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PRESENTATION

Bose George - *Keefe, Bruyette & Woods, Inc. - Analyst*

Good morning. Let's get the next session started. Next up is Flagstar Bancorp. From Flagstar we have Jim Ciroli, the CFO, and David Urban, the Head of Investor Relations. With that I'll hand it over to Jim for his presentation.

Jim Ciroli - *Flagstar Bancorp, Inc. - EVP and CFO*

Thank you, Bose, and I appreciate (technical difficulty) inviting me to present. I want also thank anyone who has been an investor in Flagstar stock. It's not been easy given some of our history, but I think what you would find year-to-date is that we've delivered. And we are at this point doing some great things.

We have a unique business model. I'm going to walk you through that business model. I want to tell you about how we are doing, what we are doing. And what I would tell you is we are doing everything at this point with our business model that we'd like to do. We've got some really strong capital, and we are generating that capital at what I think is an industry-leading pace of internal regulatory capital growth. And that gives us a lot of great growth opportunities. And you can see from our current results with ROAs and ROEs well above where other midsize banks are, that we are able to be good stewards of that capital.

So here is an overview. And what I would tell you again is when you look at the most recent results, whether they be second quarter, whether they be year-to-date. From a second quarter perspective, earned 1% (technical difficulty) max, we returned (technical difficulty). We continue to grow out our mortgage origination, our mortgage servicing, and our community banking segments. What we saw was 11% revenue growth quarter-over-quarter with only a 2% expense growth, leading to a 9% operating leverage.

Our efficiency ratio, which is a little bit higher than other banks, dropped to 68%. It's a little bit higher just because of the mortgage concentration. What we see is we continue to grow our key banking relationships. We continue to grow our mortgage origination, third-party (technical difficulty) relationships, so we continue to grow our mortgage servicing relationships.

So, as you think about those three business segments, what I think is really interesting and what I personally have not done enough to articulate and evangelize, if you will, is how those segments play (technical difficulty) in a very (technical difficulty) way, a symbiotic way. And (inaudible) internally we call (technical difficulty). And I want you to think about a flywheel spinning, having angular momentum. And then we are able to hit that wheel in a few ways to just continue to increase the angular momentum.

It's not a concept that we can take credit for; it's a really Jim Collins, the Good to Great book's guy. But I want to talk about those three business segments of ours, community (technical difficulty) mortgage origination and mortgage servicing in a way that continues to build angular momentum with our business model that you see up here. So as we think about things that we do, we are a bank. And so that gives us a funding and payments advantage. We are able to generate loans. We generate loans to large homebuilders. We generate loans to large mortgage banks and large mortgage brokers. And from those loans we build a relationship.

Those loans happen to be very nice spread assets, and typically very low credit loss assets. But the relationships that we have are -- enable us to do more correspondent lending. So that the mortgage company, the captive brokerage arm, captive (technical difficulty) company arm of the homebuilder, generates the mortgage origination. We finance that through a warehouse line. And ultimately a large part of that volume comes over to Flagstar, and we are able to earn roughly 100 basis points on that from a TPO perspective.

That mortgage origination revenue, which you see on our gain on sale line, is something that we do with a very low capital cost in a very low amount of assets. It's really what gives us the top quartile level ROA and ROE that you see in our results. From this, obviously we generate a mortgage servicing right, which we then can either sell that right or we can retain that. When we sell, we also provide financing from (inaudible) perspective, which also carries pretty nice spreads. And we are doing that at 50% to 60% LTV. So we don't think we are taking a lot of credit risk in those sort of structures.

And those relationships also bring us into other lending and commercial banking opportunities, such as deposits, treasury management. And when you own the mortgage servicing rights, you are responsible for the servicing advances. And oftentimes these customers, these borrowers, they want additional funding when they have to fund their servicing advances. So that continues to open up more commercial lending opportunities and continues to add momentum to that flywheel. Not to mention where we are subservicing the mortgage servicing right, if we've sold the mortgage servicing right and we subservice that back, there are two other benefits that we are driving.

One is obviously we have the escrow deposits, the principal and interest. The taxes and insurance sit in our bank and provide funding, very economic funding, to the commercial bank. And the second thing that we do, a large number of the MSR buyers are financial buyers that lack any kind of origination capability. And as they have a mortgage servicing right in today's environment, as rates fall, the mortgage servicing right comes like an ice cube sitting out in the sun; it just melts even faster.

And what we are able to sell them from a service standpoint is a recapture capability with our direct to consumer channel, our call center, to recapture the MSR that other competitors of ours will call. And they will just -- there will be more heat on that ice cube melting in the sun. We can go back, for a fee, and refresh that mortgage servicing right, refinance the loan, give the MSR back to the original MSR holder, and like I said, take a small fee in that. Again, adding to the ROA, adding to the ROE we see in the business.

So, what it all ends up with is a reinforcing spin of that flywheel. And when you think about that, the other thing I want you to think about is that we have roughly a 20% rate right now of internal regulatory capital generation. We are turning this past quarter 14% on common equity. So Tier 1 leverage is our constraining capital ratio, and what you see up here on the left-hand side is just where that has trended versus the minimum level, if you consider well-capitalized. And of course we have a stress buffer.

And for those of you who follow the Flagstar story, you've seen that in the month of July we redeemed our TARP preferred, which was a 9% after-tax dividend carrying piece of capital that was very onerous. And finally we convinced the regulators that we could live without that capital, and as soon as they said go, we went, and had a very successful redemption. But the important things to focus here is, when you look at the most recent quarter, we generated nearly 50 basis points of regulatory capital just through earnings retention.

And the reason for that is partially the high level of return on equity that we are generating. And the second reason is because we have already deducted from capital, there's 150 basis points (technical difficulty) on Tier 1 leverage capital related to our net operating loss deferred tax assets. And as we continue to generate profitability in the future, and I feel pretty confident about that profitability because of the derisking we have done, we are going to continue to burn away that deduction (technical difficulty) at an after-tax rate. We are retaining earnings at a pretax rate.

And that's what gives us the 20-ish type internal regulatory capital growth. Not included in that 20%-ish is the impact of our MSRs. We are currently deducting 110 basis points off our Tier 1 leverage ratio for MSRs in excess of the Basel III limits. We've already sold MSRs from a 57% of Tier 1 capital down to (technical difficulty) percent of Tier 1 capital at June 30. We've got to continue -- we've established a glide path, and we will continue to sell that down. And that additional sell down of the MSR will provide an additional 110 basis points of capital growth whenever we have that. I haven't included in the run rate of that 20% just because that's going to be I think more episodic than continuous.

But the thing I want you to think about when you think about the prior slide flywheel, is that higher capital generation. And what that means is that if we are generating capital at 20% we can probably go -- earning assets at 20%. And with an operating leverage capability that we have demonstrated over the past seven quarters, I think if we can grow earning assets at 20%, we can grow earnings north of 20%.

So, where can you do that? And what I wanted to show you is just where we think our growth opportunities are. And what we layout here in a four box -- and people around Flagstar are fond of me; I always like the four box type of scenario. You see community banking and mortgage banking and what we can do from a build perspective and what we can do from a buy perspective. We are highly focused on build. And what you see in the upper left, the warehouse business. What you saw in the second quarter, we grew our warehouse business. We grew it through continue to expand relationships and continue to meet the market when it shows up. So those have, with the fees included, roughly 400 basis point spreads.

The builder finance business is a roughly 350 basis point spread. We are seeing great traction there and continue to grow that. And we also initiated MSR lending this past quarter. Again, 50% to 60% LTVs in that business with additional ancillary revenue opportunities and roughly 500 basis point spreads. So, great asset generation options that we have just facing us right there.

If we expand the mortgage business, which we are doing from a retail perspective, so that we increase the number of purchase mortgage volume that we have, in case the market ever does turn, we can continue to grow that. What we are seeing in that business is that more and more of the top loan officers are seeking stability. And they are seeking somebody who has a balance sheet and they are seeking somebody who is a bank. Because the banks provide stability in that space.

What you see with a lot of the non-banks is they are struggling. And they are struggling because they are generally fragile. They've got very fragile balance sheets. They often have large MSRs on those balance sheets. They can't hedge the MSR because they have no collateral to pledge into the derivative relationships that they might need in order to hedge that MSR. And they just are generally capital-light. And they oftentimes aren't as robust in the risk management function, which makes them just fragile. And fragile things tend to break in times of volatility.

Here are our long-term targets. And what I would tell you is our long-term goal is to balance out our community banking business with our mortgage business. We'd like to see those be at the stasis with 50-50. We would like to see 50% of our earnings come from banking and 50% come from mortgage. And we think that would give us a long-term ROA of somewhere in the 1.2 to 1.6, which would be top quartile, top decile in the midsize bank space. And a long-term ROE, although it's my intention that the ROCE target of 13% to 18%.

So what you see this most recent quarter -- and I won't run you through the whole income statement here, but what I would tell you is -- again, just reiterating my comments from the top of the presentation -- we delivered 1.4% ROA in the second quarter of 2016. And that led us to a 14% ROCE for the quarter as well, with strong operating leverage of 9%. And brought our efficiency ratio down 6 basis points.

So at this point, rather than bore you by me talking anymore, I'd come back to the key messaging points that we have for Flagstar and open up the floor for any questions that you might have.

QUESTIONS AND ANSWERS

Bose George - *Keefe, Bruyette & Woods, Inc. - Analyst*

I'll kick it off with the first one. Can you just talk about your -- is there a target for where you guys see your Tier 1 capital over time?

Jim Ciroli - *Flagstar Bancorp, Inc. - EVP and CFO*

So Tier 1 at June 30, post the TARP transaction we just completed in July, is going to be 8.6%. By far it's our most constraining capital ratio. When you look at our total Tier 1, those ratios are significantly higher; don't really provide any constraints and aren't things we think about. We are at 8.6% post-TARP. And that's up roughly from -- if I did the same calculation at the end of March, it would be 8.2%. So just looking at the 40 basis point growth we had quarter-over-quarter, I think that will -- one more quarter will put us at the 9%. I think 9% is a comfortable space to be at for Tier 1 leverage. And we will reevaluate that as we continue to grow the balance sheet.

I think if we are going to put -- depending on the assets that we are going to put on, if we are putting on riskier assets, we will tend to be a little bit higher than that. If we continue to have the balance sheet we have, which is really low risk -- in the presentation materials, we go through and show how we think 75% of our assets on the balance sheet have just very, very low levels of inherent risk. There are things like our warehouse loans, our residential mortgages, which are all recent -- not all, but mostly recent vintage, and things like cash in our securities portfolio.

Which our securities portfolio is all govi and govi sponsoreds. And then our loans held for sale, which turns over -- which a big part of our balance sheet, we basically earn a 10 year -- we earn the mortgage rate, but funded overnight, and so we earn a pretty nice spread on that asset. It turns roughly every 30 to 40 days.

Bose George - *Keefe, Bruyette & Woods, Inc. - Analyst*

We have another question?

Jim Ciroli - *Flagstar Bancorp, Inc. - EVP and CFO*

Yes, sir?

Unidentified Audience Member

Can you talk about the competitive landscape in mortgage in particular? And also how you guys expect to position ourselves there in the future with regard to both growth and profitability? And just part of this question is because of how little we know about such a big player in Quicken, but also relative to the bank.

Jim Ciroli - *Flagstar Bancorp, Inc. - EVP and CFO*

Quicken has got a different business model. Quicken is a very DTC -- Direct-to-Consumer focus. They are very call-center focused, refi dominant kind of a player. We don't really look at Quicken as a competitor in that way. We look at them as coming to radar mortgage servicing rights. They are looking to refinance those away. But how we think about the answer to your question is predominantly by strengthening the relationships that we have.

When you think about the mortgage volume that we produce, right now somewhere between 90% and 95% of that is coming through third-party channels, either a correspondent or broker. And what you'd see in our history is that we have kind of winnowed -- not kind of; we've done a lot of winnowing in that space. So we've got the 1,200 TBOs, third-party originators, that we want to do business with, we've got strong relationships with.

Many of those on the correspondent side are warehouse line customers. Many of them, the relationship with Flagstar goes back years, and a lot of the people that have both the correspondent banking or correspondent mortgage relationship as well as the warehouse line relationship attribute Flagstar for a lot of their success, and their existence. People will say Flagstar really pioneered the mini-correspondent concept. And set up a lot of correspondents around the country and those correspondents, some of those have grown to be large correspondent mortgage companies and are very successful.

So we are continuing to build out our relationship there. We have very strong service levels. What we find is that from a competitive positioning standpoint, having that strong service level is something that a lot of the other mortgage companies don't. And it used to be Flagstar's DNA as well. When times like today, when rates are low and the refi volume is high, there are competitors out there who will take every single loan they possibly can get. They try to maximize the amount of volumes they have while rates are low and the volume is high.

We've taken a much different tack. What we will do in that situation is we will increase pricing to moderate the volume and enable us to continue to deliver on our service levels. Because if you think about our model -- which is a relationship based model, versus others (technical difficulty) transaction-based model, the transactors are just concerned about getting the next transaction. And once they get the transaction in, they don't really care. But from a relationship model, if we are dealing with brokers, if we are dealing with correspondents, we're dealing in our retail channel with real estate agents and builders, the most important thing to them, more than the price, is being able to hit your closing date.

So if you say we are going to close on August 15, you better close on August 15. You can't call someone buying a house, who maybe has sold another house, that is now homeless -- now, maybe we want that to be the 17th. That's not something that we can say. We've got to deliver on the 15th. Or it's not the transactor, it's not the mortgage borrower that's going to care, it's the real estate agent. It's the mortgage broker. It's the correspondent. It's the people that we've built longer-term relationships with that care.

So, to answer your question, a very good question, I would say the competitive advantage we have is that we've got a relationship-based model where most industries, especially Quicken (technical difficulty) -- I don't think we compete against Quicken -- is very transaction-focused (technical difficulty). Did I get all your --?

Unidentified Audience Member

I think so, yes.

Jim Ciroli - *Flagstar Bancorp, Inc. - EVP and CFO*

Thanks for the question. (technical difficulty) front row.

Unidentified Audience Member

(inaudible) (technical difficulty) management team since the troubled times that we've had in the past, and you've done a terrific job. And you've done more than I think anybody could expect. My question is how much further do you have to go at the bank to where it was at the top of the market back in 2007?

Jim Ciroli - *Flagstar Bancorp, Inc. - EVP and CFO*

I'm not quite sure. When you say back to what it was, I don't think we'll ever go back to (technical difficulty) we were. I think those times were very go-go. And there wasn't anything that we wouldn't do or put on balance sheet. So it's a very -- thank you for your compliment. And me, only being there for two years, I think a large part of the credit go to many others, including people who were here all during that time period at Flagstar, and worked endlessly to deal with the issues we had to deal with.

But I think it is the new management team, and our approach. When you look at the management team, we are all bankers, and we've all been steeped in banking and banking regulations. Our CEO started his career as a banking regulator. And so, it's that foundation that we all have. My father was a bank examiner, my uncle was a bank examiner, it's in the family. I'm the black sheep of the family. But we've got a solid foundation of risk management that we are going to -- we're not just going to take the next revenue opportunity because you've got to make hay while the sun shines.

We're going to be very thoughtful and cognizant. We've been through a lot and we don't want to go back through that again. So I don't know that we're going to get back to that 2007 time period, but I think we're going to continue to grow here. Executing on the business model that I showed you, which is something that I don't think prior management teams had, if you will. I don't think they thought about the businesses being that symbiotically related. I thought they think they just were transaction focused. Did that answer all your questions? I appreciate the question. Thank you.

Bose George - *Keefe, Bruyette & Woods, Inc. - Analyst*

We have time for about one or two more questions.

Unidentified Audience Member

Obviously the last year or so there's been a lot of focus on the reserve and where that has been obviously trended dramatically higher. Now you're taking down that reserve. I think it's at about 250 or 260 of loans. Do you have any (multiple speakers) -- do you have any update as to where we expect that to be in a year? What is -- and how you feel about your asset quality and how comfortable do you feel with that current reserve?

Jim Ciroli - *Flagstar Bancorp, Inc. - EVP and CFO*

Well, let me start with the last part of that. I don't think -- I say this every quarter. I don't think asset quality can get (technical difficulty). He will probably choke me after this. I don't think asset quality can get any better than where it is today. But I've said that, and each quarter it's got just incrementally a little bit better. No delinquencies, no nonaccruals in the commercial portfolio, and the level of nonaccruals and delinquencies in the consumer portfolio is at an all-time low level.

So back to why -- so then why do we have 2.6% of loans in our allowance? What I would tell you about that is, going back to the gentleman upfront, we are very -- our fundamental DNA of this management team is very (technical difficulty). So we are going to be quick to recognize bad news and very slow to recognize good news. And what I think that philosophy does is it sets us up for success. Because when -- not if, but when -- we experience times of volatility, when we experience times of economic crisis, we are going to be in a better position. Because we are not anticipating the world is going to be more optimistic than what it actually is.

When we look at the future, we don't assume that things are going to continue to get better. We assume that things are going to worsen. And we prepare and steel ourselves for the days when things will get worse and we'll see additional volatility. And so, you look at our ratios, we still have 400% of our commercial -- or our consumer loan book is covered by the allowance, is the rate over there. And as we have opportunities to sell loans, we have to release some of that allowance against the loans that are sold. So we are going to be slow and very cautious about doing more of that.

Bose George - *Keefe, Bruyette & Woods, Inc. - Analyst*

Thank you. We have time for one last question.

Unidentified Audience Member

Strategically you mentioned your target is 50-50 kind of mortgage to bank. Just curious why that is the right number, as you think about -- you said some of your relationships favor stability. Why not more in the bank with potentially more stability, more -- potentially higher multiple business?

Jim Ciroli - *Flagstar Bancorp, Inc. - EVP and CFO*

It comes back to the flywheel. So in order to make the flywheel run as good as it possibly can, I think we have to balance the mortgage elements of the flywheel with the banking elements of the flywheel. If we were all banking, then I think we are back into the situation with all of the other banks. And look, I'm a banker; I've been a banker my whole career; my whole life, actually. So I'm not trying to disparage banking. But I am saying what we have at Flagstar, with the balance of the mortgage business and the banking business, is rather unique. One fuels the other, and the other fuels the first. And it continues to reinforce and build angular momentum in that flywheel strategically.

So if we were to unbalance that and we were to have a much bigger commercial bank, then the mortgage business's ability to continue to feed that banking business is going to be diminished. And if we take our eye off the ball in how that community bank feeds the mortgage business, then we could get over our skis a little bit from the risk side, maybe doing too much in terms of asset growth within the housing finance space, that really wouldn't effectively feed the mortgage business. So again, I like the flywheel business model. It's unique; I don't know of anyone else who has the unique business model we have in the business, but it's important that that's balanced.

Thank you for your questions. I appreciate your time today. Thank you.

Bose George - *Keefe, Bruyette & Woods, Inc. - Analyst*

Thank you very much.
