Live Oak Bancshares, Inc.
Form 10-Q
November 08, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
ý Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2016
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	26-4596286
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1741 Tiburon Drive Wilmington, North Carolina	28403
(Address of principal executive offices)	(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 ý 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 ý 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 definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ¨	Accelerated Filer x
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 ý
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 November 7, 2016, there were 29,509,945 shares of the registrant's voting common stock outstanding and 4,723,530 shares of the registrant's non-voting common stock outstanding.

Table of Contents

Live Oak Bancshares, Inc. and Subsidiaries
Form 10-Q
For the Quarterly Period Ended September 30, 2016
TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
Live Oak Bancshares, Inc.
Consolidated Balance Sheets
As of September 30, 2016 (unaudited) and December 31, 2015*
(Dollars in thousands)

	September 30, 2016	December 31, 2015*
Assets		
Cash and due from banks	$355,485	$102,607
Certificates of deposit with other banks	7,500	10,250
Investment securities available-for-sale	70,334	53,762
Loans held for sale	345,277	480,619
Loans held for investment	766,977	279,969
Allowance for loan losses	(15,178)	(7,415)
Net loans	751,799	272,554
Premises and equipment, net	60,646	62,653
Foreclosed assets	2,235	2,666
Servicing assets	49,729	44,230
Other assets	26,735	23,281
Total assets	$1,669,740	$1,052,622
Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Noninterest-bearing	$28,461	$21,502
Interest-bearing	1,374,556	783,286
Total deposits	1,403,017	804,788
Long term borrowings	28,074	28,375
Other liabilities	24,497	19,971
Total liabilities	1,455,588	853,134
Shareholders' equity		
Preferred stock, no par value, 1,000,000 authorized, none issued or outstanding at September 30, 2016 and December 31, 2015	—	—
Class A common stock, no par value, 100,000,000 shares authorized, 29,491,520 and 29,449,369 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively	145,284	137,492
Class B common stock, no par value, 10,000,000 shares authorized, 4,723,530 shares issued and outstanding at September 30, 2016 and December 31, 2015	50,015	50,015
Retained earnings	18,723	12,140
Accumulated other comprehensive income (loss)	130	(192)
Total shareholders' equity attributed to Live Oak Bancshares, Inc.	214,152	199,455
Noncontrolling interest	—	33
Total equity	214,152	199,488
Total liabilities and shareholders' equity	$1,669,740	$1,052,622

* Derived from audited consolidated financial statements.
See Notes to Unaudited Consolidated Financial Statements

1

Table of Contents

Live Oak Bancshares, Inc.
Consolidated Statements of Income
For the three and nine months ended September 30, 2016 and 2015 (unaudited)
(Dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Interest income				
Loans and fees on loans	$14,961	$8,728	$38,868	$22,866
Investment securities, taxable	337	211	840	587
Other interest earning assets	264	84	650	220
Total interest income	15,562	9,023	40,358	23,673
Interest expense				
Deposits	3,689	1,997	9,376	5,274
Borrowings	242	395	725	1,280
Total interest expense	3,931	2,392	10,101	6,554
Net interest income	11,631	6,631	30,257	17,119
Provision for loan losses	3,806	1,212	8,692	2,339
Net interest income after provision for loan losses	7,825	5,419	21,565	14,780
Noninterest income				
Loan servicing revenue	5,860	4,216	15,725	11,678
Loan servicing asset revaluation	(3,421)	(2,650)	(5,051)	(4,234)
Net gains on sales of loans	21,833	15,424	52,813	46,604
Equity in loss of non-consolidated affiliates	—	—	—	(26)
Gain on sale of investment in non-consolidated affiliate	—	—	—	3,782
Gain on sale of investment securities available-for-sale	1	12	1	12
Construction supervision fee income	502	344	1,799	877
Other noninterest income	657	424	1,925	1,267
Total noninterest income	25,432	17,770	67,212	59,960
Noninterest expense				
Salaries and employee benefits	17,471	9,949	45,875	27,623
Travel expense	2,218	2,200	6,394	5,914
Professional services expense	907	493	2,345	1,891
Advertising and marketing expense	1,097	1,051	3,425	3,177
Occupancy expense	1,058	703	3,306	1,920
Data processing expense	1,252	773	3,864	2,388
Equipment expense	611	642	1,696	1,473
Other loan origination and maintenance expense	806	673	2,001	1,384
Other expense	1,798	1,579	5,155	3,811
Total noninterest expense	27,218	18,063	74,061	49,581
Income before taxes	6,039	5,126	14,716	25,159
Income tax expense	2,561	2,228	6,432	10,272
Net income	3,478	2,898	8,284	14,887
Net loss attributable to noncontrolling interest	1	3	9	23
Net income attributable to Live Oak Bancshares, Inc.	$3,479	$2,901	$8,293	$14,910
Basic earnings per share	$0.10	$0.09	$0.24	$0.50
Diluted earnings per share	$0.10	$0.09	$0.24	$0.48

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

Live Oak Bancshares, Inc.
Consolidated Statements of Comprehensive Income
For the three and nine months ended September 30, 2016 and 2015 (unaudited)
(Dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	$3,478	$2,898	$8,284	$14,887
Other comprehensive (loss) income before tax:				
Net unrealized (loss) gain on investment securities arising during the period	(115)	151	525	15
Reclassification adjustment for (gain) loss on sale of securities available-for-sale included in net income	(1)	(12)	(1)	(12)
Other comprehensive (loss) income before tax	(116)	139	524	3
Income tax benefit (expense)	45	(53)	(202)	(1)
Other comprehensive (loss) income, net of tax	(71)	86	322	2
Total comprehensive income	$3,407	$2,984	$8,606	$14,889

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

Live Oak Bancshares, Inc.
Consolidated Statements of Changes in Shareholders' Equity
For the nine months ended September 30, 2016 and 2015 (unaudited)
(Dollars in thousands)

	Common stock Shares Class A	Class B	Amount	Retained earnings (accumulated deficit)	Accumulated other comprehensive income (loss)	Non-controlling interest	Total equity
Balance at December 31, 2014	23,896,400	4,723,530	$98,672	$ (6,943)	$ 85	$ —	$91,814
Net income (loss)	—	—	—	14,910	—	(23)	14,887
Other comprehensive income	—	—	—	—	2	—	2
Consolidation of investment with non-controlling interest	—	—	—	—	—	35	35
Stock option exercises	47,570	—	215	—	—	—	215
Stock option based compensation expense	—	—	726	—	—	—	726
Restricted stock expense	—	—	83	—	—	—	83
Capital contribution from non-controlling interest	—	—	—	—	—	22	22
Issuance of common stock in connection with initial public offering, net of issue costs	5,500,000	—	87,171	—	—	—	87,171
Dividends (distributions to shareholders)	—	—	—	(859)	—	—	(859)
Balance at September 30, 2015	29,443,970	4,723,530	$186,867	$ 7,108	$ 87	$ 34	$194,096
Balance at December 31, 2015	29,449,369	4,723,530	$187,507	$ 12,140	$ (192)	$ 33	$199,488
Net income (loss)	—	—	—	8,293	—	(9)	8,284
Other comprehensive income	—	—	—	—	322	—	322
Issuance of restricted stock	16,745	—	—	—	—	—	—
Stock option exercises	25,406	—	147	—	—	—	147
Stock option based compensation expense	—	—	1,752	—	—	—	1,752
Restricted stock expense	—	—	5,893	—	—	—	5,893
Acquisition of non-controlling interest	—	—	—	—	—	(24)	(24)
Dividends (distributions to shareholders)	—	—	—	(1,710)	—	—	(1,710)
Balance at September 30, 2016	29,491,520	4,723,530	$195,299	$ 18,723	$ 130	$ —	$214,152

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

Live Oak Bancshares, Inc.
Consolidated Statements of Cash Flows
For the nine months ended September 30, 2016 and 2015 (unaudited)
(Dollars in thousands)

	Nine Months Ended September 30,	
	2016	2015
Cash flows from operating activities		
Net income	$8,284	$14,887
Adjustments to reconcile net income to net cash used by operating activities:		
Depreciation and amortization	3,201	1,917
Provision for loan losses	8,692	2,339
Amortization of premium on securities, net of accretion	135	36
Amortization (accretion) of discount on unguaranteed loans, net	773	1,650
Deferred tax (benefit) expense	(510)	936
Originations of loans held for sale	(701,415)	(740,378)
Proceeds from sales of loans held for sale	555,192	508,322
Net gains on sale of loans held for sale	(52,813)	(46,604)
Net loss on sale of foreclosed assets	61	12
Net increase in servicing assets	(5,499)	(5,591)
Gain on sale of securities available-for-sale	(1)	(12)
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	1,752	726
Restricted stock expense	5,893	83
Equity in loss of non-consolidated affiliates	—	26
Changes in assets and liabilities:		
Other assets	(858)	(2,431)
Other liabilities	2,652	2,025
Net cash used by operating activities	(174,461)	(265,823)
Cash flows from investing activities		
Purchases of securities available-for-sale	(24,946)	(15,437)
Proceeds from sales, maturities, calls, and principal paydowns of securities available-for-sale	8,764	13,106
Proceeds from sale/collection of foreclosed assets	680	514
Maturities of certificates of deposit with other banks	2,750	—
Proceeds from sale of investment in non-consolidated affiliate	—	9,896
Net cash acquired in consolidation of equity method investment	—	319
Capital contribution from non-controlling interest	—	22
Loan originations and principal collections, net	(154,738)	66,835
Purchases of premises and equipment, net	(1,194)	(29,295)
Net cash (used in) provided by investing activities	(168,684)	45,960

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

Live Oak Bancshares, Inc.
Consolidated Statements of Cash Flows (Continued)
For the nine months ended September 30, 2016 and 2015 (unaudited)
(Dollars in thousands)

	Nine Months Ended September 30,	
	2016	2015
Cash flows from financing activities		
Net increase in deposits	598,229	240,548
Proceeds from long term borrowings	—	12,960
Repayment of long term borrowings	(301)	(12,730)
Repayment of short term borrowings	—	(6,100)
Stock option exercises	147	215
Sale of common stock, net	—	87,171
Shareholder dividend distributions	(2,052)	(2,222)
Net cash provided by financing activities	596,023	319,842
Net increase in cash and cash equivalents	252,878	99,979
Cash and cash equivalents, beginning	102,607	29,902
Cash and cash equivalents, ending	$355,485	$129,881
Supplemental disclosure of cash flow information		
Interest paid	$10,120	$6,501
Income tax	5,739	11,312
Supplemental disclosures of noncash operating, investing, and financing activities		
Unrealized holding gains on available-for-sale securities, net of taxes	$322	$2
Transfers from loans to foreclosed real estate and other repossessions	406	700
Transfers from foreclosed real estate to SBA receivable	96	—
Transfers of loans accounted for as secured borrowing collateral to other assets	—	4,575
Transfer of loans held for sale to loans held for investment	339,322	7,410
Transfer of loans held for investment to loans held for sale	2,296	2,129
Contingent consideration in acquisition of controlling interest in equity method investment	24	170

See Notes to Unaudited Consolidated Financial Statements

Table of Contents

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 its 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. On July 28, 2015 the Company completed its initial public offering. In 2010, the Bank formed Live Oak Number One, Inc., a wholly-owned subsidiary, to hold properties foreclosed on by the Bank.
During 2011, the Company formed Independence Aviation, LLC, a wholly-owned subsidiary, for the purpose of purchasing and operating aircraft used for business purposes of the Company. The net assets of Independence Aviation, LLC were transferred to the Company and the Bank effective December 31, 2015 resulting in its dissolution.
In addition to the Bank, the Company owns Live Oak Grove, LLC, opened in September 2015 for the purpose of providing Company employees and business visitors an on-site restaurant location, 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 program and USDA-guaranteed loans, and 504 Fund Advisors, LLC (“504FA”), formed to serve as the investment adviser 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. Transactions in the third quarter of 2015 and first quarter of 2016 increased the Company’s ownership to 92.9%. On September 1, 2016, the Company acquired the remaining 7.1% ownership from a third party investor in exchange for contingent consideration estimated to total $24 thousand.
In August 2016, the Company formed Live Oak Ventures, Inc. for the purpose of investing in businesses that align with the Company's strategic initiative to be a leader in online banking for small businesses.
The Company earns revenue primarily from the sale of SBA-guaranteed loans. This income is comprised of net gains on the sale of loans, revenues on the servicing of sold loans and valuation of loan servicing rights. Net interest income is another contributor to 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 nine months ended September 30, 2016 are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2016. The consolidated balance sheet as of December 31, 2015 has been derived from the audited consolidated financial statements contained in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2015, filed with the Securities Exchange Commission on March 14, 2016 (SEC File No. 001-37497) (the "2015 Annual Report"). A summary description of the significant accounting policies followed by the Company is set forth in Note 1 of the Notes to Consolidated Financial Statements in the Company’s 2015 Annual Report. These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes in the Company's 2015 Annual Report.

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.

Amounts in all tables in the Notes to Unaudited Consolidated Financial Statements have been presented in thousands, except percentage, time period, stock option, share and per share data or where otherwise indicated.

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

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.
Loans Reclassified to Held for Investment
Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are classified as held for investment ("HFI") and reported at their outstanding principal amount adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans and unamortized premium or discount on purchased loans. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method. Loans originated and intended for sale are classified as held for sale ("HFS") and carried at the lower of cost or estimated fair value.
During the second quarter of 2016, the Bank transferred $318.8 million in unguaranteed loans from the HFS category to the HFI category to better reflect current intentions of the Company.
Allowance for Loan Losses
The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.
The allowance for loan losses is evaluated on a regular basis by management and is based upon management’s periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.
Upon transfer from held for sale classification, loans held for investment become subject to the allowance for loan loss review process. As a result of this process, the above mentioned $318.8 million loan reclassification resulted in a $4.0 million increase in the provision for loan losses during the second quarter of 2016.
During the second quarter of 2016, the Company also implemented enhancements to the methodology for estimating the allowance for loan losses, including refinements to the measurement of qualitative factors in the estimation process. Management believes these enhancements will improve the precision of the process for estimating the allowance, but did not fundamentally change the Company's approach. These revisions resulted in a $390 thousand reduction in the provision for loan losses during the second quarter of 2016.
Reclassifications
Certain reclassifications have been made to the prior period’s consolidated financial statements to place them on a comparable basis with the current year. Net income and shareholders’ equity previously reported were not affected by these reclassifications.
Note 2. Recent Accounting Pronouncements
In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-08, “Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)” (“ASU 2016-08”). This guidance amends the previously issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606).” ASU 2016-08 clarifies the implementation guidance on principal versus agent considerations in order to determine if revenue will be recognized on a gross or net basis. This guidance is effective for the Company on January 1, 2018 and is not expected to have a material impact on the consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, “Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”). ASU 2016-09 simplifies the accounting for share-based payment transactions for items including income tax consequences, classification of awards as equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 will be effective for the Company on January 1, 2017 and the Company is currently assessing the impact the adoption of this standard will have on the consolidated financial statements. Early adoption is permitted.

Table of Contents

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

In April 2016, the FASB issued ASU No. 2016-10, "Identifying Performance Obligations and Licensing" ("ASU 2016-10"). This guidance amends the previously issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09"). ASU 2016-10 clarifies the guidance related to identifying performance obligations and accounting for licenses of intellectual property. The amendments will be effective for the Company on January 1, 2018. The Company does not expect these amendments to have a material effect on its consolidated financial statements.

In May 2016, the FASB issued ASU No. 2016-12, "Narrow-Scope Improvements and Practical Expedients" ("ASU 2016-12"). This guidance also amends the previously issued ASU No. 2014-09 to clarify guidance related to collectibility, noncash consideration, presentation of sales tax and transition. The amendments will be effective for the Company on January 1, 2018. The Company does not expect these amendments to have a material effect on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, "Measurement of Credit Losses on Financial Instruments" ("ASU 2016-13"). This new guidance replaces the incurred loss impairment methodology in current standards with an expected credit loss methodology and requires consideration of a broader range of information to determine credit loss estimates. ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 will be effective for the Company on January 1, 2020. The Company is currently evaluating the effect the implementation of the new standard will have on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, "Classification of Certain Cash Receipts and Cash Payments" ("ASU 2016-15"). This guidance amends the Accounting Standards Codification 230, "Statement of Cash Flows," to clarify how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The ASU addresses cash flow issues including: (i) debt prepayment or debt extinguishment costs, (ii) zero-coupon bonds, (iii) settlement of a contingent consideration liability, (iv) proceeds from the settlement of insurance claims, (v) proceeds from corporate-owned life insurance, (vi) distributions received from equity method investees, (vii) beneficial interests in securitization transactions, and (viii) the "predominance principle." ASU 2016-15 will be effective for the Company on January 1, 2018. The Company does not expect these amendments to have a material effect on its 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 September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Basic earnings per share:				
Net income available to common shareholders	$3,479	$ 2,901	$8,293	$ 14,910
Weighted-average basic shares outstanding	34,206,942	32,824,587	34,191,014	30,037,436
Basic earnings per share	$0.10	$ 0.09	$0.24	$ 0.50
Diluted earnings per share:				
Net income available to common shareholders, for diluted earnings per share	$3,479	$ 2,901	$8,293	$ 14,910

Total weighted-average basic shares outstanding	34,206,943	33,824,587	34,191,014	34,037,436
Add effect of dilutive stock options and restricted stock grants	794,874	1,092,695	812,408	892,794
Total weighted-average diluted shares outstanding	35,001,817	34,917,282	35,003,422	34,930,230
Diluted earnings per share	$ 0.10	$ 0.09	$ 0.24	$ 0.48
Anti-dilutive shares	1,778,995	1,391,828	1,778,995	1,562,168

9

Table of Contents

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

Note 4. Investment Securities
The carrying amount of investment securities and their approximate fair values are reflected in the following table:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
September 30, 2016				
US government agencies	$ 20,770	$ 98	$ 7	$20,861
Residential mortgage-backed securities	47,356	184	89	47,451
Mutual fund	1,997	25	—	2,022
Total	$ 70,123	$ 307	$ 96	$70,334
December 31, 2015				
US government agencies	$ 21,992	$ 81	$ 5	$22,068
Residential mortgage-backed securities	30,131	1	374	29,758
Mutual fund	1,951	—	15	1,936
Total	$ 54,074	$ 82	$ 394	$53,762

During the three and nine months ended September 30, 2016, the Company sold one mortgage-backed security for $1.9 million at a gain of $1 thousand.
During the three months ended September 30, 2015, the Company sold three US government agency securities for $8.3 million at a gain of $12 thousand. In addition, during the first and second quarters of 2015, the Company sold six mortgage-backed securities at their carrying amount for $3.4 million in an odd-lot consolidation.
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	
September 30, 2016	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US government agencies	$1,515	$ 7	$—	$ —	$1,515	$ 7
Residential mortgage-backed securities	20,696	76	1,676	13	22,372	89
Total	$22,211	$ 83	$1,676	$ 13	$23,887	$ 96

	Less Than 12 Months		12 Months or More		Total	
December 31, 2015	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US government agencies	$7,990	$ 5	$—	$ —	$7,990	$ 5
Residential mortgage-backed securities	26,015	333	3,019	41	29,034	374
Mutual fund	1,936	15	—	—	1,936	15
Total	$35,941	$ 353	$3,019	$ 41	$38,960	$ 394

At September 30, 2016, there were two mortgage-backed securities in unrealized loss positions for greater than 12 months and seven mortgage-backed securities and one US government agency security in an unrealized loss position for less than 12 months. Unrealized losses at December 31, 2015 were comprised of three mortgage-backed securities in unrealized loss positions for greater than 12 months and one US government agency security, twelve mortgage-backed securities and the 504 Fund mutual fund investment 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 September 30, 2016 and December 31, 2015 were backed by US government sponsored enterprises (“GSEs”).

Table of Contents

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

The following is a summary of investment securities by maturity:

	September 30, 2016	
	Available-for-Sale	
	Amortized cost	Fair value
US government agencies		
Within one year	$7,998	$8,007
One to five years	12,772	12,854
Total	20,770	20,861
Residential mortgage-backed securities		
Five to ten years	7,817	7,872
After 10 years	39,539	39,579
Total	47,356	47,451
Total	$68,126	$68,312

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 504 Fund mutual fund investment.

At September 30, 2016 and December 31, 2015, an investment security with a fair market value of $1.5 million and $1.3 million, respectively, was pledged to secure a line of credit with the Company’s correspondent bank. At September 30, 2016, an investment security with a fair market value of $101 thousand was pledged to the Ohio State Treasurer to allow the Company's trust department to conduct business in the state of Ohio and an investment security with a fair market value of $1.2 million was pledged to the Company's trust department for uninsured trust assets held by the trust department.

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

Note 5. Loans Held for Investment and Allowance for Loan Losses

Loan Portfolio Segments

The following describes 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 "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.

Commercial Real Estate

Commercial real estate loans are extensions of credit secured by owner occupied and non-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 commercial real estate 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. The Bank chooses to finance businesses operating in specific 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, practice ownership experience and debt service capacity. Minimum guidelines have been set with regard to these various factors and deviations from those guidelines require compensating strengths when considering a proposed loan.

12

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

Loans consist of the following:

	September 30, 2016	December 31, 2015
Commercial & Industrial		
Agriculture	$1,503	$30
Death Care Management	9,584	4,832
Healthcare	33,822	15,240
Independent Pharmacies	80,317	41,588
Registered Investment Advisors	61,521	18,358
Veterinary Industry	34,922	21,579
Other Industries	41,660	3,230
Total	263,329	104,857
Construction & Development		
Agriculture	34,867	11,351
Death Care Management	2,500	769
Healthcare	28,454	7,231
Independent Pharmacies	2,387	101
Registered Investment Advisors	900	378
Veterinary Industry	11,662	3,834
Other Industries	20,080	658
Total	100,850	24,322
Commercial Real Estate		
Agriculture	5,637	1,863
Death Care Management	50,611	20,327
Healthcare	99,519	37,684
Independent Pharmacies	14,697	7,298
Registered Investment Advisors	8,388	2,808
Veterinary Industry	98,003	59,999
Other Industries	30,713	4,752
Total	307,568	134,731
Commercial Land		
Agriculture	94,111	16,036
Total	94,111	16,036
Total Loans[1]	765,858	279,946
Net Deferred Costs	7,613	3,056
Discount on SBA 7(a) Unguaranteed[2]	(6,494)	(3,033)
Loans, Net of Unearned	$766,977	$279,969

1 Total loans include $29.6 million and $17.2 million of U.S. government guaranteed loans as of September 30, 2016 and December 31, 2015, 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.

Table of Contents

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

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 select borrowers' 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

The following tables summarize the risk grades of each category:

	Risk Grades 1 - 4	Risk Grade 5	Risk Grades 6 - 8	Total
September 30, 2016				
Commercial & Industrial				
Agriculture	$ 1,445	$ 58	$ —	$1,503
Death Care Management	9,351	225	8	9,584
Healthcare	26,658	1,497	5,667	33,822
Independent Pharmacies	73,847	4,790	1,680	80,317
Registered Investment Advisors	58,427	2,730	364	61,521
Veterinary Industry	30,736	1,980	2,206	34,922
Other Industries	41,660	—	—	41,660
Total	242,124	11,280	9,925	263,329
Construction & Development				
Agriculture	34,867	—	—	34,867
Death Care Management	2,500	—	—	2,500
Healthcare	26,042	2,412	—	28,454
Independent Pharmacies	2,387	—	—	2,387
Registered Investment Advisors	900	—	—	900
Veterinary Industry	10,177	1,485	—	11,662
Other Industries	20,080	—	—	20,080
Total	96,953	3,897	—	100,850
Commercial Real Estate				
Agriculture	5,637	—	—	5,637
Death Care Management	45,801	3,228	1,582	50,611
Healthcare	93,248	5,270	1,001	99,519
Independent Pharmacies	12,613	2,084	—	14,697
Registered Investment Advisors	8,388	—	—	8,388
Veterinary Industry	83,540	3,787	10,676	98,003
Other Industries	30,713	—	—	30,713
Total	279,940	14,369	13,259	307,568
Commercial Land				
Agriculture	92,379	1,582	150	94,111
Total	92,379	1,582	150	94,111
Total[1]	$ 711,396	$ 31,128	$ 23,334	$765,858

15

Table of Contents

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

	Risk Grades 1 - 4	Risk Grade 5	Risk Grades 6 - 8	Total
December 31, 2015				
Commercial & Industrial				
Agriculture	$ 30	$ —	$ —	$30
Death Care Management	4,728	104	—	4,832
Healthcare	8,334	2,160	4,746	15,240
Independent Pharmacies	36,704	3,430	1,454	41,588
Registered Investment Advisors	17,508	850	—	18,358
Veterinary Industry	16,800	1,817	2,962	21,579
Other Industries	3,089	141	—	3,230
Total	87,193	8,502	9,162	104,857
Construction & Development				
Agriculture	11,194	157	—	11,351
Death Care Management	769	—	—	769
Healthcare	7,231	—	—	7,231
Independent Pharmacies	101	—	—	101
Registered Investment Advisors	378	—	—	378
Veterinary Industry	2,581	1,253	—	3,834
Other Industries	658	—	—	658
Total	22,912	1,410	—	24,322
Commercial Real Estate				
Agriculture	1,863	—	—	1,863
Death Care Management	18,223	425	1,679	20,327
Healthcare	33,529	2,930	1,225	37,684
Independent Pharmacies	6,210	1,088	—	7,298
Registered Investment Advisors	2,808	—	—	2,808
Veterinary Industry	45,453	3,171	11,375	59,999
Other Industries	4,752	—	—	4,752
Total	112,838	7,614	14,279	134,731
Commercial Land				
Agriculture	16,036	—	—	16,036
Total	16,036	—	—	16,036
Total[1]	$ 238,979	$ 17,526	$ 23,441	$279,946

1 Total loans include $29.6 million of U.S. government guaranteed loans as of September 30, 2016, segregated by risk grade as follows: Risk Grades 1 – 4 = $8.8 million, Risk Grade 5 = $7.0 million, Risk Grades 6 – 8 = $13.8 million. As of December 31, 2015, total loans include $17.2 million of U.S. government guaranteed loans, segregated by risk grade as follows: Risk Grades 1 – 4 = $0, Risk Grade 5 = $2.6 million, Risk Grades 6 – 8 = $14.6 million.

Table of Contents

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

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. 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
September 30, 2016								
Commercial & Industrial								
Agriculture	$ —	$ —	$ —	$ —	$ —	$ 1,503	$ 1,503	$ —
Death Care Management	—	—	—	—	—	9,584	9,584	—
Healthcare	212	623	1,377	2,589	4,801	29,021	33,822	—
Independent Pharmacies	—	327	288	421	1,036	79,281	80,317	—
Registered Investment Advisors	—	—	—	—	—	61,521	61,521	—
Veterinary Industry	41	31	1,238	573	1,883	33,039	34,922	—
Other Industries	—	—	—	—	—	41,660	41,660	—
Total	253	981	2,903	3,583	7,720	255,609	263,329	—
Construction & Development								
Agriculture	—	—	—	—	—	34,867	34,867	—
Death Care Management	—	—	—	—	—	2,500	2,500	—
Healthcare	—	—	—	—	—	28,454	28,454	—
Independent Pharmacies	—	—	—	—	—	2,387	2,387	—
Registered Investment Advisors	—	—	—	—	—	900	900	—
Veterinary Industry	—	—	—	—	—	11,662	11,662	—
Other Industries	—	—	—	—	—	20,080	20,080	—
Total	—	—	—	—	—	100,850	100,850	—
Commercial Real Estate								
Agriculture	—	—	—	—	—	5,637	5,637	—
Death Care Management	—	—	204	1,423	1,627	48,984	50,611	—
Healthcare	—	201	127	46	374	99,145	99,519	—
Independent Pharmacies	—	550	—	—	550	14,147	14,697	—
Registered Investment Advisors	—	—	—	—	—	8,388	8,388	—
Veterinary Industry	1,119	3,460	2,178	2,037	8,794	89,209	98,003	—
Other Industries	—	—	—	—	—	30,713	30,713	—
Total	1,119	4,211	2,509	3,506	11,345	296,223	307,568	—
Commercial Land								
Agriculture	150	—	—	—	150	93,961	94,111	—
Total	150	—	—	—	150	93,961	94,111	—
Total[1]	$ 1,522	$ 5,192	$ 5,412	$ 7,089	$ 19,215	$ 746,643	$ 765,858	$ —

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

	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, 2015								
Commercial & Industrial								
Agriculture	$ —	$ —	$ —	$ —	$ —	$ 30	$ 30	$ —
Death Care Management	—	—	—	—	—	4,832	4,832	—
Healthcare	—	1,854	30	2,337	4,221	11,019	15,240	—
Independent Pharmacies	314	603	—	—	917	40,671	41,588	—
Registered Investment Advisors	—	—	—	—	—	18,358	18,358	—
Veterinary Industry	208	466	1,131	394	2,199	19,380	21,579	—
Other Industries	—	—	—	—	—	3,230	3,230	—
Total	522	2,923	1,161	2,731	7,337	97,520	104,857	—
Construction & Development								
Agriculture	—	—	—	—	—	11,351	11,351	—
Death Care Management	—	—	—	—	—	769	769	—
Healthcare	—	—	—	—	—	7,231	7,231	—
Independent Pharmacies	—	—	—	—	—	101	101	—
Registered Investment Advisors	—	—	—	—	—	378	378	—
Veterinary Industry	—	—	—	—	—	3,834	3,834	—
Other Industries	—	—	—	—	—	658	658	—
Total	—	—	—	—	—	24,322	24,322	—
Commercial Real Estate								
Agriculture	—	—	—	—	—	1,863	1,863	—
Death Care Management	1,456	223	—	—	1,679	18,648	20,327	—
Healthcare	—	240	135	831	1,206	36,478	37,684	—
Independent Pharmacies	—	—	—	—	—	7,298	7,298	—
Registered Investment Advisors	—	—	—	—	—	2,808	2,808	—
Veterinary Industry	311	5,079	2,048	3,172	10,610	49,389	59,999	—
Other Industries	—	—	—	—	—	4,752	4,752	—
Total	1,767	5,542	2,183	4,003	13,495	121,236	134,731	—
Commercial Land								
Agriculture	—	—	—	—	—	16,036	16,036	—
Total	—	—	—	—	—	16,036	16,036	—
Total[1]	$ 2,289	$ 8,465	$ 3,344	$ 6,734	$ 20,832	$ 259,114	$ 279,946	$ —

1 Total loans include $29.6 million of U.S. government guaranteed loans as of September 30, 2016, of which $6.3 million is greater than 90 days past due, $5.8 million is 30-89 days past due and $17.5 million is included in current loans as presented above. As of December 31, 2015, total loans include $17.2 million of U.S. government guaranteed loans, of which $5.9 million is greater than 90 days past due, $6.7 million is 30-89 days past due and $4.6

million is included in current loans as presented above.

Table of Contents

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

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 $165 thousand and $358 thousand for the three months ended September 30, 2016 and 2015, respectively, and for the nine months ended September 30, 2016 and 2015 interest income would have increased approximately $451 thousand and $665 thousand, respectively. All nonaccrual loans are included in the held for investment portfolio.

Nonaccrual loans as of September 30, 2016 and December 31, 2015 are as follows:

September 30, 2016	Loan Balance	Guaranteed Balance	Unguaranteed Exposure
Commercial & Industrial			
Healthcare	$4,178	$ 2,862	$ 1,316
Independent Pharmacies	709	552	157
Veterinary Industry	1,852	1,648	204
Total	6,739	5,062	1,677
Commercial Real Estate			
Death Care Management	1,627	1,264	363
Healthcare	173	35	138
Veterinary Industry	5,334	4,270	1,064
Total	7,134	5,569	1,565
Commercial Land			
Agriculture	150	38	112
Total	150	38	112
Total	$14,023	$ 10,669	$ 3,354

December 31, 2015	Loan Balance	Guaranteed Balance	Unguaranteed Exposure
Commercial & Industrial			
Healthcare	$2,367	$ 2,188	$ 179
Independent Pharmacies	314	308	6
Veterinary Industry	1,733	1,572	161
Total	4,414	4,068	346
Commercial Real Estate			
Death Care Management	1,456	1,290	166
Healthcare	966	798	168
Veterinary Industry	5,531	4,174	1,357
Total	7,953	6,262	1,691
Total	$12,367	$ 10,330	$ 2,037

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

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 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 Allowance for Loan and Lease Losses 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).

Prior to December 31, 2015, all loans subject to impairment recognition were individually evaluated for impairment. Effective December 31, 2015, the Company's policy for impaired loan accounting subjects all loans to impairment recognition; however, loan relationships with unguaranteed credit exposure of less than $100,000 are generally not evaluated on an individual basis for impairment and instead are evaluated collectively using a methodology based on historical specific reserves on similar sized loans. Any loan not meeting the above criteria and 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. This revision to the allowance methodology did not have a material impact on the allowance recorded at December 31, 2015.
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.

20

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

The following table details activity in the allowance for loan losses by portfolio segment allowance for the periods presented:

Three months ended:	Construction & Development	Commercial Real Estate	Commercial & Industrial	Commercial Land	Total
September 30, 2016					
Beginning Balance	$ 1,208	$ 4,079	$ 5,601	$ 1,421	$12,309
Charge offs	—	—	(939)	—	(939)
Recoveries	—	1	1	—	2
Provision	225	261	2,907	413	3,806
Ending Balance	$ 1,433	$ 4,341	$ 7,570	$ 1,834	$15,178
September 30, 2015					
Beginning Balance	$ 844	$ 2,346	$ 1,653	$ 340	$5,183
Charge offs	—	(7)	(280)	—	(287)
Recoveries	—	12	33	—	45
Provision	336	(260)	830	306	1,212
Ending Balance	$ 1,180	$ 2,091	$ 2,236	$ 646	$6,153

Nine months ended:	Construction & Development	Commercial Real Estate	Commercial & Industrial	Commercial Land	Total
September 30, 2016					
Beginning Balance	$ 1,064	$ 2,486	$ 2,766	$ 1,099	$7,415
Charge offs	—	(7)	(1,307)	(63)	(1,377)
Recoveries	—	4	444	—	448
Provision	369	1,858	5,667	798	8,692
Ending Balance	$ 1,433	$ 4,341	$ 7,570	$ 1,834	$15,178
September 30, 2015					
Beginning Balance	$ 586	$ 2,291	$ 1,369	$ 161	$4,407
Charge offs	—	(128)	(638)	—	(766)
Recoveries	—	100	73	—	173
Provision	594	(172)	1,432	485	2,339
Ending Balance	$ 1,180	$ 2,091	$ 2,236	$ 646	$6,153

Table of Contents

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

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:

September 30, 2016	Construction & Development	Commercial Real Estate	Commercial & Industrial	Commercial Land	Total
Allowance for Loan Losses:					
Loans individually evaluated for impairment	$ —	$ 1,385	$ 1,563	$ —	$2,948
Loans collectively evaluated for impairment[2]	1,433	2,956	6,007	1,834	12,230
Total allowance for loan losses	$ 1,433	$ 4,341	$ 7,570	$ 1,834	$15,178
Loans receivable[1]:					
Loans individually evaluated for impairment	$ —	$ 13,541	$ 4,371	$ 144	$18,056
Loans collectively evaluated for impairment[2]	100,850	294,027	258,958	93,967	747,802
Total loans receivable	$ 100,850	$ 307,568	$ 263,329	$ 94,111	$765,858

December 31, 2015	Construction & Development	Commercial Real Estate	Commercial & Industrial	Commercial Land	Total
Allowance for Loan Losses:					
Loans individually evaluated for impairment	$ —	$ 1,090	$ 672	$ —	$1,762
Loans collectively evaluated for impairment[2]	1,064	1,396	2,094	1,099	5,653
Total allowance for loan losses	$ 1,064	$ 2,486	$ 2,766	$ 1,099	$7,415
Loans receivable[1]:					
Loans individually evaluated for impairment	$ —	$ 9,821	$ 3,226	$ —	$13,047
Loans collectively evaluated for impairment[2]	24,322	124,910	101,631	16,036	266,899
Total loans receivable	$ 24,322	$ 134,731	$ 104,857	$ 16,036	$279,946

1 Loans receivable includes $29.6 million of U.S. government guaranteed loans as of September 30, 2016, of which $13.9 million are impaired. As of December 31, 2015, loans receivable includes $17.2 million of U.S. government guaranteed loans, of which $14.1 million are considered impaired.

2 Included in loans collectively evaluated for impairment are impaired loans with individual unguaranteed exposure of less than $100 thousand. As of September 30, 2016, these balances totaled $8.6 million, of which $6.7 million are guaranteed by the U.S. government and $1.9 million are unguaranteed. As of December 31, 2015, these balances totaled $8.6 million, of which $7.5 million are guaranteed by the U.S. government and $1.1 million are unguaranteed. The allowance for loan losses associated with these loans totaled $406 thousand and $352 thousand as of September 30, 2016 and December 31, 2015, respectively.

Table of Contents

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

Loans classified as impaired as of the dates presented are summarized in the following tables.

September 30, 2016	Recorded Investment	Guaranteed Balance	Unguaranteed Exposure
Commercial & Industrial			
Death Care Management	$ 8	$ —	$ 8
Healthcare	5,722	3,172	2,550
Independent Pharmacies	2,020	985	1,035
Registered Investment Advisors	735	—	735
Veterinary Industry	2,546	1,779	767
Total	11,031	5,936	5,095
Commercial Real Estate			
Death Care Management	1,785	1,264	521
Healthcare	1,001	290	711
Independent Pharmacies	552	—	552
Veterinary Industry	12,128	6,405	5,723
Total	15,466	7,959	7,507
Commercial Land			
Agriculture	144	38	106
Total	144	38	106
Total	$ 26,641	$ 13,933	$ 12,708

December 31, 2015	Recorded Investment	Guaranteed Balance	Unguaranteed Exposure
Commercial & Industrial			
Healthcare	$ 4,442	$ 3,341	$ 1,101
Independent Pharmacies	1,546	637	909
Veterinary Industry	2,256	1,731	525
Total	8,244	5,709	2,535
Commercial Real Estate			
Death Care Management	1,454	1,290	164
Healthcare	965	799	166
Veterinary Industry	11,003	6,349	4,654
Total	13,422	8,438	4,984
Total	$ 21,666	$ 14,147	$ 7,519

Table of Contents

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

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 and net deferred loan fees or costs.

	September 30, 2016				
	Recorded Investment				
	With a Recorded Allowance	With No Recorded Allowance	Total	Unpaid Principal Balance	Related Allowance Recorded
Commercial & Industrial					
Death Care Management	$—	$ 8	$8	$8	$ —
Healthcare	5,122	600	5,722	6,599	825
Independent Pharmacies	1,841	179	2,020	2,109	495
Registered Investment Advisors	735	—	735	731	412
Veterinary Industry	2,255	291	2,546	2,996	199
Total	9,953	1,078	11,031	12,443	1,931
Commercial Real Estate					
Death Care Management	1,422	363	1,785	1,921	8
Healthcare	800	201	1,001	1,001	61
Independent Pharmacies	552	—	552	550	310
Veterinary Industry	9,471	2,657	12,128	12,844	1,044
Total	12,245	3,221	15,466	16,316	1,423
Commercial Land					
Agriculture	—	144	144	213	—
Total	—	144	144	213	—
Total Impaired Loans	$22,198	$ 4,443	$26,641	$28,972	$ 3,354

	December 31, 2015				
	Recorded Investment				
	With a Recorded Allowance	With No Recorded Allowance	Total	Unpaid Principal Balance	Related Allowance Recorded
Commercial & Industrial					
Healthcare	$4,242	$ 200	$4,442	$4,742	$ 478
Independent Pharmacies	1,199	347	1,546	2,041	287
Veterinary Industry	2,051	205	2,256	3,270	138
Total	7,492	752	8,244	10,053	903
Commercial Real Estate					
Death Care Management	1,454	—	1,454	1,591	9
Healthcare	965	—	965	1,096	96
Veterinary Industry	9,265	1,738	11,003	11,856	1,106
Total	11,684	1,738	13,422	14,543	1,211
Total Impaired Loans	$19,176	$ 2,490	$21,666	$24,596	$ 2,114

Live Oak Bancshares, Inc.
Notes to Unaudited Consolidated Financial Statements

	Three months ended September 30, 2016		Three months ended September 30, 2015	
	Average Balance	Interest Income Recognized	Average Balance	Interest Income Recognized
Commercial & Industrial				
Death Care Management	$9	$ —	$—	$ —
Healthcare	6,345	38	3,460	24
Independent Pharmacies	1,946	18	2,395	13
Registered Investment Advisors	742	7	—	—
Veterinary Industry	2,501	13	3,790	5
Total	11,543	76	9,645	42
Commercial Real Estate				
Death Care Management	1,801	2	1,412	—
Healthcare	1,012	12	2,474	—
Independent Pharmacies	551	2	—	—
Veterinary Industry	12,218	87	11,412	42
Total	15,582	103	15,298	42
Commercial Land				
Agriculture	156	—	—	—
Total	156	—	—	—
Total	$27,281	$ 179	$24,943	$ 84

	Nine months ended September 30, 2016		Nine months ended September 30, 2015	
	Average Balance	Interest Income Recognized	Average Balance	Interest Income Recognized
Commercial & Industrial				
Death Care Management	$ 9	$ —	$ —	$ —
Healthcare	5,777	60	3,388	72
Independent Pharmacies	1,927	51	2,524	38
Registered Investment Advisors	588	13	—	—
Veterinary Industry	2,715	29	3,482	13
Total	11,016	153	9,394	123
Commercial Real Estate				
Death Care Management	1,811	5	1,461	—
Healthcare	1,013	27	2,372	—
Independent Pharmacies	551	2	—	—
Veterinary Industry	12,266	249	11,357	132
Total	15,641	283	15,190	132
Commercial Land				
Agriculture	355	—	—	—
Total	355	—	—	—