to common shareholders, for diluted EPS	\$ 3,935	\$ 6,661	\$ 12,008	\$ 6,959
Total weighted-average basic shares outstanding	28,636,182	21,202,728	28,628,177	20,790,765
Add effect of dilutive stock options and restricted stock grants	862,217	73,379	811,645	141,680
Total weighted-average diluted shares outstanding	29,498,399	21,276,107	29,439,822	20,932,445
Diluted earnings per share	\$ 0.13	\$ 0.31	\$ 0.41	\$ 0.33
Anti-dilutive securities	916,199	1,528,520	956,199	1,528,520

Pro forma earnings per share

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Because the Company was not a taxable entity prior to August 3, 2014, pro forma amounts for income tax expense and basic and diluted earnings per share have been presented below assuming the Company's effective tax rate of 38.5% for the three and six months ended June 30, 2014.

	Three Months Ended	Six Months Ended
Pro forma net income available to common shareholders, after tax	\$ 4,096	\$ 4,280
Pro forma basic earnings per share	\$ 0.19	\$ 0.21
Pro forma diluted earnings per share	\$ 0.19	\$ 0.20

Table of Contents**Live Oak Bancshares, Inc.****Notes to Unaudited Consolidated Financial Statements****Note 4. Securities**

The carrying amount of securities and their approximate fair values are reflected in the following table:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
<u>June 30, 2015</u>				
US government agencies	\$ 35,229	\$ 213	\$ 18	\$ 35,424
Residential mortgage-backed securities	13,574	22	205	13,391
Mutual fund	1,913		9	1,904
	\$ 50,716	\$ 235	\$ 232	\$ 50,719
<u>December 31, 2014</u>				
US government agencies	\$ 35,207	\$ 127	\$ 25	\$ 35,309
Residential mortgage-backed securities	13,973	92	56	14,009
	\$ 49,180	\$ 219	\$ 81	\$ 49,318

During the three months ended June 30, 2015, the Company sold six mortgage-backed securities at their carrying amount for \$3.4 million in an odd-lot consolidation and purchased two mortgage-backed securities totaling \$4.0 million for the purpose of complying with the Community Reinvestment Act. In addition, during the first quarter of 2015, the Company invested \$1.9 million in the 504 Fund mutual fund. The investment in this mutual fund was purchased at current market value; 190,380.762 shares at \$9.98 per share. There were no calls or maturities during the three and six months ending June 30, 2015. There were no calls, purchases, sales or maturities of securities during the three and six months ended June 30, 2014.

The following tables show gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position.

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2015						
US government agencies	\$	\$	\$ 1,231	\$ 18	\$ 1,231	\$ 18
Residential mortgage-backed securities	7,451	161	3,346	44	10,797	205

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Mutual fund	1,904	9	1,904	9
Total	\$ 9,355	\$ 170	\$ 4,577	\$ 62
			\$ 13,932	\$ 232

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2014						
US government agencies	\$	\$	\$ 1,224	\$ 25	\$ 1,224	\$ 25
Residential mortgage-backed securities	2,234	4	5,158	52	7,392	56
Total	\$ 2,234	\$ 4	\$ 6,382	\$ 77	\$ 8,616	\$ 81

Table of Contents**Live Oak Bancshares, Inc.****Notes to Unaudited Consolidated Financial Statements****Note 4. Securities (Continued)**

At June 30, 2015, there were four securities, consisting of one US government agency security and three residential mortgage-backed securities, in unrealized loss positions for greater than 12 months; and six securities, consisting of five mortgage-backed securities and the 504 Fund mutual fund, in unrealized loss positions for less than 12 months. Unrealized losses at December 31, 2014, were comprised of six securities, consisting of one US agency security and five mortgage-backed securities, in unrealized loss positions for greater than 12 months; and one mortgage-backed security in an unrealized loss position for less than 12 months.

These unrealized losses are primarily the result of volatility in the market and are related to market interest rates. Since none of the unrealized losses relate to marketability of the securities or the issuer's ability to honor redemption obligations, none of the securities are deemed to be other than temporarily impaired.

All residential mortgage-backed securities in the Company's portfolio at June 30, 2015 and December 31, 2014 were backed by U.S. government sponsored enterprises (GSEs).

The following is a summary of investment securities by maturity:

	June 30, 2015	
	Available for sale	
	Amortized cost	Fair value
One to five years	\$ 33,979	\$ 34,193
Five to ten years	2,068	2,053
After 10 years	12,756	12,569
	\$ 48,803	\$ 48,815

The table above reflects contractual maturities. Actual results will differ as the loans underlying the mortgage-backed securities may repay sooner than scheduled. This table excludes the 540 Fund mutual fund investment.

At June 30, 2015 and December 31, 2014, investment securities with a fair market value of \$1.3 million were pledged to secure a line of credit with the Company's correspondent bank.

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Live Oak Bancshares, Inc.

Notes to Unaudited Consolidated Financial Statements

Note 5. Loans and Allowance for Loan Losses

Loan Portfolio Segments

The following describe the risk characteristics relevant to each of the portfolio segments. Each loan category is assigned a risk grade during the origination and closing process based on criteria described later in this section.

Commercial and Industrial

Commercial and industrial loans (C&I) receive similar underwriting treatment as commercial real estate loans in that the repayment source is analyzed to determine its ability to meet cash flow coverage requirements as set forth by Bank policies. Repayment of the Bank's C&I loans generally comes from the generation of cash flow as the result of the borrower's business operations. This business cycle itself brings a certain level of risk to the portfolio. In some instances, these loans may carry a higher degree of risk due to a variety of reasons—illiquid collateral, specialized equipment, highly depreciable assets, uncollectable accounts receivable, revolving balances, or simply being unsecured. As a result of these characteristics, the SBA guarantee on these loans is an important factor in mitigating risk.

Construction and Development

Construction and development loans are for the purpose of acquisition and development of land to be improved through the construction of commercial buildings. Such loans are usually paid off through the conversion to permanent financing for the long-term benefit of the borrower's ongoing operations. At the completion of the project, if the loan is converted to permanent financing or if scheduled loan amortization begins, it is then reclassified to the Owner Occupied Commercial Real Estate segment. Underwriting of construction and development loans typically includes analysis of not only the borrower's financial condition and ability to meet the required debt obligations, but also the general market conditions associated with the area and type of project being funded.

Owner Occupied Commercial Real Estate

Owner occupied commercial real estate loans are extensions of credit secured by owner occupied collateral. Underwriting generally involves intensive analysis of the financial strength of the borrower and guarantor, liquidation value of the subject collateral, the associated unguaranteed exposure, and any available secondary sources of repayment, with the greatest emphasis given to a borrower's capacity to meet cash flow coverage requirements as set forth by Bank policies. Such repayment of owner-occupied loans is commonly derived from the successful ongoing operations of the business occupying the property. These typically include small businesses and professional practices.

Commercial Land

Commercial land loans are extensions of credit secured by farmland. Such loans are often for land improvements related to agricultural endeavors that may include construction of new specialized facilities. These loans are usually repaid through the conversion to permanent financing, or if scheduled loan amortization begins, for the long-term benefit of the borrower's ongoing operations. Underwriting generally involves intensive analysis of the financial strength of the borrower and guarantor, liquidation value of the subject collateral, the associated unguaranteed exposure, and any available secondary sources of repayment, with the greatest emphasis given to a borrower's capacity to meet cash flow coverage requirements as set forth by Bank policies.

Each of the loan types referenced in the sections above is further segmented into verticals in which the Bank chooses to operate - Death Care, Healthcare (medical, dental, ophthalmic), Pharmacy, Investment Advisors, Veterinary, Family Entertainment, Agriculture, Wine & Craft Beverages, Self-Storage and Hotels. Hotels is a new area of emphasis for which there was no loan activity as of June 30, 2015. The Bank chooses to finance businesses operating in these industries because of certain similarities. The similarities range from historical default and loss characteristics to business operations. However, there are differences that create the necessity to underwrite these loans according to varying criteria and guidelines. When underwriting a loan, the Bank considers numerous factors such as cash flow coverage, the credit scores of the guarantors, revenue growth and practice ownership experience and debt service capacity. Minimum guidelines have been set with regard to these various factors and deviations from those guidelines requiring compensating strengths when considering a proposed loan.

Table of Contents**Live Oak Bancshares, Inc.****Notes to Unaudited Consolidated Financial Statements****Note 5. Loans and Allowance for Loan Losses (Continued)**

Loans consist of the following:

	June 30, 2015	December 31, 2014
Commercial & Industrial	\$ 90,213	\$ 81,057
Death Care Management	4,274	3,603
Family Entertainment Centers	488	333
Healthcare	12,464	12,319
Independent Pharmacies	37,379	34,079
Registered Investment Advisors	14,312	9,660
Veterinary Industry	21,070	20,902
Wine & Craft Beverage	75	
Other Industries	151	161
Construction & Development	18,282	9,526
Agriculture	7,092	3,910
Death Care Management	484	92
Family Entertainment Centers	122	
Healthcare	7,061	2,957
Independent Pharmacies	483	215
Veterinary Industry	2,698	2,207
Wine & Craft Beverage	159	
Other Industries	183	145
Owner Occupied Commercial Real Estate	124,634	111,620
Agriculture	3,127	259
Death Care Management	19,510	18,879
Family Entertainment Centers	1,294	872
Healthcare	30,343	26,173
Independent Pharmacies	5,179	4,750
Registered Investment Advisors	2,463	2,161
Self Storage	167	
Veterinary Industry	61,225	57,934
Wine & Craft Beverage	1,016	

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Other Industries	310	592
Commercial Land	4,264	1,248
Agriculture	4,264	1,248
Total Loans ¹	237,393	203,451
Net Deferred Costs	2,491	2,060
Discount on SBA 7(a) Unguaranteed ²	(2,272)	(1,575)
Loans, Net of Unearned	\$ 237,612	\$ 203,936

¹ Total loans include \$21.8 million and \$21.3 million of U.S. government guaranteed loans as of June 30, 2015 and December 31, 2014, respectively.

² The Company measures the carrying value of the retained portion of loans sold at fair value under ASC Subtopic 825-10. The value of these retained loan balances is discounted based on the estimates derived from comparable unguaranteed loan sales.

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Live Oak Bancshares, Inc.

Notes to Unaudited Consolidated Financial Statements

Note 5. Loans and Allowance for Loan Losses (Continued)

Credit Risk Profile

The Bank uses internal loan reviews to assess the performance of individual loans by industry segment. An independent review of the loan portfolio is performed annually by an external firm. The goal of the Bank's annual review of each borrower's financial performance is to validate the adequacy of the risk grade assigned.

The Bank uses a grading system to rank the quality of each loan. The grade is periodically evaluated and adjusted as performance dictates. Loan grades 1 through 4 are passing grades and grade 5 is special mention. Collectively, grades 6 through 8 represent classified loans in the Bank's portfolio. The following guidelines govern the assignment of these risk grades:

Exceptional Loans (1 Rated): These loans are of the highest quality, with strong, well-documented sources of repayment. Debt service coverage (DSC) is over 1.75X based on historical results. Secondary source of repayment is strong, with a loan to value (LTV) of 65% or less if secured solely by commercial real estate (CRE). Discounted collateral coverage from all sources should exceed 125%. Guarantors have credit scores above 740.

Quality Loans (2 Rated): These loans are of good quality, with good, well-documented sources of repayment. DSC is over 1.25X based on historical or pro-forma results. Secondary source of repayment is good, with a LTV of 75% or less if secured solely by CRE. Discounted collateral coverage should exceed 100%. Guarantors have credit scores above 700.

Acceptable Loans (3 rated): These loans are of acceptable quality, with acceptable sources of repayment. DSC of over 1.00X based on historical or pro-forma results. Companies that do not meet these credit metrics must be evaluated to determine if they should be graded below this level.

Acceptable Loans (4 rated): These loans are considered very weak pass. These loans are riskier than a 3-rated credit, but due to various mitigating factors are not considered a Special Mention or worse. The mitigating factors must clearly be identified to offset further downgrade. Examples of loans that may be put in this category include start-up loans and loans with less than 1:1 cash flow coverage with other sources of repayment.

Special mention (5 rated): These loans are considered as emerging problems, with potentially unsatisfactory characteristics. These loans require greater management attention. A loan may be put into this category if the Bank is unable to obtain financial reporting from a company to fully evaluate its position.

Substandard (6 rated): Loans graded Substandard are inadequately protected by current sound net worth, paying capacity of the borrower, or pledged collateral. They typically have unsatisfactory characteristics causing more than

acceptable levels of risk, and have one or more well-defined weaknesses that could jeopardize the repayment of the debt.

Doubtful (7 rated): Loans graded Doubtful have inherent weaknesses that make collection or liquidation in full questionable. Loans graded Doubtful must be placed on non-accrual status.

Loss (8 rated): Loss rated loans are considered uncollectible and of such little value that their continuance as an active Bank asset is not warranted. The asset should be charged off, even though partial recovery may be possible in the future.

Table of Contents**Live Oak Bancshares, Inc.****Notes to Unaudited Consolidated Financial Statements****Note 5. Loans and Allowance for Loan Losses (Continued)**

The following tables summarize the risk grades of each category:

	Risk Grades 1 - 4	Risk Grade 5	Risk Grades 6 - 8	Total ¹
<u>June 30, 2015</u>				
Commercial & Industrial	\$ 73,965	\$ 3,144	\$ 13,104	\$ 90,213
Death Care Management	4,170	104		4,274
Family Entertainment Centers	488			488
Healthcare	7,355	920	4,189	12,464
Independent Pharmacies	31,554	1,441	4,384	37,379
Registered Investment Advisors	14,312			14,312
Veterinary Industry	16,011	528	4,531	21,070
Wine & Craft Beverage	75			75
Other Industries		151		151
Construction & Development	18,282			18,282
Agriculture	7,092			7,092
Death Care Management	484			484
Family Entertainment Centers	122			122
Healthcare	7,061			7,061
Independent Pharmacies	483			483
Veterinary Industry	2,698			2,698
Wine & Craft Beverage	159			159
Other Industries	183			183
Owner Occupied Commercial Real Estate	99,812	4,679	20,143	124,634
Agriculture	3,127			3,127
Death Care Management	16,812	1,022	1,676	19,510
Family Entertainment Centers	1,294			1,294
Healthcare	26,060	1,725	2,558	30,343
Independent Pharmacies	4,987	192		5,179
Registered Investment Advisors	2,463			2,463
Self Storage	167			167

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Veterinary Industry	43,586	1,740	15,899	61,225
Wine & Craft Beverage	1,016			1,016
Other Industries	300		10	310
Commercial Land	4,264			4,264
Agriculture	4,264			4,264
Total	\$ 196,323	\$ 7,823	\$ 33,247	\$ 237,393

Table of Contents**Live Oak Bancshares, Inc.****Notes to Unaudited Consolidated Financial Statements****Note 5. Loans and Allowance for Loan Losses (Continued)**

	Risk Grades 1 - 4	Risk Grade 5	Risk Grades 6 - 8	Total ¹
December 31, 2014				
Commercial & Industrial	\$ 63,777	\$ 4,546	\$ 12,734	\$ 81,057
Death Care Management	3,603			3,603
Family Entertainment Centers	333			333
Healthcare	6,995	538	4,786	12,319
Independent Pharmacies	27,673	2,726	3,680	34,079
Registered Investment Advisors	9,660			9,660
Veterinary Industry	15,513	1,121	4,268	20,902
Other Industries		161		161
Construction & Development	9,526			9,526
Agriculture	3,910			3,910
Death Care Management	92			92
Healthcare	2,957			2,957
Independent Pharmacies	215			215
Veterinary Industry	2,207			2,207
Other Industries	145			145
Owner Occupied Commercial Real Estate	87,883	5,219	18,518	111,620
Agriculture	259			259
Death Care Management	16,519	639	1,721	18,879
Family Entertainment Centers	872			872
Healthcare	22,778	938	2,457	26,173
Independent Pharmacies	4,709	41		4,750
Registered Investment Advisors	2,161			2,161
Veterinary Industry	40,281	3,601	14,052	57,934
Other Industries	304		288	592
Commercial Land	1,248			1,248
Agriculture	1,248			1,248
Total	\$ 162,434	\$ 9,765	\$ 31,252	\$ 203,451

¹ Total loans include \$21.8 million of U.S. government guaranteed loans as of June 30, 2015, segregated by risk grade as follows: Risk Grades 1 - 4 = \$0, Risk Grade 5 = \$378 thousand, Risk Grades 6 - 8 = \$21.5 million. As of December 31, 2014 total loans include \$21.3 million of U.S. government guaranteed loans, segregated by risk grade as follows: Risk Grades 1 - 4 = \$0, Risk Grade 5 = \$1.1 million, Risk Grades 6 - 8 = \$20.2 million.

Table of Contents**Live Oak Bancshares, Inc.****Notes to Unaudited Consolidated Financial Statements****Note 5. Loans and Allowance for Loan Losses (Continued)****Past Due Loans**

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Also, loans less than 30 days past due and accruing are included within current loans shown below. The following tables show an age analysis of past due loans as of the dates presented.

	Less Than 30 Days Past Due & Not Accruing	30-89 Days Past Due & Accruing	30-89 Days Past Due & Not Accruing	Greater Than 90 Days Past Due	Total Not Accruing & Past Due Loans	Current Loans	Total Loans	Loans 90 Days or More Past Due & Still Accruing
June 30, 2015								
Commercial & Industrial	\$ 779	\$ 1,029	\$ 281	\$ 5,372	\$ 7,461	\$ 82,752	\$ 90,213	\$
Death Care Management						4,274	4,274	
Family Entertainment Centers						488	488	
Healthcare		346	135	1,626	2,107	10,357	12,464	
Independent Pharmacies		631	140	1,541	2,312	35,067	37,379	
Registered Investment Advisors						14,312	14,312	
Veterinary Industry	779	52	6	2,205	3,042	18,028	21,070	
Wine & Craft Beverage						75	75	
Other Industries						151	151	
Construction & Development						18,282	18,282	
Agriculture						7,092	7,092	
Death Care Management						484	484	

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Family Entertainment Centers						122	122
Healthcare						7,061	7,061
Independent Pharmacies						483	483
Veterinary Industry						2,698	2,698
Wine & Craft Beverage						159	159
Other Industries						183	183
Owner Occupied Commercial Real Estate	1,541	4,201	1,355	10,333	17,430	107,204	124,634
Agriculture						3,127	3,127
Death Care Management				1,677	1,677	17,833	19,510
Family Entertainment Centers						1,294	1,294
Healthcare	181		24	2,224	2,429	27,914	30,343
Independent Pharmacies						5,179	5,179
Registered Investment Advisors						2,463	2,463
Self Storage						167	167
Veterinary Industry	1,360	4,201	1,331	6,432	13,324	47,901	61,225
Wine & Craft Beverage						1,016	1,016
Other Industries						310	310
Commercial Land						4,264	4,264
Agriculture						4,264	4,264
Total¹	\$ 2,320	\$ 5,230	\$ 1,636	\$ 15,705	\$ 24,891	\$ 212,502	\$ 237,393

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Live Oak Bancshares, Inc.

Notes to Unaudited Consolidated Financial Statements

Note 5. Loans and Allowance for Loan Losses (Continued)

	Less Than 30 Days Past Due & Not Accruing	30-89 Days Past Due & Accruing	30-89 Days Past Due & Not Accruing	Greater Than 90 Days Past Due	Total Not Accruing & Past Due Loans	Current Loans	Total Loans	Loans 90 Days or More Past Due & Still Accruing
December 31, 2014								
Commercial & Industrial	\$ 1,025	\$ 1,433	\$ 236	\$ 5,872	\$ 8,566	\$ 72,491	\$ 81,057	\$
Death Care Management						3,603	3,603	
Family Entertainment Centers						333	333	
Healthcare		1,059	232	2,420	3,711	8,608	12,319	
Independent Pharmacies		98		1,224	1,322	32,757	34,079	
Registered Investment Advisors						9,660	9,660	
Veterinary Industry	1,025	276	4	2,228	3,533	17,369	20,902	
Other Industries						161	161	
Construction & Development						9,526	9,526	
Agriculture						3,910	3,910	
Death Care Management						92	92	
Healthcare						2,957	2,957	
Independent Pharmacies						215	215	
Veterinary Industry						2,207	2,207	
Other Industries						145	145	
Owner Occupied Commercial Real Estate	2,464	5,246	2,181	6,914	16,805	94,815	111,620	

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Agriculture						259	259
Death Care Management			1,721	1,721	17,158	18,879	
Family Entertainment Centers					872	872	
Healthcare	145	230	2,082	2,457	23,716	26,173	
Independent Pharmacies					4,750	4,750	
Registered Investment Advisors					2,161	2,161	
Veterinary Industry	2,464	5,101	1,951	2,836	12,352	45,582	57,934
Other Industries			275	275	317	592	
Commercial Land					1,248	1,248	
Agriculture					1,248	1,248	
Total¹	\$ 3,489	\$ 6,679	\$ 2,417	\$ 12,786	\$ 25,371	\$ 178,080	\$ 203,451

¹ Total loans include \$21.8 million of U.S. government guaranteed loans as of June 30, 2015, of which \$14.1 million is greater than 90 days past due, \$3.5 million is 30-89 days past due and \$4.3 million is included in current loans as presented above. As of December 31, 2014, total loans include \$21.3 million of U.S. government guaranteed loans, of which \$11.7 million is greater than 90 days past due, \$3.5 million is 30-89 days past due and \$6.1 million is included in current loans as presented above.

Table of Contents**Live Oak Bancshares, Inc.****Notes to Unaudited Consolidated Financial Statements****Note 5. Loans and Allowance for Loan Losses (Continued)****Nonaccrual Loans**

Loans that become 90 days delinquent, or in cases where there is evidence that the borrower's ability to make the required payments is impaired, are placed in nonaccrual status and interest accrual is discontinued. If interest on nonaccrual loans had been accrued in accordance with the original terms, interest income would have increased by approximately \$102 thousand and \$75 thousand for the three months ended June 30, 2015 and 2014, respectively and for the six months ended June 30, 2015 and 2014 would have increased approximately \$261 thousand and \$127 thousand, respectively. All nonaccrual loans are included in the held for investment portfolio.

Nonaccrual loans as of June 30, 2015 and December 31, 2014 are as follows:

June 30, 2015	Loan Balance	Guaranteed Balance	Unguaranteed Exposure
Commercial & Industrial	\$ 6,432	\$ 5,931	\$ 501
Healthcare	1,761	1,586	175
Independent Pharmacies	1,681	1,456	225
Veterinary Industry	2,990	2,889	101
Owner Occupied Commercial Real Estate	13,229	10,641	2,588
Death Care Management	1,677	1,469	208
Healthcare	2,429	1,918	511
Veterinary Industry	9,123	7,254	1,869
Total	\$ 19,661	\$ 16,572	\$ 3,089

December 31, 2014	Loan Balance	Guaranteed Balance	Unguaranteed Exposure
Commercial & Industrial	\$ 7,133	\$ 6,620	\$ 513
Healthcare	2,652	2,368	284
Independent Pharmacies	1,224	1,139	85
Veterinary Industry	3,257	3,113	144

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Owner Occupied Commercial Real Estate	11,559	8,935	2,624
Death Care Management	1,721	1,505	216
Healthcare	2,312	1,919	393
Veterinary Industry	7,251	5,236	2,015
Other Industries	275	275	
Total	\$ 18,692	\$ 15,555	\$ 3,137

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Live Oak Bancshares, Inc.

Notes to Unaudited Consolidated Financial Statements

Note 5. Loans and Allowance for Loan Losses (Continued)

Allowance for Loan Loss Methodology

The methodology and the estimation process for calculating the Allowance for Loan Losses (ALL) is described below:

Estimated credit losses should meet the criteria for accrual of a loss contingency, i.e., a provision to the allowance for loan losses (ALL), set forth in GAAP. The Company's methodology for determining the ALL is based on the requirements of GAAP, the Interagency Policy Statement on the ALL and other regulatory and accounting pronouncements. The ALL is determined by the sum of three separate components: (i) the impaired loan component, which addresses specific reserves for impaired loans; (ii) the general reserve component, which addresses reserves for pools of homogeneous loans; and (iii) an unallocated reserve component (if any) based on management's judgment and experience. The loan pools and impaired loans are mutually exclusive; any loan that is impaired is excluded from its homogenous pool for purposes of that pool's reserve calculation, regardless of the level of impairment.

The ALL policy for pooled loans is governed in accordance with banking regulatory guidance for homogenous pools of non-impaired loans that have similar risk characteristics. The Company follows a consistent and structured approach for assessing the need for reserves within each individual loan pool.

Loans are considered impaired when, based on current information and events, it is probable that the creditor will be unable to collect all interest and principal payments due according to the originally contracted, or reasonably modified, terms of the loan agreement. The Company has determined that loans that meet the criteria defined below must be reviewed quarterly to determine if they are impaired.

All commercial loans classified substandard or worse.

Any other delinquent loan that is in a nonaccrual status, or any loan that is delinquent more than 89 days and still accruing interest.

Any loan which has been modified such that it meets the definition of a Troubled Debt Restructuring (TDR). Any loan determined to be impaired is subjected to an impairment analysis, which is a calculation of the probable loss on the loan. This portion is the loan's impairment, and is established as a specific reserve against the loan, or charged against the ALL.

Individual specific reserve amounts imply probability of loss and may not be carried in the reserve indefinitely. When the amount of the actual loss becomes reasonably quantifiable, the amount of the loss is charged off against the ALL, whether or not all liquidation and recovery efforts have been completed. If the total amount of the individual specific reserve that will eventually be charged off cannot yet be sufficiently quantified, but some portion of the impairment can be viewed as a confirmed loss then the confirmed loss portion should be charged off against the ALL and the individual specific reserve reduced by a corresponding amount.

For impaired loans, the reserve amount is calculated on a loan-specific basis. The Company utilizes two methods of analyzing impaired loans not guaranteed by the SBA:

The Fair Market Value of Collateral method utilizes the value at which the collateral could be sold considering the appraised value, appraisal discount rate, prior liens and selling costs. The amount of the reserve is the deficit of the estimated collateral value compared to the loan balance.

The Present Value of Future Cash Flows method takes into account the amount and timing of cash flows and the effective interest rate used to discount the cash flows.

Table of Contents**Live Oak Bancshares, Inc.****Notes to Unaudited Consolidated Financial Statements****Note 5. Loans and Allowance for Loan Losses (Continued)**

The following tables detail activity in the allowance for loan losses by portfolio segment allowance for the periods presented:

Three months ended:	Construction & Development	Owner Occupied Commercial Real Estate	Commercial & Industrial	Commercial Land	Total
June 30, 2015					
Beginning Balance	\$ 755	\$ 2,062	\$ 2,063	\$ 354	\$ 5,234
Charge offs		(42)	(186)		(228)
Recoveries		87	40		127
Provision	89	239	(264)	(14)	50
Ending Balance	\$ 844	\$ 2,346	\$ 1,653	\$ 340	\$ 5,183
June 30, 2014					
Beginning Balance	\$ 480	\$ 1,921	\$ 812	\$	\$ 3,213
Charge offs		(119)	(8)		(127)
Recoveries		5	2		7
Provision	(180)	124	506	25	475
Ending Balance	\$ 300	\$ 1,931	\$ 1,312	\$ 25	\$ 3,568

Six months ended:	Construction & Development	Owner Occupied Commercial Real Estate	Commercial & Industrial	Commercial Land	Total
June 30, 2015					

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Beginning Balance	\$ 586	\$ 2,291	\$ 1,369	\$ 161	\$ 4,407
Charge offs		(121)	(358)		(479)
Recoveries		88	40		128
Provision	258	88	602	179	1,127
Ending Balance	\$ 844	\$ 2,346	\$ 1,653	\$ 340	\$ 5,183

June 30, 2014

Beginning Balance	\$ 350	\$ 1,511	\$ 862	\$	\$ 2,723
Charge offs		(119)	(8)		(127)
Recoveries		67	6		73
Provision	(50)	472	452	25	899
Ending Balance	\$ 300	\$ 1,931	\$ 1,312	\$ 25	\$ 3,568

The following tables detail the recorded allowance for loan losses and the investment in loans related to each portfolio segment, disaggregated on the basis of impairment evaluation methodology:

	Construction & Development	Owner Occupied Commercial Real Estate	Commercial & Industrial	Commercial Land	Total
June 30, 2015					
Allowance for Loan Losses:					
Loans individually evaluated for impairment	\$	\$ 1,092	\$ 677	\$	\$ 1,769
Loans collectively evaluated for impairment	844	1,254	976	340	3,414
Total allowance for loan losses	\$ 844	\$ 2,346	\$ 1,653	\$ 340	\$ 5,183
Loans receivable ¹ :					
Loans individually evaluated for impairment	\$	\$ 16,694	\$ 9,023	\$	\$ 25,717
Loans collectively evaluated for impairment	18,282	107,940	81,190	4,264	211,676
Total loans receivable	\$ 18,282	\$ 124,634	\$ 90,213	\$ 4,264	\$ 237,393

Table of Contents**Live Oak Bancshares, Inc.****Notes to Unaudited Consolidated Financial Statements****Note 5. Loans and Allowance for Loan Losses (Continued)**

December 31, 2014	Construction & Development	Owner Occupied Commercial Real Estate	Commercial & Industrial	Commercial Land	Total
Allowance for Loan Losses:					
Loans individually evaluated for impairment	\$	\$ 1,051	\$ 676	\$	\$ 1,727
Loans collectively evaluated for impairment	586	1,240	693	161	2,680
Total allowance for loan losses	\$ 586	\$ 2,291	\$ 1,369	\$ 161	\$ 4,407
Loans Receivable ¹:					
Loans individually evaluated for impairment	\$	\$ 16,551	\$ 10,226	\$	\$ 26,777
Loans collectively evaluated for impairment	9,526	95,069	70,831	1,248	176,674
Total loans receivable	\$ 9,526	\$ 111,620	\$ 81,057	\$ 1,248	\$ 203,451

¹ Loans receivable includes \$21.8 million of U.S. government guaranteed loans as of June 30, 2015, of which \$20.3 million are included in loans individually evaluated for impairment and \$1.6 million are included in loans collectively evaluated for impairment, as presented above. As of December 31, 2014, loans receivable includes \$21.3 million of U.S. government guaranteed loans, of which \$19.5 million are included in loans individually evaluated for impairment and \$2.0 million are included in loans collectively evaluated for impairment, as presented above.

Table of Contents**Live Oak Bancshares, Inc.****Notes to Unaudited Consolidated Financial Statements****Note 5. Loans and Allowance for Loan Losses (Continued)**

Loans individually evaluated for impairment as of the dates presented are summarized in the following tables.

June 30, 2015	Unpaid Principal Balance	Guaranteed Balance	Unguaranteed Exposure
Commercial & Industrial	\$ 9,023	\$ 7,434	\$ 1,589
Healthcare	3,311	2,746	565
Independent Pharmacies	2,492	1,799	693
Veterinary Industry	3,220	2,889	331
Owner Occupied Commercial Real Estate	16,694	12,837	3,857
Death Care Management	1,677	1,469	208
Healthcare	2,429	1,919	510
Veterinary Industry	12,588	9,449	3,139
Total	\$ 25,717	\$ 20,271	\$ 5,446

December 31, 2014	Unpaid Principal Balance	Guaranteed Balance	Unguaranteed Exposure
Commercial & Industrial	\$ 10,226	\$ 8,341	\$ 1,885
Healthcare	4,217	3,540	677
Independent Pharmacies	2,203	1,492	711
Veterinary Industry	3,806	3,309	497
Owner Occupied Commercial Real Estate	16,551	11,155	5,396
Death Care Management	1,721	1,505	216
Healthcare	2,312	1,919	393
Veterinary Industry	12,243	7,456	4,787
Other Industries	275	275	

Total	\$ 26,777	\$ 19,496	\$ 7,281
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Table of Contents**Live Oak Bancshares, Inc.****Notes to Unaudited Consolidated Financial Statements****Note 5. Loans and Allowance for Loan Losses (Continued)**

The following table presents evaluated balances of loans classified as impaired at the dates presented that carried an associated reserve as compared to those with no reserve. The recorded investment includes accrued interest, net deferred loan fees or costs and any non-accreted loan discount.

<u>Three months ended June 30, 2015:</u>	Unpaid Principal Balance	Recorded Investment	Total Reserve	Average Recorded Investment	Interest Income Recognized
Loans with no allowance	\$ 1,020	\$ 1,008	\$	\$ 2,852	\$ 7
Commercial & Industrial	331	327		1,622	5
Healthcare	97	95		352	1
Independent Pharmacies	191	190		1,150	2
Veterinary Industry	43	42		120	2
Owner Occupied Commercial Real Estate	689	681		1,230	2
Healthcare	166	164		143	
Veterinary Industry	523	517		1,087	2
Loans with an allowance	24,697	24,649	1,769	24,533	87
Commercial & Industrial	8,693	8,686	677	8,313	38
Healthcare	3,213	3,215	298	2,968	24
Independent Pharmacies	2,303	2,299	345	2,601	11
Veterinary Industry	3,177	3,172	34	2,744	3
Owner Occupied Commercial Real Estate	16,004	15,963	1,092	16,220	49
Death Care Management	1,677	1,675	11	1,418	
Healthcare	2,263	2,260	78	2,359	
Veterinary Industry	12,064	12,028	1,003	12,443	49
Total	\$ 25,717	\$ 25,657	\$ 1,769	\$ 27,385	\$ 94

<u>Three months ended June 30, 2014:</u>	Unpaid Principal	Recorded Investment	Total Reserve	Average Recorded	Interest Income
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	Balance			Investment	Recognized
Loans with no allowance	\$ 1,051	\$ 1,037	\$	\$ 6,220	\$ 8
Commercial & Industrial	211	208		3,690	3
Healthcare	91	89		705	1
Veterinary Industry	120	119		2,985	2
Owner Occupied Commercial Real Estate	840	829		2,530	5
Veterinary Industry	840	829		2,530	5
Loans with an allowance	17,397	17,560	436	11,774	101
Commercial & Industrial	6,374	6,462	245	3,444	24
Healthcare	2,148	2,183	8	2,831	
Independent Pharmacies	372	371	137		17
Veterinary Industry	3,854	3,908	100	613	7