OpusBank
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October 19, 2016 - Investor and Analyst Call

(Brett Villaume) Good morning. Joining me on today's call is Stephen Gordon, Opus Bank's Founding Chairman, CEO and President, Michael Allison, Co-President and President of the Commercial Bank and Nicole Carrillo, Chief Financial Officer. Today's discussion may entail forward-looking statements, which are intended to be covered by the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. You'll find a discussion of these forward-looking statements in our recent FDIC filings and at the end of the conference call discussion summary that we 8-K'd this morning and that is available on the Investor Relations section of Opus Bank's website at investor.opusbank.com/presentations. Now, I will turn the call over to Stephen Gordon, Founding Chairman, CEO and President.

(Stephen H. Gordon) Good morning. I would like to take a moment and provide a little background that explains our rationale behind hosting the call today. Over the past two days, we have had numerous conference calls and received emails in which we requested that investors and analysts submit all of their questions in connection with our earnings pre-announcement that we issued on Monday, October 17, 2016. We are holding this call to ensure that we share the answers to those questions with all investors and analysts simultaneously, as opposed to having one-off, individual calls. We will not be taking questions on the call today, and we thank you for sharing all of your questions. Today's call is specifically being held to discuss credit related topics. We will not be discussing our earnings for the third quarter of 2016, which we intend to discuss on our previously scheduled earnings conference call on Monday, October 24, 2016 at 7:00 am. Please note our earnings call is now scheduled to take place one hour earlier than originally scheduled. We will now proceed with our call.

1. **Have you been adequately provisioning for loan losses and can you explain the reserving methodology? (Nicole Carrillo)**
    - We believe we have been consistently and adequately provisioning for loan losses by applying a methodology that has been reviewed by our regulators and our internal and external auditors. Our allowance for loan losses includes general reserves for non-impaired loans and specific reserves for impaired loans. Our general reserves are based on qualitative factors and quantitative loss factors, which are derived from our historical loss experience over the past twelve quarters, including the charge-offs taken in the current quarter, with the most recent four quarters being most heavily weighted. In quarters where we do not have charge-offs we utilize FDIC peer data for historical losses. We evaluate specific reserves for impaired loans, which are loans where we do not believe we will collect all principal and interest contractually due to us. This reserve is estimated using either a discounted cash flow analysis or by measurement of the fair value of the underlying collateral of the loan.
2. **What were the "new developments" that resulted in the charge-offs? How did the 8 loan charge-offs develop? Could these loans have been communicated any earlier? (Michael Allison)**
    - When a loan is determined to be impaired and a loss is probable, a specific reserve is established. When there is a confirmed loss event, that specific reserve would then become a charge-off. To the extent the specific reserve and the charge-off amounts are the same, there would be no direct impact to the provision for loan losses or the income statement for that charge-off.
    - This was the situation for almost all of the eight loan relationships for which we recorded a charge-off. We have been establishing specific reserves over the last eight quarters as the quality of these loans deteriorated. When we became aware of information on the loans that confirmed a loss during the quarter, we moved the specific reserve amounts that we had previously established to a charge-off. The confirmation of a loss event is the culmination of

our review of impaired loans that includes sign off by risk, credit, finance, and other related contributors and usually occurs around the end of a quarter to consider all information received. This includes information that we receive up to the filing of our financials for the quarter.

- We will walk you through one loan relationship, which was a Technology loan, that had the largest difference between the specific reserve and the charge-off amount. The difference between the specific reserve and the charge-off amount on this one Technology loan was $17 million and comprised almost 80% of the impact that the charge-offs directly had on the income statement. For this loan, we receive monthly information on its revenue and performance that we compare to its forecasts to determine if they are meeting their plans which help to drive our valuation of the company. When we received the most recent financial information for this company at the end of September, the monthly financial performance had severely declined, it had missed its most recent monthly targets, and had re-forecasted for the remainder of the year to the extent that we believed we would not receive payments in accordance with our expectations. As such, for this one loan, we determined that this was a confirmed loss event. Prior to this change in its financial condition, we were using an enterprise value for the company for our evaluation, however, based on the changes in the financial performance, we used a liquidation value approach in accordance with regulatory and accounting guidance at September 30, 2016. Using a liquidation value resulted in a $17 million decline in the collateral value.

3. **How were these eight relationships reviewed relative to the rest of the portfolio? (Nicole Carrillo)**
    - These loans are all managed by our Special Credits group, which has a formalized discipline and process of performing ongoing reviews of problem loans, financial and collateral detail to develop strategies for resolution. In addition to our normal portfolio management practices, once a loan reaches the watch category it becomes part of this ongoing formalized problem loan review process.
4. **Were the charge-offs caused by collateral issues? (Nicole Carrillo)**
    - There was deterioration in the underlying financial performance of the client for each of these loans that led them to be viewed as collateral dependent. The shortfall between the collateral value, measured through independent third party appraisals, enterprise value assessment, or liquidation values, and the loan balance triggered a charge-off when a loss event was confirmed during the third quarter.
5. **In the prior quarter, management discussed five credits that comprised 90% of the total nonaccrual loans. Please explain how the eight loan relationships with charge-offs this quarter relate to the five loan relationships discussed previously. (Nicole Carrillo)**
    - At June 30, 2016, the five credits previously referenced made up 88% of total nonaccrual loans and subsequently had charge-offs in the third quarter. Two of the additional three loan relationships were also nonaccrual loans (i.e. part of the remaining 12%) at June 30th and also had charge-offs during the third quarter. One loan relationship was identified as nonaccrual during the third quarter and had a charge off of $2.0 million in the same period. At September 30, 2016, five of the eight loan relationships that had charge-offs have a remaining balance of $19.1 million that is included in our nonaccrual loan balance.
6. **What divisions were the eight loan relationships with charge-offs part of? (Michael Allison)**
    - The charge-offs during the third quarter were comprised of $23.4 million from Technology Banking, $7.5 million from Healthcare Banking, specifically our Practice group not our Provider loans, $7.1 million from our Commercial Banking division and $2.0 million from Corporate Finance. These eight relationships had $16.7 million of specific reserves recorded over the last eight quarters. It is important to note that our Healthcare Banking division is

comprised of both our Provider focus and Practice focus. Provider loans comprise approximately 80% of our Healthcare Banking loan portfolio. We believe the Practice portfolio charge-offs should not be viewed as indicative of Provider portfolio performance.

7. **What were the inflows and outflows within total criticized loans that led to the flat quarter-over-quarter level? What risk rating migration took place during the quarter? (Nicole Carrillo)**
    - Total criticized loans increased by $914,000 quarter-to-quarter. The net change was driven by charge-offs, which reduced the balance by $40 million, upgrades, which reduced the balance by $21.1 million, and downgrades, which increased the balance by $62.0 million. The downgrades of $62.0 million were primarily comprised of two loans totaling $23.3 million from Technology Banking, two loans totaling $15.0 million from Commercial Banking, one loan totaling $8.5 million from Healthcare Banking and one loan totaling $11.6 million from Structured Finance. Only one loan migrated to substandard, which was from Technology banking. We continue to focus meaningful attention on resolving criticized loans, which resulted in the $21.1 million of upgrades during the quarter.
8. **Did the Technology loan previously mentioned as a potential upgrade have a charge-off? (Michael Allison)**
    - No. The Technology loan we previously mentioned showed improved trends and we received a third party valuation that supported the release of the specific reserve that had been previously recorded for it.
9. **How large is the Technology Banking portfolio? (Nicole Carrillo)**
    - As of September 30, 2016, there were $253.7 million in outstanding Technology loans and $298.0 million in total Technology loan commitments, down from $279.5 million and $318.1 million at June 30, 2016, respectively.
10. **What changes are being made going forward in terms of processes and structure? (Stephen H. Gordon)**
    - We've committed to specific enhancements to our loan processes, credit monitoring, approval and review which will be, in part, accomplished through the dedication of deeper talent and resources. Examples of numerous improvements we will be making include, but are not limited to, bifurcating the chief credit officer role into two separate roles: a chief credit officer dedicated to our commercial real estate lending activities and the addition of a chief credit officer dedicated to our commercial and specialty banking C&I focus. We are also going to be lowering our in-house maximum hold limits, which we believe will reduce the risk of single event impact, and lowering approval authority levels, which we believe will increase scrutiny and oversight in the credit approval process.
11. **Is there more to come in terms of charge-offs and problem loans? (Michael Allison)**
    - As our portfolio continues to season, we expect to see both positive and negative migration in individual credits. We believe the steps we are taking will improve our credit performance.
12. **What changes are you estimating for the composition of your growth? (Stephen H. Gordon)**
    - We previously announced that we de-emphasized Technology Banking and will continue to evaluate risk adjusted returns and concentrations in all of our business lines.
13. **Do you need to slow growth in the other divisions besides Technology Banking? (Stephen H. Gordon)**
    - We believe that opportunities exist in our other divisions to continue to grow loans with attractive risk adjusted returns, which we will continue to evaluate over time in all of our portfolios.
14. **How will the changes in loss factors affect provisioning going forward? (Nicole Carrillo)**
    - The change in the loss factor will increase the reserve that we are allocating to unimpaired loans going forward. If we experience losses less than what was recorded in the current

quarter going forward, the loss factor attributed to unimpaired loans should decline over time under our current methodology.

15. **Will you have enough capital to continue your growth trajectory? (Stephen H. Gordon)**
    - These charge-offs do not require us to raise capital, however, as we grow, we anticipate that we may opportunistically look to access the capital markets as we did in June 2016 when we issued $135 million of subordinated debt.
16. **Will there be a change to your dividend policy? (Stephen H. Gordon)**
    - Given the net loss in the third quarter, we will not be paying a dividend in connection with the third quarter but it is our intention to resume paying a dividend commensurate with our future earnings performance. We have not had a stated dividend payout ratio to date.
17. **Are you going to change your earnings guidance? (Stephen H. Gordon)**
    - Consistent with our historical practice, we will continue to provide detail on the drivers of our future financial performance, from which investors and analysts can build their models, but we will not provide forward earnings guidance.
18. **Will there be incentive compensation "clawbacks" for the lenders tied to these credits? How will the compensation of credit-related employees be handled? (Stephen H. Gordon)**
    - Consistent with our practice, we will withhold incentive compensation from the originating bankers on these eight loan relationships.
    - Credit-related employees associated with these charge-offs will be impacted as well.

In concluding our remarks for today, as Chairman, CEO & President of Opus, I would like to add that I will be requesting that the Board of Directors not award me any annual discretionary bonus related to the 2016 fiscal year. This concludes our remarks for the call today. We appreciate your participation in today's call and will look forward to speaking with you all on Monday, October 24th at 7:00am PST for our scheduled earnings call. Thank you.

About Opus Bank
Opus Bank is an FDIC-insured California-chartered commercial bank with $7.5 billion of total assets, $6.1 billion of total loans and $6.2 billion in total deposits, as of June 30, 2016. Opus Bank provides superior ideas and solutions, and banking products to its clients through its Retail Bank, Commercial Bank, Merchant Bank, and Correspondent Bank. Opus Bank offers a suite of treasury and cash management and depository solutions and a wide range of loan products, including commercial, healthcare, media and entertainment, corporate finance, multifamily residential, commercial real estate, and structured finance, and is an SBA preferred lender. Opus Bank offers commercial escrow services and facilitates 1031 Exchange transactions through its Escrow and Exchange divisions. Opus Bank provides clients with financial and advisory services related to raising equity capital, targeted acquisition and divestiture strategies, general mergers and acquisitions, debt and equity financing, balance sheet restructuring, valuation, strategy, and performance improvement through its Merchant Banking Division and its broker-dealer subsidiary, Opus Financial Partners, LLC. Opus Bank's subsidiary, PENSCO Trust Company, is a leading tech-enabled alternative asset IRA custodian with over $12 billion of custodial assets and over 48,000 client accounts, which are comprised of self-directed investors, financial institutions, capital raisers, and financial advisors. Opus Bank operates 56 banking offices, including 32 in California, 21 in the Seattle/Puget Sound region in Washington, two in the Phoenix metropolitan area of Arizona, and one in Portland, Oregon. Opus Bank is an Equal Housing Lender. For additional information about Opus Bank, please visit our website: www.opusbank.com.

Forward-Looking Statements
The supplemental information furnished here contains certain forward-looking statements. Forward-looking statements are neither historical facts nor assurances of future performance. The Bank generally identifies forward-looking statements by terminology such as "outlook," "believes," "expects," "potential," "continues,"

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