

OptimumBank Holdings, Inc.  
Form 10-K  
March 31, 2014

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K**

**ANNUAL REPORT**

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

**For the fiscal year ended December 31, 2013**

**Commission File Number: 000-50755**

**OPTIMUMBANK HOLDINGS, INC.**

(Exact name of registrant as specified in its charter)

**Florida**

(State or other jurisdiction of incorporation or organization)

**55-0865043**

(I.R.S. Employer Identification No.)

**2477 East Commercial Blvd., Fort Lauderdale, FL 33308**

(Address of principal executive offices)

Registrant's telephone number, including area code: **(954) 776-2332**

Securities registered pursuant to Section 12(b) of the Act:

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
Common Stock, par value \$0.01 per share	NASDAQ Capital Market

Securities registered pursuant to Section 12(g) of the Act:

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1993. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form

10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act): Yes No

The aggregate market value of the registrant’s common stock held by non-affiliates of the registrant (6,462,927 shares) on December 31, 2013, was approximately \$10,017,537, computed by reference to the closing market price at \$1.55 per share as of June 28, 2013. For purposes of this information, the outstanding shares of common stock owned by directors and executive officers of the registrant were deemed to be shares of common stock held by affiliates.

The number of shares of common stock, par value \$0.01 per share, of the registrant outstanding as of March 15, 2014 was 8,011,077 shares.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held on April 29, 2014, to be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days of the issuer’s fiscal year end are incorporated by reference into Part III, Items 10 through 14, of this Annual Report on Form 10-K.

**Table of Contents**

	<b>Page</b>
<b><u>PART I</u></b>	
<u>Item 1. Business</u>	2
<u>Item 2. Properties</u>	18
<u>Item 3. Legal Proceedings</u>	18
<u>Item 4. Mine Safety Disclosure</u>	19
<b><u>PART II</u></b>	
<u>Item 5. Market for the Registrant’s Common Equity and Related Stockholder Matters</u>	19
<u>Item 6. Selected Financial Data</u>	20
<u>Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	21
<u>Item 8. Financial Statements</u>	38
<u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	83
<u>Item 9A. Controls and Procedures</u>	83
<b><u>PART III</u></b>	
<u>Item 10. Directors, Executive Officers, and Corporate Governance</u>	85
<u>Item 11. Executive Compensation</u>	85
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management</u>	85
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	86
<u>Item 14. Principal Accounting Fees and Services</u>	86
<b><u>PART IV</u></b>	
<u>Item 15. Exhibits and Financial Statement Schedules</u>	87

## **PART I**

### Item 1. Business

#### **Forward-Looking Statements**

We have made forward-looking statements in this Annual Report about the financial condition, results of operations, and business of our company. These statements are not historical facts and include expressions concerning the future that are subject to risks and uncertainties. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among other things, the following possibilities:

- general economic conditions, either nationally or regionally, that are less favorable than expected resulting in, among other things, a deterioration in credit quality and an increase in credit risk-related losses and expenses;
- changes in the interest rate environment that reduce margins;
- competitive pressure in the banking industry that increases significantly;
- changes that occur in the regulatory environment; and
- changes that occur in business conditions and the rate of inflation.

When used in this Annual Report, the words “believes,” “estimates,” “plans,” “expects,” “should,” “may,” “might,” “outlook,” “anticipates,” as well as similar expressions, as they relate to OptimumBank Holdings, Inc., or its management, are intended to identify forward-looking statements.

#### **General**

OptimumBank Holdings, Inc. is a Florida corporation (the “Company”) formed in 2004 as a bank holding company for OptimumBank (the “Bank”). The Company’s only business is the ownership and operation of the Bank and its Bank’s subsidiaries. The Bank is a Florida state chartered bank established in 2000, with deposits insured by the Federal Deposit Insurance Corporation (“FDIC”). The Bank offers a variety of community banking services to individual and corporate customers through its three banking offices located in Broward County, Florida. The Bank has 17 wholly-owned subsidiaries primarily engaged in holding and disposing of foreclosed real estate and one subsidiary primarily engaged in managing foreclosed real estate.

The Company is subject to the supervision and regulation of the Board of Governors of the Federal Reserve System (the “Federal Reserve”). OptimumBank is subject to the supervision and regulation of the State of Florida Office of Financial Regulation (“OFR”) and the FDIC. OptimumBank is a member of the Federal Home Loan Bank of Atlanta.

At December 31, 2013, the Company had total assets of \$128.8 million, net loans of \$79.2 million, total deposits of \$98.7 million and stockholders’ deficit of \$0.2 million. During 2013, the Company incurred a net loss of \$7.1 million.

## Recent Developments

### Consent Order, Amended Consent Order, and Written Agreement.

On April 16, 2010, the Bank agreed to the issuance of the Consent Order by the FDIC and the OFR (the “Consent Order”), which required the Bank to take certain measures to improve its safety and soundness. Pursuant to the Consent Order, the Bank was required to take certain measures to improve its capital position, reduce its level of problem assets, reduce its loan concentrations in certain portfolios, improve management practices and board supervision and assure that its reserve for loan losses is maintained at an appropriate level. Among the corrective actions required were for the Bank to have and maintain a Tier 1 leverage ratio of at least 8% and a total risk-based capital ratio of 12% beginning 90 days from the issuance of the Consent Order. Effective February 28, 2014, the Bank agreed to the issuance of an Amended Consent Order by the FDIC and the OFR.

In addition to the Consent Order, on June 22, 2010, the Company entered into a Written Agreement, with the Federal Reserve Bank of Atlanta, which required the Company to take certain measures to ensure the Bank complied with the Consent Order. Under the Written Agreement, the Company is subject to restrictions on paying interest on debt, or paying dividends or distributions of stock, including its common stock, as well as incurring additional debt or redeeming stock. Additional details on the Consent Order and the Written Agreement are contained in “Business-Supervision and Regulation- Consent Order- and -Written Agreement.”

At December 31, 2013, the Bank had a Tier 1 leverage ratio of 4.21%, and a total risk-based capital ratio of 6.55%. At December 31, 2013, the Bank would have needed approximately \$5.5 million in additional capital in order to comply with the total risk-based capital ratio requirement of the Consent Order. Additional information on the Bank’s capital adequacy is contained in “Item 7- Management’s Discussion and Analysis of Results of Operations and Financial Condition.”

## Banking Products

The Bank’s revenues are primarily derived from interest on, and fees received in connection with, real estate, and other loans, and from interest from mortgage-backed securities and short-term investments. The principal sources of funds for the Bank’s lending activities are deposits, borrowings, repayment of loans, and the repayment, or maturity of investment securities. The Bank’s principal expenses are the interest paid on deposits, and operating and general administrative expenses.

As is the case with banking institutions generally, the Bank's operations are materially and significantly influenced by general economic conditions and by related monetary and fiscal policies of financial institution regulatory agencies, including the Federal Reserve and the FDIC. Deposit flows and costs of funds are influenced by interest rates on competing investments and general market rates of interest. Lending activities are affected by the demand for financing of real estate and other types of loans, which in turn is affected by the interest rates at which such financing may be offered and other factors affecting local demand and availability of funds. The Bank faces strong competition attracting deposits (its primary source of lendable funds) and originating loans.

The Bank provides a range of consumer and commercial banking services to individuals and businesses. The basic services offered include: demand interest-bearing and noninterest-bearing accounts, money market deposit accounts, NOW accounts, time deposits, Visa debit cards, cash management, direct deposits, notary services, money orders, night depository, travelers' checks, cashier's checks, domestic collections, savings bonds, bank drafts, automated teller services, drive-in tellers, and banking by mail. The Bank makes residential and commercial real estate loans and consumer loans. The Bank offers business lending lines for working capital needs. Growing businesses can use the loans to expand inventory, take discounts, offset receivables, or establish new structured financing and repayment plans that are consistent with the cash flow of the business. The Bank provides ATM cards and Visa debit cards, as a part of the Star, Presto and Cirrus networks, thereby permitting customers to utilize the convenience of ATMs worldwide. The Bank does not have trust powers and provides no trust services.



## Strategy

The Bank's continuing goal is to become one of the leading community banking organizations in Broward County, Florida through steady, reasonable and controlled growth and a prudent operating strategy.

The operating and business strategy emphasize the following:

- Local management and local decision making resulting in rapid, personalized customer service, rapid credit decisions and expedited closings;
- Maintaining a presence in Broward County through a branch network. Currently, the Bank has three branch banking offices in Broward County;
- Real estate, commercial and consumer lending activities by originating adjustable rate residential and commercial mortgage loans, commercial loans, and consumer loans for Bank customers;
- Maintaining high credit quality through strict underwriting criteria through the Bank's knowledge of the real estate values and borrowers in its market area;
- Personalized products and service by striving to provide innovative financial products, high service levels and to maintain strong customer relationships. The Bank seeks customers who prefer to conduct business with a locally owned and managed institution.

The Bank's management is focusing its efforts on a long-term strategy with the following objectives:

- Stabilize the Loan Portfolio- Management devotes significant resources to the identification and workout of problem loans and has been successful in reducing same.

- Increase and Diversify Loan Originations- Management is focused on increasing its loan production to add more interest bearing assets and interest income to its asset based and has increased same. In addition, management is diversifying its loan originations and portfolio to include commercial and consumer loans, in addition to residential and commercial real estate loans.
- Lower the Cost of Deposits- Management is focused on changing the Bank's deposit mix by replacing higher cost interest bearing time deposits with non-interest bearing demand deposits, which has occurred.
- Increase Capital Ratios- Management continues to seek additional sources of capital to increase the Bank's capital ratios, allow the Bank to grow, implement its business plan and return to profitability.

## Lending Activities

The Bank offers real estate, commercial and consumer loans, to individuals and small businesses and other organizations that are located in or conduct a substantial portion of their business in its market area. The Bank's market area consists of the tri-county area of Broward, Miami-Dade and Palm Beach counties. The Bank's net loans at December 31, 2013 were \$79.2 million, or 61.5% of total assets. The interest rates charged on loans varied with the degree of risk, maturity, and amount of the loan, and are further subject to competitive pressures, money market rates, availability of funds, and government regulations. The Bank has no foreign loans or loans for highly leveraged transactions.

The Bank's loan portfolio is concentrated in two major areas: residential and commercial real estate loans. As of December 31, 2013, 79.4% of the loan portfolio consisted of loans secured by mortgages on real estate, of which approximately 32.4% of the total loan portfolio was secured by one-to-four family residential properties. The real estate loans are located primarily in the tri-county market area.

The Bank's real estate loans are secured by mortgages and consist primarily of loans to individuals and businesses for the purchase or improvement of, or investment in, real estate. These real estate loans were made at fixed or variable interest rates and are normally adjustable rate mortgages which adjust annually after the initial three to five year period. The Bank's fixed rate loans generally are for terms of five years or less, and are repayable in monthly installments based on a maximum 30-year amortization schedule.

Loan originations are derived primarily from director and employee referrals, existing customers, and direct marketing. Certain credit risks are inherent in making loans. These include prepayment risks, risks resulting from uncertainties in the future value of collateral, risks resulting from changes in economic and industry conditions including interest rates, and risks inherent in dealing with individual borrowers. A significant portion of the Bank's portfolio is collateralized by real estate in South Florida, which is susceptible to local economic downturns. The Bank attempts to minimize credit losses through various means. On larger credits, it relies on the cash flow and assets of a debtor as the source of repayment as well as the value of the underlying collateral. The Bank also generally limits its loans to up to 80% of the value of the underlying real estate collateral. The Bank generally charge a prepayment penalty if a loan is repaid within the first two to three years of origination to recover any fees it paid for the origination of the loan.

## Deposit Activities

Deposits are the major source of the Bank's funds for lending and other investment activities. The Bank considers the majority of its regular savings, demand, NOW, money market deposit accounts and CD's under \$100,000 to be core

deposits. These accounts comprised approximately 78.0% of the Bank's total deposits at December 31, 2013. Approximately 65.0% of the deposits at December 31, 2013 were certificates of deposit. Generally, the Bank attempts to maintain the rates paid on its deposits at a competitive level. Time deposits of \$100,000 and over made up approximately 22.0% of the Bank's total deposits at December 31, 2013. Although these large deposits are not traditionally considered core deposits, the majority of these deposits have served as a stable source of funds in the Bank's targeted market. The majority of the deposits are generated from Broward County.

#### Investments

The Bank's investment securities portfolio was approximately \$23.0 million and \$18.6 million at December 31, 2013 and 2012, respectively, representing 17.8% and 12.9% of its total assets. At December 31, 2013, approximately 69.9% of this portfolio was invested in U.S. government agency mortgage-backed securities and 30.1% of this portfolio was invested in private mortgage-backed securities. Mortgage backed securities generally have a shorter life than the stated maturity. The Bank's investments are managed in relation to loan demand and deposit growth, and are generally used to provide for the investment of excess funds at minimal risk levels while providing liquidity to fund increases in loan demand or to offset fluctuations in deposits.

The Excess Balance Account is the excess cash the Bank has available over and above daily cash needs. This money is invested on an overnight basis with the Federal Reserve.

#### Correspondent Banking

Correspondent banking involves one bank providing services to another bank which cannot provide that service for itself from an economic or practical standpoint. OptimumBank is required to purchase correspondent services offered by larger banks, including check collections, purchase of federal funds, security safekeeping, investment services, coin and currency supplies, and sales of loans to or participations with correspondent banks.

OptimumBank has established a correspondent relationship with Independent Bankers Bank of Florida. The Bank pays for such services in cash as opposed to keeping compensating balances. The Bank also sell loan participations to other banks with respect to loans which exceed its lending limit.

#### Data Processing

The Bank outsources most of its data processing services, including an automated general ledger and deposit accounting; however, it services all its loans in-house.

#### Internet Banking

The Bank maintains a website at [www.optimumbank.com](http://www.optimumbank.com) where retail and business customers can access account balances, view current account activity and their previous statement, view images of paid checks, transfer funds between accounts, and bill payment. The Bank now offers its retail customers mobile access to their account information, with the option to setup alerts, deposit checks across a broad range of phones and mobile devices. The Bank now offers its business customers remote deposit capture and online cash management services that include ACH origination and wire transfers using token technology for security.

#### Competition

OptimumBank encounters strong competition both making loans and attracting deposits. The deregulation of the banking industry and the widespread enactment of state laws which permit multi-bank holding companies as well as an increasing level of interstate banking have created a highly competitive environment for commercial banking. In one or more aspects of its business, OptimumBank competes with other commercial banks, savings and loan associations, credit unions, finance companies, mutual funds, insurance companies, brokerage and investment banking companies, and other financial intermediaries. Most of these competitors, some of which are affiliated with bank holding companies, have substantially greater resources and lending limits, and may offer certain services that OptimumBank does not currently provide. In addition, many of its non-bank competitors are not subject to the same extensive federal regulations that govern federally insured banks. Recent federal and state legislation has heightened the competitive environment in which financial institutions must conduct their business, and the potential for competition among financial institutions of all types has increased significantly. The Bank focuses its efforts on smaller loans, which is generally neglected by its competitors.

To compete, OptimumBank relies upon specialized services, responsive handling of customer needs, and personal contacts by its officers, directors, and staff. Large multi-branch banking competitors tend to compete primarily by rate and the number and location of branches while smaller, independent financial institutions tend to compete primarily by rate and personal service.

## Employees

As of December 31, 2013, the Bank had twenty full-time employees, including executive officers. These employees are not represented by a collective bargaining unit. The Bank considers its relations with employees good.

## Supervision and Regulation

Banks and their holding companies are extensively regulated under both federal and state law. The following is a brief summary of certain statutes, rules, regulations and enforcement actions affecting OptimumBank Holdings, Inc. and OptimumBank. This summary is qualified in its entirety by reference to the particular statutory and regulatory provisions referred to below and is not intended to be an exhaustive description of the statutes or regulations applicable to the business of the Company or the Bank. Supervision, regulation, and examination of banks by regulatory agencies are intended primarily for the protection of depositors, rather than shareholders.

**Consent Order, Amended Consent Order.** In 2008, the Company and the Bank began to experience a substantial increase in impaired and non-performing loans and associated credit losses due to the nationwide economic recession and the related drop in real estate values in south Florida. As a result, the Company's net income for 2008 was only \$520,000. These trends continued in 2009 and 2010, with the result that the Company and the Bank sustained net losses of \$11.5 million in 2009 and \$8.5 million in 2010, primarily from significant increases in the provision for loan losses. These operating losses have eroded OptimumBank's regulatory capital and weakened its financial condition. As a result of these losses and other related operating issues, on April 16, 2010, OptimumBank agreed to enter into a Consent Order with the FDIC and Florida Office of Financial Regulation, and, on June 22, 2010, the Company was required to enter into a Written Agreement with the Federal Reserve Bank of Atlanta, or Federal Reserve. Effective February 28, 2014, the Bank agreed to the issuance of an Amended Consent Order by the FDIC and the OFR.

The Consent Order imposes a number of requirements on the Bank intended to improve the Bank's condition, including a requirement that the Bank maintain a ratio of Tier 1 capital to adjusted total assets (the "Tier 1 Leverage Ratio") of 8.0%, and a ratio of total risk based capital to risk-weighted assets of 12.0% (the "Total Risk Based Capital Ratio"). On December 31, 2013, the Bank had a Tier 1 Leverage ratio of 4.21% and a Total Risk Based Capital Ratio of 6.55%.

The Consent Order contains the following principal requirements:

- The Bank is required to have and retain qualified and appropriately experienced senior management, including a chief executive officer, a chief lending officer and a chief financial officer, who are given the authority to implement the provisions of the Consent Order.
- Any proposed changes in the Bank's Board of Directors or senior executive officers are subject to the prior consent of the FDIC and the OFR.
- The Bank is required to maintain fully funded allowance for loan and lease losses satisfactory to the FDIC and the OFR and a minimum Tier 1 leverage capital ratio of 8% and a total risk-based capital ratio of 12% for as long as the Consent Order remains in effect.



- The Bank must undertake over a two-year period a scheduled reduction of the balance of loans classified “substandard” and “doubtful” in its 2009 FDIC examination by at least 75%.
- The Bank is required to reduce the volume of its adversely classified private label mortgage backed securities under a plan acceptable to the FDIC and OFR.
- The Bank must submit to the FDIC and the OFR for their review and comment a written business/strategic plan covering the overall operation of the Bank.
- The Bank must implement a plan to improve earnings, addressing goals and strategies for improving and sustaining earnings, major areas for improvement in the Bank’s operating performance, realistic and comprehensive budgets and a budget review process.
- The Bank must revise and implement its written lending and collection policy to provide effective guidance and control of the lending function. The Bank is required to revise, implement and incorporate recommendations of the FDIC and OFR with respect to the following policies or plans:

Lending and Collection Policies

Investment Policy

Liquidity, Contingency Funding and Funds Management Plan

Interest Rate Risk Management Policy

Internal Loan Review and Grading System

Internal Control Policy

A plan to reduce concentration in commercial real estate loans.

- The Bank must develop and implement a satisfactory interest rate risk management policy that is appropriate to the size of the Bank and the complexity of its assets.
- The Bank may not pay any dividends or bonuses without the prior approval of the FDIC.
- The Bank may not accept, renew or rollover any brokered deposits except with the prior approval of the FDIC.

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- The Bank is required to notify the FDIC prior to undertaking asset growth of 10% or more per annum while the Consent Order remains in effect.
  
- The Bank is required to file periodic progress reports with the FDIC and the OFR.

Management believes that the Bank is currently in substantial compliance with all the requirements of the Consent Order, except for the following requirements:

- Maintenance of a Tier 2 capital ratio of 12%;

- Scheduled reduction by October 31, 2011 of 60% of loans classified as substandard and doubtful in the 2009 FDIC Examination; and
- Development of a plan to reduce Bank's concentration in commercial real estate loans acceptable to the supervisory authorities.

The Bank has implemented comprehensive policies and plans to address all of the requirements of the Consent Order and has incorporated recommendations from the FDIC and OFR into these policies and plans.

***Written Agreement with the Federal Reserve.*** The Written Agreement between the Company and the Federal Reserve requires the Company to serve as a source of strength to certain aspects of the capitalization, operation and management of the Bank. The Company also agreed that while the Written Agreement remains in effect, without prior approval of the Federal Reserve, it will not:

- declare or pay dividends.
- directly or indirectly take dividends or any other form of payment representing a reduction in capital from OptimumBank.
- make any distributions of interest, principal, or other sums on subordinated debentures or trust preferred securities.
- incur, increase, or guarantee any debt or purchase or redeem any shares of its stock.
- appoint any new director or senior executive officer, or change the responsibilities of any senior executive officer so that the officer would assume a different senior executive officer position.

Management believes that the Company is in substantial compliance with all the provisions of the Written Agreement with the Federal Reserve.

***Dodd-Frank Act.*** On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, into law. The Dodd-Frank Act will have a broad impact on the financial services industry, including potentially significant regulatory and compliance changes including, among other things, (1) enhanced resolution authority of troubled and failing banks and their holding companies; (2) potential changes to capital and liquidity requirements; (3) changes to regulatory examination fees; (4) changes to assessments to be paid to the FDIC for federal deposit insurance; and (5) numerous other provisions designed to improve supervision and oversight of, and strengthening safety and soundness for, the financial services sector. Additionally, the Dodd-Frank Act establishes a new framework for systemic risk oversight within the financial system to be distributed among new and existing federal regulatory agencies, including the Financial Stability Oversight Council, the Board of Governors of the Federal Reserve System, or the Federal Reserve, the Office of the Comptroller of the Currency, or the OCC, and the Federal Deposit Insurance Corporation, or the FDIC. Many of the requirements called for in the Dodd-Frank Act will be implemented over time and most will be subject to implementing regulations over the course of several years. Given the uncertainty associated with the manner in which the provisions of the Dodd-Frank Act will be implemented by the various regulatory agencies and through regulations, the full extent of the impact such requirements will have on the Bank's operations is unclear. The changes resulting from the Dodd-Frank Act may impact the profitability of the Bank's business activities, require changes to certain of its business practices, impose upon it more stringent capital, liquidity and leverage ratio requirements or otherwise adversely affect the Bank's business. These changes may also require the Bank to invest significant management attention and resources to evaluate and make necessary changes in order to comply with new statutory and regulatory requirements. Failure to comply with any such laws, regulations, or principles or changes thereto, may negatively impact the Bank's results of operations and financial condition. While the Bank cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have on it, these changes could be materially adverse to its investors and shareholders.

The following items provide a brief description of the impact of the Dodd-Frank Act on the Bank's operations and activities, both currently and prospectively.

Increased Capital Standards and Enhanced Supervision. The federal banking agencies are required to establish minimum leverage and risk-based capital requirements for banks and bank holding companies. These new standards will be no lower than existing regulatory capital and leverage standards applicable to insured depository institutions and may, in fact, be higher when established by the agencies. Compliance with heightened capital standards may reduce the Bank's ability to generate or originate revenue-producing assets and thereby restrict revenue generation from banking and non-banking operations. The Dodd-Frank Act also increases regulatory oversight, supervision and examination of banks, bank holding companies and their respective subsidiaries by the appropriate regulatory agency. Compliance with new regulatory requirements and expanded examination processes could increase the Company's cost of operations.

The Consumer Financial Protection Bureau. The Dodd-Frank Act creates a new, independent Consumer Financial Protection Bureau, or the Bureau, within the Federal Reserve. The Bureau is tasked with establishing and implementing rules and regulations under certain federal consumer protection laws with respect to the conduct of providers of certain consumer financial products and services. The Bureau has rulemaking authority over many of the statutes governing products and services offered to bank consumers. Generally, we will not be directly subject to the rules and regulations of the Bureau. However, the Dodd-Frank Act permits states to adopt consumer protection laws and regulations that are stricter than those regulations promulgated by the Bureau and state attorneys general are permitted to enforce consumer protection rules adopted by the Bureau against certain state-chartered institutions. Any such new regulations could increase the cost of operations and, as a result, could limit the Bank's ability to expand into these products and services.

Deposit Insurance. The Dodd-Frank Act makes permanent the \$250,000 deposit insurance limit for insured deposits. Amendments to the Federal Deposit Insurance Act also revise the assessment base against which an insured depository institution's deposit insurance premiums paid to the FDIC's Deposit Insurance Fund, or the DIF, will be calculated. Under the amendments, the assessment base will no longer be the institution's deposit base, but rather its average consolidated total assets less its average tangible equity. Additionally, the Dodd-Frank Act makes changes to the minimum designated reserve ratio of the DIF, increasing the minimum from 1.15 percent to 1.35 percent of the estimated amount of total insured deposits, and eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds. Several of these provisions could increase the FDIC deposit insurance premiums paid by us. The Dodd-Frank Act also provides that, effective one year after the date of enactment, depository institutions may pay interest on demand deposits.

Transactions with Affiliates. The Dodd-Frank Act enhances the requirements for certain transactions with affiliates under Sections 23A and 23B of the Federal Reserve Act, including an expansion of the definition of "covered transactions" and increasing the amount of time for which collateral requirements regarding covered transactions must be maintained.

Transactions with Insiders. Insider transaction limitations are expanded through the strengthening on loan restrictions to insiders and the expansion of the types of transactions subject to the various limits.

**Enhanced Lending Limits.** The Dodd-Frank Act strengthens the existing limits on a depository institution's credit exposure to one borrower. Current banking law limits a depository institution's ability to extend credit to one person (or group of related persons) in an amount exceeding certain thresholds. The Dodd-Frank Act expands the scope of these restrictions to include credit exposure arising from derivative transactions, repurchase agreements, and securities lending and borrowing transactions.

### ***Company Regulation***

**General.** As a bank holding company registered under the Bank Holding Company Act of 1956 (the "BHCA"), OptimumBank Holdings, Inc. is subject to the regulation and supervision of, and inspection by, the Federal Reserve Board ("Federal Reserve"). The Company is also required to file with the Federal Reserve annual reports and other information regarding its business operations, and those of its subsidiaries. In the past, the BHCA limited the activities of bank holding companies and their subsidiaries to activities which were limited to banking, managing or controlling banks, furnishing services to or performing services for their subsidiaries or engaging in any other activity which the Federal Reserve determined to be so closely related to banking or managing or controlling banks as to be properly incidental thereto. Under the Gramm-Leach-Bliley Financial Modernization Act of 1999 which is discussed below, bank holding companies now have the opportunity to seek broadened authority, subject to limitations on investment, to engage in activities that are "financial in nature" if all of their subsidiary depository institutions are well capitalized, well managed, and have at least a satisfactory rating under the Community Reinvestment Act, which is also discussed below.

In this regard, the BHCA prohibits a bank holding company, with certain limited exceptions, from (i) acquiring or retaining direct or indirect ownership or control of more than 5% of the outstanding voting stock of any company which is not a bank or bank holding company, or (ii) engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or performing services for its subsidiaries, unless such non-banking business is determined by the FRB to be so closely related to banking or managing or controlling banks as to be properly incident thereto. In making such determinations, the FRB is required to weigh the expected benefit to the public, such as greater convenience, increased competition or gains in efficiency, against the possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. Generally, bank holding companies, such as OptimumBank Holdings, Inc., are required to obtain prior approval of the Federal Reserve to engage in any new activity not previously approved by the Federal Reserve.

**Change of Control.** The BHCA also requires that every bank holding company obtain the prior approval of the Federal Reserve before it may acquire all or substantially all of the assets of any bank, or ownership or control of any voting shares of any bank, if after such acquisition it would own or control, directly or indirectly, more than 5% of the voting shares of such bank. In approving bank acquisitions by bank holding companies, the Federal Reserve is required to consider the financial and managerial resources and future prospects of the bank holding company and the banks concerned, the convenience and needs of the communities to be served, including the parties' performance under the Community Reinvestment Act (discussed below) and various competitive factors. As described in greater detail below, pursuant to the Riegle-Neal Interstate Banking and Branch Efficiency Act of 1994 (the "Interstate Banking and

Branching Act”), a bank holding company is permitted to acquire banks in states other than its home state.

The BHCA further prohibits a person or group of persons from acquiring “control” of a bank holding company unless the Federal Reserve Bank has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Exchange Act would, under the circumstances set forth in the presumption, constitute acquisition of control of the bank holding company. In addition, any person or group of persons must obtain the approval of the Federal Reserve under the BHCA before acquiring 25% (5% in the case of an acquirer that is already a bank holding company) or more of the outstanding common stock of a bank holding company, or otherwise obtaining control or a “controlling influence” over the bank holding company.



***Interstate Banking and Branching.*** The Interstate Banking and Branching Act provides for nationwide interstate banking and branching. Under the law, interstate acquisitions of banks or bank holding companies in any state by bank holding companies in any other state are permissible subject to certain limitations. Florida also has a law that allows out-of-state bank holding companies (located in states that allow Florida bank holding companies to acquire banks and bank holding companies in that state) to acquire Florida banks and Florida bank holding companies. The law essentially provides for out-of-state entry by acquisition only (and not by interstate branching) and requires the acquired Florida bank to have been in existence for at least three years. Interstate branching and consolidation of existing bank subsidiaries in different states is permissible. A Florida bank also may establish, maintain, and operate one or more branches in a state other than Florida pursuant to an interstate merger transaction in which the Florida bank is the resulting bank.

***Financial Modernization.*** The Gramm-Leach-Bliley Act of 1999 (the “GLB Act”) sought to achieve significant modernization of the federal bank regulatory framework by allowing the consolidation of banking institutions with other types of financial services firms, subject to various restrictions and requirements. In general, the GLB Act repealed most of the federal statutory barriers which separated commercial banking firms from insurance and securities firms and authorized the consolidation of such firms in a “financial services holding company.” We have no current plans to utilize the structural options created by the GLB Act.

***Securities Regulation and Corporate Governance.*** The Company’s common stock is registered with the Securities and Exchange Commission (the “SEC”) under Section 12(g) of the Securities Exchange Act of 1934, and we are subject to restrictions, reporting requirements and review procedures under federal securities laws and regulations. The Company is also subject to the rules and reporting requirements of the NASDAQ Global Market, on which its common stock is traded. Like other issuers of publicly traded securities, the Company must also comply with the corporate governance reforms enacted under the Sarbanes-Oxley Act of 2002 (“The Sarbanes-Oxley Act”) and the rules of the SEC and NASDAQ Stock Market adopted pursuant to the Sarbanes Oxley Act. Among other things, these reforms, effective as of various dates, require certification of financial statements by the chief executive officer and chief financial officer, prohibit the provision of specified services by independent auditors, require pre-approval of independent auditor services, define director independence and require certain committees, and a majority of a subject company’s board of directors, to consist of independent directors, establish additional disclosure requirements in reports filed with the SEC, require expedited filing of reports, require management evaluation and auditor attestation of internal controls, prohibit loans by the issuer (but not by certain depository institutions) to directors and officers, set record-keeping requirements, mandate complaint procedures for the reporting of accounting and audit concerns by employees, and establish penalties for non-compliance.

#### ***Bank Regulation***

***General.*** OptimumBank is chartered under the laws of the State of Florida, and its deposits are insured by the FDIC to the extent provided by law. OptimumBank is subject to comprehensive regulation, examination and supervision by the FDIC and the Florida Office of Financial Regulation, or Florida OFR, and to other laws and regulations applicable to banks. Such regulations include limitations on loans to a single borrower and to its directors, officers and employees;

limitations on the types of activities a state bank can conduct; restrictions on the opening and closing of branch offices; the maintenance of required capital ratios; the granting of credit under equal and fair conditions; and the disclosure of the costs and terms of such credit. OptimumBank is examined periodically by the FDIC and the Florida OFR, to whom it submits periodic reports regarding its financial condition and other matters. The FDIC and the Florida OFR have a broad range of powers to enforce regulations under their jurisdiction, and to take discretionary actions determined to be for the protection and safety and soundness of banks, including the institution of cease and desist orders and the removal of directors and officers. The FDIC and the Florida OFR also have the authority to approve or disapprove mergers, consolidations, and similar corporate actions.

**Consent Order.** On April 16, 2010, OptimumBank agreed to the issuance of the Consent Order with the FDIC and the Florida Office of Financial Regulation. Under the Consent Order, the Bank is required to implement a number of corrective measures intended to improve the Bank's condition, including a requirement to maintain certain minimum capital ratios. The Consent Order also contains significant operating restrictions. The principal requirements of the Consent Order are described in "Business- Supervision and Regulation- Consent Order." Effective February 28, 2014, the Bank agreed to the issuance of an Amended Consent Order by the FDIC and the OFR.

**Capital Adequacy Requirements.** Banks are required to maintain capital at adequate levels based on a percentage of assets and off-balance sheet exposures, adjusted for risk weights ranging from 0% to 100%. Under the risk-based standard, capital is classified into two tiers. Tier 1 capital consists of common shareholders' equity (excluding the unrealized gain (loss) on available-for-sale securities), trust preferred securities subject to certain limitations, and minus certain intangible assets. Tier 2 capital consists of the general allowance for credit losses except for certain limitations. An institution's qualifying capital base for purposes of its risk-based capital ratio consists of the sum of its Tier 1 and Tier 2 capital. The regulatory minimum requirements are 4% for Tier 1 and 8% for total risk-based capital. At December 31, 2013, the Bank's Tier 1 and total risk-based capital ratios were 5.29% and 6.55%, respectively.

Banks are also required to maintain capital at a minimum level based on total assets, which is known as the leverage ratio. The minimum requirement for the leverage ratio is 4%, but all but the highest rated institutions are required to maintain ratios 100 to 200 basis points above the minimum. At December 31, 2013, the Bank's leverage ratio was 4.21%.

The Consent Order imposes higher capital requirements on OptimumBank. Under the Consent Order, OptimumBank must maintain a Tier 1 Leverage Ratio of 8.0%, and a total risk based capital ratio of 12.0%. With a Tier 1 Leverage ratio of 8.12% and a Total Risk Based Capital Ratio of 11.48% at December 31, 2012, the Bank did not meet the total risk-based capital ratio as required by the Consent Order.

The FDIC Improvement Act of 1993 ("FDICIA") contains "prompt corrective action" provisions pursuant to which banks are to be classified into one of five categories based upon capital adequacy, ranging from "well capitalized" to "critically undercapitalized" and which require (subject to certain exceptions) the appropriate federal banking agency to take prompt corrective action with respect to an institution which becomes "significantly undercapitalized" or "critically undercapitalized."

The FDIC has issued regulations to implement the "prompt corrective action" provisions of FDICIA. In general, the regulations define the five capital categories as follows:

- an institution is “well capitalized” if it has a total risk-based capital ratio of 10% or greater, has a Tier 1 risk-based capital ratio of 6% or greater, has a leverage ratio of 5% or greater and is not subject to any written capital order or directive to meet and maintain a specific capital level for any capital measures;
- an institution is “adequately capitalized” if it has a total risk-based capital ratio of 8% or greater, has a Tier 1 risk-based capital ratio of 4% or greater, and has a leverage ratio of 4% or greater;

- an institution is “undercapitalized” if it has a total risk-based capital ratio of less than 8%, has a Tier 1 risk-based capital ratio that is less than 4% or has a leverage ratio that is less than 4%;
- an institution is “significantly undercapitalized” if it has a total risk-based capital ratio that is less than 6%, a Tier 1 risk-based capital ratio that is less than 3% or a leverage ratio that is less than 3%; and
- an institution is “critically undercapitalized” if its “tangible equity” is equal to or less than 2% of its total assets.

The FDIC, after an opportunity for a hearing, has authority to downgrade an institution from “well capitalized” to “adequately capitalized” or to subject an “adequately capitalized” or “undercapitalized” institution to the supervisory actions applicable to the next lower category, for supervisory concerns.

Generally, FDICIA requires that an “undercapitalized” institution must submit an acceptable capital restoration plan to the appropriate federal banking agency within 45 days after the institution becomes “undercapitalized” and the agency must take action on the plan within 60 days. The appropriate federal banking agency may not accept a capital restoration plan unless, among other requirements, each company having control of the institution has guaranteed that the institution will comply with the plan until the institution has been adequately capitalized on average during each of the three consecutive calendar quarters and has provided adequate assurances of performance. The aggregate liability under this provision of all companies having control of an institution is limited to the lesser of:

- 5% of the institution’s total assets at the time the institution becomes “undercapitalized”; or
- the amount which is necessary, or would have been necessary, to bring the institution into compliance with all capital standards applicable to the institution as of the time the institution fails to comply with the plan filed pursuant to FDICIA.

An “undercapitalized” institution may not acquire an interest in any company or any other insured depository institution, establish or acquire additional branch offices or engage in any new business unless the appropriate federal banking agency has accepted its capital restoration plan, the institution is implementing the plan, and the agency determines that the proposed action is consistent with and will further the achievement of the plan, or the appropriate Federal banking agency determines the proposed action will further the purpose of the “prompt corrective action” sections of FDICIA.

If an institution is “critically undercapitalized,” it must comply with the restrictions described above. In addition, the appropriate Federal banking agency is authorized to restrict the activities of any “critically undercapitalized” institution and to prohibit such an institution, without the appropriate Federal banking agency’s prior written approval, from:

- entering into any material transaction other than in the usual course of business;
- engaging in any covered transaction with affiliates (as defined in Section 23A(b) of the Federal Reserve Act);
- paying excessive compensation or bonuses; and

- paying interest on new or renewed liabilities at a rate that would increase the institution's weighted average costs of funds to a level significantly exceeding the prevailing rates of interest on insured deposits in the institution's normal market areas.

The "prompt corrective action" provisions of FDICIA also provide that in general no institution may make a capital distribution if it would cause the institution to become "undercapitalized." Capital distributions include cash (but not stock) dividends, stock purchases, redemptions, and other distributions of capital to the owners of an institution.

Additionally, FDICIA requires, among other things, that:

- only a "well capitalized" depository institution may accept brokered deposits without prior regulatory approval, and
- the appropriate federal banking agency annually examines all insured depository institutions, with some exceptions for small, "well capitalized" institutions and state-chartered institutions examined by state regulators.

As of December 31, 2013, OptimumBank met the FDIC definition of an "undercapitalized institution" based upon not meeting the required total risk-based capital ratio of 8% or greater. Had the Bank met said ratio it would have met the FDIC definition of an "adequately capitalized institution."

For additional information regarding OptimumBank's capital ratios and requirements, see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Capital Adequacy."

**Dividends.** The Company's ability to pay dividends is substantially dependent on the ability of OptimumBank to pay dividends to the Company. As a state chartered bank, OptimumBank is subject to dividend restrictions set by Florida law and the FDIC. Except with the prior approval of the Florida OFR, all dividends of any Florida bank must be paid out of retained net profits from the current period and the previous two years, after deducting expenses, including losses and bad debts. Under the Federal Deposit Insurance Act, an FDIC-insured institution may not pay any dividend if payment would cause it to become undercapitalized or while it is undercapitalized. The FDIC and the Florida OFR also have the general authority to limit the dividend payment by banks if such payment may be deemed to constitute an unsafe and unsound practice. The Bank's ability to pay dividends is further restricted under the Consent Order and the Company's ability to pay dividends is also restricted under its Written Agreement with the Federal Reserve. At December 31, 2013, the Bank and Company could not pay cash dividends.

***Loans to One Borrower.*** Florida law generally allows a state bank such as OptimumBank to extend credit to any one borrower (and certain related entities of such borrower) in an amount up to 25% of its capital accounts, provided that the unsecured portion may not exceed 15% of the capital accounts of the bank. Based upon OptimumBank's capital, the maximum loan OptimumBank is currently permitted to make is approximately \$1.3 million, provided the unsecured portion does not exceed approximately \$0.8 million.

***Transactions with Affiliates.*** Under federal law, federally insured banks are subject, with certain exceptions, to certain restrictions on any extension of credit to their parent holding companies or other affiliates, on investment in the stock or other securities of affiliates, and on the taking of such stock or securities as collateral from any borrower. In addition, banks are prohibited from engaging in certain tie-in arrangements in connection with any extension of credit or the providing of any property or service.



**Change of Bank Control.** Florida law restricts the amount of voting stock of a bank that a person may acquire without the prior approval of banking regulators. The overall effect of such laws is to make it more difficult to acquire a bank by tender offer or similar means than it might be to acquire control of another type of corporation. Consequently, shareholders of financial institutions are less likely to benefit from the rapid increases in stock prices that often result from tender offers or similar efforts to acquire control of other companies.

Under Florida law, no person or group of persons may, directly or indirectly or acting by or through one or more persons, purchase or acquire a controlling interest in any bank which would result in the change in control of that bank unless the Florida OFR first shall have approved such proposed acquisition. A person or group will be deemed to have acquired “control” of a bank (i) if the person or group, directly or indirectly or acting by or through one, or more other persons, owns, controls, or has power to vote 25% or more of any class of voting securities of the bank, or controls in any manner the election of a majority of the directors of the bank, or (ii) if the Florida OFR determines that such person exercises a controlling influence over the management or policies of the bank. In any case where a proposed purchase of voting securities would give rise to a presumption of control, the person or group who proposes to purchase the securities must first file written notice of the proposal to the Florida OFR for its review and approval. Subsections 658.27(2) and 658.28(3), Florida Statutes, refer to a potential change of control of a financial institution at a 10% or more threshold and rebuttable presumption of control. Accordingly, the name of any subscriber acquiring more than 10% of the voting securities of OptimumBank must be submitted to the Florida OFR for prior approval.

**USA Patriot Act.** The USA Patriot Act was enacted after September 11, 2001, to provide the federal government with powers to prevent, detect, and prosecute terrorism and international money laundering, and has resulted in promulgation of several regulations that have a direct impact on banks. There are a number of programs that financial institutions must have in place such as: (i) Bank Secrecy Act/Anti-Money Laundering programs to manage risk; (ii) Customer Identification Programs to determine the true identity of customers, document and verify the information, and determine whether the customer appears on any federal government list of known or suspected terrorist or terrorist organizations; and (iii) monitoring for the timely detection and reporting of suspicious activity and reportable transactions. Over the past few years, enforcement, and compliance monitoring, of these anti-money laundering laws has dramatically increased. As a result, the Bank has increased the attention and resources it dedicates to compliance with these laws.

**Other Consumer Laws.** Florida usury laws and federal laws concerning interest rates limit the amount of interest and various other charges collected or contracted by a bank. OptimumBank’s loans are also subject to federal laws applicable to consumer credit transactions, such as the:

- Federal Truth-In-Lending Act governing disclosures of credit terms to consumer borrowers;
- Community Reinvestment Act requiring financial institutions to meet their obligations to provide for the total credit needs of the communities they serve, including investing their assets in loans to low and moderate-income borrowers;

- Home Mortgage Disclosure Act requiring financial institutions to provide information to enable public officials to determine whether a financial institution is fulfilling its obligations to meet the housing needs of the community it serves;
- Equal Credit Opportunity Act prohibiting discrimination on the basis of race, creed or other prohibitive factors in extending credit;
- Real Estate Settlement Procedures Act which requires lenders to disclose certain information regarding the nature and cost of real estate settlements, and prohibits certain lending practices, as well as limits escrow account amounts in real estate transactions;

- Fair Debt Collection Act governing the manner in which consumer debts may be collected by collection agencies;
- Fair and Accurate Credit Transactions Act which establishes additional rights for consumers to obtain and correct credit reports, addresses identity theft, and establishes additional requirements for consumer reporting agencies and financial institutions that provide adverse credit information to a consumer reporting agency; and
- The rules and regulations of various federal agencies charged with the responsibility of implementing such federal laws.

OptimumBank's deposit and loan operations are also subject to the:

- The Gramm-Leach-Bliley Act of 1999 privacy provisions, which require the Bank maintain privacy policies intended to safeguard consumer financial information, to disclose these policies to its customers, and allow customers to "opt-out" of having their financial service providers disclose their confidential financial information to non-affiliated third parties, subject to certain exceptions;
- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records; and
- Electronic Funds Transfer Act and Regulation E, which govern automatic deposits to, and withdrawals from, deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

#### *Other Regulation*

**Enforcement Powers.** Congress has provided the federal bank regulatory agencies with an array of powers to enforce laws, rules, regulations and orders. Among other things, the agencies may require that institutions cease and desist from certain activities, may preclude persons from participating in the affairs of insured depository institutions, may suspend or remove deposit insurance, and may impose civil money penalties against institution-affiliated parties for certain violations.

**Community Redevelopment Act.** Bank holding companies and their subsidiary banks are subject to the provisions of the Community Reinvestment Act of 1977 (“CRA”) and the regulations promulgated thereunder by the appropriate bank regulatory agency. Under the terms of the CRA, the appropriate federal bank regulatory agency is required, in connection with its examination of a bank, to assess such bank’s record in meeting the credit needs of the community served by that bank, including low-and moderate-income neighborhoods. The regulatory agency’s assessment of the Bank’s record is made available to the public. Further, such assessment is required of any bank which has applied to charter a bank, obtain deposit insurance coverage for a newly chartered institution, establish a new branch office that will accept deposits, relocate an office, or merge or consolidate with, or acquire the assets or assume the liabilities of, a federally regulated financial institution. In the case of a bank holding company applying for approval to acquire a bank or other bank holding company, the Federal Reserve will assess the record of each subsidiary bank of the applicant bank holding company, and such records may be the basis for denying the application.

*Effect of Governmental Monetary Policies*

The Company's earnings are affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The Federal Reserve monetary policies have had, and will likely continue to have, an important impact on the operating results of financial institutions through its power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The monetary policies of the Federal Reserve have major effects upon the levels of loans, investments and deposits through its open market operations in United States Government securities and through its regulation of the discount rate on borrowings of member banks and the reserve requirement against member bank deposits. It is not possible to predict the nature or impact of future changes in monetary and fiscal policies.

**Statistical Profile and Other Financial Data**

Reference is hereby made to the statistical and financial data contained in the sections captioned "Selected Financial Data" and "Management's Discussion and Analysis of Financial Condition and Results of Operations," for statistical and financial data providing a review of the Bank's business activities.

## Item 2. Properties

The following table sets forth information with respect to the Bank's main office and branch offices as of December 31, 2013.

Location	Year Facility Opened	Facility Status
<u>Executive Office and Ft. Lauderdale Branch:</u> 2477 East Commercial Boulevard Fort Lauderdale, Florida 33308	2004	Owned
Plantation Branch Office: 10197 Cleary Boulevard Plantation, Florida 33324	2000	Owned
Deerfield Beach Branch Office:	2004	Leased (1)

2215 West Hillsboro Boulevard  
Deerfield Beach, Florida 22442

**(1) At December 31, 2013, the future minimum lease payments are approximately as follows (in thousands):**

<b>Year Ending December 31,</b>	<b>Amount</b>
2014	\$84

Item 3. Legal Proceedings

From time-to-time, the Bank is involved in litigation arising in the ordinary course of its business. As of the date of the filing of this Form 10-K, management is of the opinion that the ultimate aggregate liability represented thereby, if any, will not have a material adverse effect on the Bank's consolidated financial condition or results of operations.

Item 4. Mine Safety Disclosure

Not applicable.

PART II

Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters

The Company's common stock currently trades on the NASDAQ Capital Market under the symbol "OPHC." The table below presents the high and low sales prices for the periods indicated.

<b>Year</b>	<b>Quarter</b>	<b>High</b>	<b>Low</b>
2012	First	\$5.43	\$0.38
	Second	\$3.75	\$0.56
	Third	\$0.74	\$0.40
	Fourth	\$0.68	\$0.41
2013	First	\$0.88	\$0.45
	Reverse Stock Split		
	Second	\$1.82	\$1.26
	Third	\$1.62	\$1.35
	Fourth	\$1.71	\$1.11

The Company had approximately 901 holders registered or in street names as of December 31, 2013.

On February 24, 2014, the NASDAQ Stock Market notified the Company that it has failed to comply with the NASDAQ Listing Rule requiring the Company to maintain a minimum stockholders' equity of \$2.5 million. The Company has commenced an appeal concerning this notification.

During 2013, the Company sold 104,166 shares of the Company's common stock at a price of \$1.20 per share to accredited investors. During the fourth quarter of 2013, the Company also issued 28,873 shares of the Company's common stock to four directors. The shares had a value of \$1.50 per share.

During the fourth quarter of 2012, the Company sold 400,000 shares of the Company's common stock at a price of \$0.40 per share to three affiliated investors in a transaction that was exempt from registration under Section 4(2) of the Securities Act of 1933. During the fourth quarter of 2012, the Company also issued 52,593 shares of the Company's common stock to four directors in payment of directors' fees in a transaction that was exempt from registration under Section 4(2) of the Securities Act of 1933. The shares had a value of \$0.53 per share.

At December 31, 2013, the Bank and Company could not pay cash dividends and the Company does not anticipate that it will pay dividends on its common stock in the foreseeable future. Banking regulations place certain restrictions on dividends and loans or advances made by the Bank to the Company. The amount of cash dividends that may be paid by the Bank to the Company is based on the Bank's net earnings of the current year combined with the Bank's retained earnings of the preceding two years, as defined by state banking regulations. However, for any dividend declaration, the Company must consider additional factors such as the amount of current period net earnings, liquidity, asset quality, capital adequacy and economic conditions. It is likely that these factors would further limit the amount of dividends which the Company could declare. Furthermore, the Bank's ability to pay dividends is restricted under the Consent Order issued by the FDIC and Florida Office of Financial Regulation and banking laws. The Company's ability to pay dividends is also restricted under its Written Agreement with the Federal Reserve.



## Item 6. Selected Financial Data

**At December 31, or for the Year Then Ended****(Dollars in thousands, except per share figures)**

	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
At Year End:					
Cash and cash equivalents	\$13,881	23,611	22,776	14,367	36,784
Securities held to maturity	0	0	100	51,057	81,141
Security available for sale	22,990	18,648	28,907	0	0
Loans, net	79,249	85,209	89,217	113,542	134,126
All other assets	12,663	16,275	13,572	11,339	17,906
<b>Total assets</b>	<b>\$128,783</b>	<b>143,743</b>	<b>154,472</b>	<b>190,305</b>	<b>269,957</b>
Deposit accounts	98,692	101,611	107,895	148,238	151,682
Federal Home Loan Bank advances	22,740	27,700	31,700	31,700	57,700
Other borrowings	0	0	0	0	41,800
Junior subordinated debenture	5,155	5,155	5,155	5,155	5,155
All other liabilities	2,412	2,367	2,936	2,377	2,332
Stockholders' (deficit) equity	(216	) 6,910	6,786	2,835	11,288
<b>Total liabilities and stockholders' (deficit) equity</b>	<b>\$128,783</b>	<b>143,743</b>	<b>154,472</b>	<b>190,305</b>	<b>269,957</b>
For the Year:					
Total interest income	5,280	5,162	6,422	8,787	14,006
Total interest expense	1,919	2,581	3,427	4,867	8,351
Net interest income	3,361	2,581	2,995	3,920	5,655
Provision (credit) for loan losses	2,194	1,653	(149	) 3,645	15,794
Net interest income (expense) after (credit) provision for loan losses	1,167	928	3,144	275	(10,139)
Noninterest income (expense)	144	258	379	1,394	(145)
Noninterest expenses	8,066	5,883	7,229	9,773	4,698
Loss before income taxes (benefit)	(6,755	) (4,697	) (3,706	) (8,104	) (14,982)
Income taxes (benefit)	320	0	41	349	(3,501)
<b>Net loss</b>	<b>\$(7,075)</b>	<b>(4,697)</b>	<b>(3,747)</b>	<b>(8,453)</b>	<b>(11,481)</b>
<b>Net loss per share, basic (1)</b>	<b>\$(.89)</b>	<b>(.69)</b>	<b>(3.28)</b>	<b>(41.26)</b>	<b>(56.05)</b>
<b>Net loss per share, diluted (1)</b>	<b>\$(.89)</b>	<b>(.69)</b>	<b>(3.28)</b>	<b>(41.26)</b>	<b>(56.05)</b>

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Weighted-average number of shares outstanding, basic (1)	7,913,585	6,840,668	1,144,076	204,840	240,840
Weighted-average number of shares outstanding, diluted (1)	7,913,585	6,840,668	1,144,076	240,840	240,840

20

**Ratios and Other Data:**

	2013		2012		2011		2010		2009	
Return on average assets	(5.3	)%	(3.1	)%	(2.1	)%	(3.8	)%	(4.2	)%
Return on average equity	(216.8	)%	(60.3	)%	(204.0	)%	(127.6	)%	(55.6	)%
Average equity to average assets	2.4	%	5.2	%	1.0	%	3.0	%	7.6	%
Net interest margin during the year	2.9	%	1.9	%	1.8	%	1.9	%	2.1	%
Interest-rate differential during the year	3.0	%	2.5	%	1.8	%	1.9	%	1.9	%
Net yield on average interest-earning assets	4.5	%	3.9	%	3.8	%	4.2	%	5.3	%
Noninterest expenses to average assets	5.8	%	3.6	%	4.1	%	4.4	%	1.7	%
Ratio of average interest-earning assets to average interest-bearing liabilities	.95		1.1		1.0		1.0		1.1	
Nonperforming loans and foreclosed assets as a percentage of total assets at end of year	12.7	%	19.5	%	23.0	%	19.8	%	10.9	%
Allowance for loan losses as a percentage of total loans at end of year	2.7	%	2.8	%	2.6	%	3.2	%	6.5	%
Total number of banking offices	3		3		3		3		3	
Total shares outstanding at end of year (1)	8,011,077		7,877,800		5,602,777		204,840		204,840	
Book value per share at end of year (1)	\$(.03	)	.88		1.21		13.84		55.10	

(1) All share and per share amounts have been adjusted to reflect the 1-for-4 reverse stock split declared in 2013.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.****General**

The Company is a Florida corporation formed in 2004 as a one bank holding company for OptimumBank. The Bank is a Florida chartered bank established in 2000, with deposits insured by the Federal Deposit Insurance Corporation. The Bank is headquartered and has its corporate office in Fort Lauderdale, Florida, and operates three full service branch offices located in Broward County, Florida.

At December 31, 2013, the Company had total assets of \$128.8 million, net loans of \$79.2 million, and total deposits of \$98.7 million and stockholders' deficit of \$0.2 million. During 2013, the Company had a net loss of \$7.1 million.

**Critical Accounting Policies**

The Company's financial condition and results of operations are sensitive to accounting measurements and estimates of matters that are inherently uncertain. When applying accounting policies in areas that are subjective in nature, the Company must use its best judgment to arrive at the carrying value of certain assets. One of the most critical accounting policies applied by the Company is related to the valuation of its loan portfolio.

A variety of estimates impact the carrying value of the Company's loan portfolio including the calculation of the allowance for loan losses, valuation of underlying collateral, the timing of loan charge-offs and the amount and amortization of loan fees and deferred origination costs.

The calculation of the allowance for loan losses is a complex process containing estimates which are inherently subjective and susceptible to significant revision as current information becomes available. The allowance is established and maintained at a level management believes is adequate to cover losses resulting from the inability of borrowers to make required payments on loans. Estimates for loan losses are determined by analyzing risks associated with specific loans and the loan portfolio, current trends in delinquencies and charge-offs, the views of the Company's regulators, changes in the size and composition of the loan portfolio and peer comparisons. The analysis also requires consideration of the economic climate and direction, changes in the economic and interest rate environment which may impact a borrower's ability to pay, legislation impacting the banking industry and economic conditions specific to the tri-county region the Bank serves in Southeast Florida. Because the calculation of the allowance for loan losses relies on the Company's estimates and judgments relating to inherently uncertain events, results may differ from management's estimates.

The allowance for loan losses is also discussed as part of “Loan Portfolio, Asset Quality and Allowance for Loan Losses” and in Note 3 of Notes to the Consolidated Financial Statements. The Company’s significant accounting policies are discussed in Note 1 of Notes to the Consolidated Financial Statements.

## Regulation and Legislation

As a state-chartered commercial bank, the Bank is subject to extensive regulation by the Florida Office of Financial Regulation, or Florida OFR, and the FDIC. The Bank files reports with the Florida OFR and the FDIC concerning its activities and financial condition, in addition to obtaining regulatory approvals prior to entering into certain transactions such as mergers with or acquisitions of other financial institutions. Periodic examinations are performed by the Florida OFR and the FDIC to monitor the Bank’s compliance with the various regulatory requirements. The Company is also subject to regulation and examination by the Federal Reserve Board of Governors.

## Loan Portfolio, Asset Quality and Allowance for Loan Losses

The Bank’s primary business is making real estate loans. This activity may subject the Bank to potential loan losses, the magnitude of which depends on a variety of economic factors affecting borrowers which are beyond its control. For the past several years, there has been a dramatic decrease in housing and real estate values in south Florida, coupled with a significant increase in the rate of unemployment. With most of the Bank’s loans concentrated in south Florida, the decline in local economic conditions has adversely affected the values of the Bank’s real estate collateral. These trends have contributed to an increase in the Bank’s impaired loans and reduced asset quality. As of December 31, 2013, the Bank’s impaired loans were approximately \$13.6 million, or 17.1% of the net loan portfolio. All of these loans are on our books for 90 percent of appraised value. Impaired loans and real estate owned was approximately \$21.2 million as of this same date, or 16.4% of total assets. If market conditions continue to deteriorate, they may lead to additional valuation adjustments on the Bank’s loan portfolio and real estate owned as it continues to reassess the market value of its loan portfolio, the losses associated with impaired loans, and the net realizable value of real estate owned.

The following table sets forth the composition of the Bank's loan portfolio:

	At December 31, 2013		2012		2011	
	Amount	% of Total	Amount	% of Total	Amount	Total
	<b>(dollars in thousands)</b>					
Residential real estate	\$26,468	32.64 %	\$30,064	34.32 %	\$31,142	34.03 %
Multi-family real estate	3,605	4.44	3,916	4.47	4,109	4.49
Commercial real estate	27,883	34.40	39,126	44.66	44,312	48.42
Land and construction	6,459	7.97	7,276	8.30	11,783	12.87
Commercial	16,584	20.45	7,158	8.17	0	.00
Consumer	81	.10	70	.08	175	.19
<b>Total loans</b>	<b>81,080</b>	<b>100.00%</b>	<b>87,610</b>	<b>100.00%</b>	<b>91,521</b>	<b>100.00%</b>
Add (deduct):						
Allowance for loan losses	(2,211 )		(2,459 )		(2,349 )	
Net deferred loan costs and premiums	380		58		45	
<b>Loans, net</b>	<b>\$79,249</b>		<b>\$85,209</b>		<b>\$89,217</b>	

	At December 31, 2010		2009	
	Amount	% of Total	Amount	% of Total
	<b>(dollars in thousands)</b>			
Residential real estate	\$40,130	34.27 %	\$55,915	39.06 %
Multi-family real estate	4,213	3.60	5,162	3.61
Commercial real estate	55,119	47.07	58,901	41.14
Land and construction	17,292	14.77	22,355	15.61
Consumer	358	.29	836	.58
<b>Total loans</b>	<b>117,112</b>	<b>100.00%</b>	<b>143,169</b>	<b>100.00%</b>
Add (deduct):				
Allowance for loan losses	(3,703 )		(9,363 )	
Net deferred loan costs and premiums	133		320	
<b>Loans, net</b>	<b>\$113,542</b>		<b>\$134,126</b>	



The following table sets forth the activity in the allowance for loan losses (in thousands):

	<b>Year Ended December 31,</b>				
	2013	2012	2011	2010	2009
Beginning balance	\$2,459	\$2,349	\$3,703	\$9,363	\$1,906
Provision (credit) for loan losses	2,194	1,653	(149 )	3,645	15,794
Loans charged off	(2,959)	(1,848)	(1,739)	(9,424)	(8,337 )
Recoveries	517	305	534	119	0
Ending balance	\$2,211	\$2,459	\$2,349	\$3,703	\$9,363

The allowance for loan losses represents management’s estimate of probable incurred losses inherent in the existing loan portfolio. The allowance for loan losses is increased by the provision for loan losses charged to expense and reduced by loans charged off, net of recoveries. The allowance for loan losses represented 2.73% and 2.81% of the total loans outstanding at December 31, 2013 and 2012, respectively.

The Bank evaluates the allowance for loan losses on a regular basis. The allowance for loan losses is determined based on a periodic review of several factors: reviews and evaluation of individual loans, historical loan loss experiences, 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 current economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of two components. The first component consists of amounts specifically reserved (“specific allowance”) for specific loans identified as impaired, as defined by FASB Accounting Standards Codification No. 310 (“ASC 310”). Impaired loans are those loans that management has estimated will not be repaid as agreed upon. The Bank measures impairment on a loan by loan basis for all of its loans by either the present value of expected future cash flows discounted at the loan’s effective interest rate, the loan’s obtainable market price, or the fair value of the collateral if the loan is collateral-dependent. A loan may be impaired (i.e. not expected to be repaid as agreed), but may be sufficiently collateralized such that the Bank expects to recover all principal and interest eventually, and therefore no specific reserve is warranted.

The second component is a general reserve (“general allowance”) on all of the Bank’s loans, other than those identified as impaired. The Bank groups these loans into categories with similar characteristics and then applies a loss factor to each group which is derived from the Bank’s historical loss experience for that category adjusted for qualitative factors such as economic conditions and other trends or uncertainties that could affect management’s estimate of probable loss. The aggregate of these two components results in the Bank’s total allowance for loan losses.





The following table sets forth the Bank's allowance for loan losses by loan type (dollars in thousands):

	<b>At December 31,</b>		<b>2012</b>		<b>2011</b>	
	<b>2013</b>	<b>% of Total Amount Loans</b>	<b>Amount Loans</b>	<b>% of Total Amount Loans</b>	<b>Amount Loans</b>	<b>% of Total Amount Loans</b>
Residential real estate	\$49	32.64 %	\$434	34.32 %	\$566	34.03 %
Multi-family real estate	4	4.44	267	4.47	247	4.49
Commercial real estate	934	34.40	1,372	44.66	1,334	48.42
Land and construction	458	7.97	166	8.30	187	12.87
Commercial	61	20.45	216	8.17	0	.00
Consumer	0	.10	4	.08	15	.19
Unallocated	705	.00	0	.00	0	.00
<b>Total allowance for loan losses</b>	<b>\$2,211</b>	<b>100.00 %</b>	<b>\$2,459</b>	<b>100.00 %</b>	<b>\$2,349</b>	<b>100.00 %</b>
<b>Allowance for loan losses as a percentage of total loans outstanding</b>		<b>2.73 %</b>		<b>2.81 %</b>		<b>2.57 %</b>

	<b>At December 31,</b>		<b>2009</b>	
	<b>2010</b>	<b>% of Total Amount Loans</b>	<b>Amount Loans</b>	<b>% of Total Amount Loans</b>
Residential real estate	\$1,285	34.27 %	\$2,049	39.06 %
Multi-family real estate	282	3.60	489	3.61
Commercial real estate	1,542	47.07	1,466	41.14
Land and construction	514	14.77	5,227	15.61
Consumer	80	.29	132	.58
<b>Total allowance for loan losses</b>	<b>\$3,703</b>	<b>100.00 %</b>	<b>\$9,363</b>	<b>100.00 %</b>
<b>Allowance for loan losses as a percentage of total loans outstanding</b>		<b>3.16 %</b>		<b>6.54 %</b>

The following summarizes impaired loans (in thousands):

	December 31, 2013			At December 31, 2012		
	Unpaid Recorded Investment	Principal Balance	Related Allowance	Unpaid Recorded Investment	Principal Balance	Related Allowance
With no related allowance recorded:						
Residential real estate	\$7,100	\$7,607	\$ 0	\$7,573	\$8,024	\$ 0
Commercial real estate	4,128	4,534	0	8,661	11,412	0
Land and construction	0	0	0	886	2,410	0
Consumer	0	0	0	0	0	0
Commercial	1,216	1,458	0			
With an allowance recorded:						
Commercial real estate	1,099	2,913	192	2,874	2,874	366
Total:						
Residential real estate	\$7,100	\$7,607	\$ 0	\$7,573	\$8,024	\$ 0
Commercial real estate	\$5,227	\$7,447	\$ 192	\$11,535	\$14,286	\$ 366
Land and construction	\$0	\$0	\$ 0	\$886	\$2,410	\$ 0
Consumer	\$0	\$0	\$ 0	\$0	\$0	\$ 0
Commercial	\$1,216	\$1,458				
Total	\$13,543	\$16,512	\$ 192	\$19,994	\$24,720	\$ 366

During 2013, 2012 and 2011, the average net investment in impaired loans and interest income recognized and received on impaired loans is as follows (in thousands):

	Year Ended December 31,		
	2013	2012	2011
Average investment in impaired loans	\$17,859	\$25,743	\$37,549
Interest income recognized on impaired loans	\$596	\$175	\$367
Interest income received on a cash basis on impaired loans	\$1,183	\$616	\$834

Nonaccrual and past due loans were as follows as of December 31, 2013, 2012, 2011 and 2010 (in thousands):

	At December 31,			
	2013	2012	2011	2010
Nonaccrual loans	\$8,817	\$17,079	\$27,819	\$34,530

Past ninety days or more, but still accruing interest	\$0	\$0	\$0	\$0
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## Liquidity and Capital Resources

Liquidity represents an institution's ability to meet current and future obligations through liquidation or maturity of existing assets or the acquisition of additional liabilities. The Bank's ability to respond to the needs of depositors and borrowers and to benefit from investment opportunities is facilitated through liquidity management.

The Bank's primary sources of cash during the year ended December 31, 2013, were from principal repayments of securities available for sale of \$8.7 million, proceeds from sale of securities available for sale of \$2.0 million, and proceeds from net loan payoffs \$3.1 million. Cash was used primarily to repay \$2.9 million of deposits, repay \$5.0 million of Federal Home Loan Bank advances and purchase \$15.7 million in securities. In order to increase its core deposits, the Bank has priced its deposit rates competitively. The Bank will adjust rates on its deposits to attract or retain deposits as needed. The Bank obtains funds primarily from depositors in its market area.

In addition to obtaining funds from depositors, the Bank may borrow funds from other financial institutions. OptimumBank is a member of the Federal Home Loan Bank of Atlanta, which allows it to borrow funds under a pre-arranged line of credit equal to \$31.7 million. As of December 31, 2013, the Bank had \$22.7 million in borrowings outstanding from the Federal Home Loan Bank of Atlanta to facilitate loan fundings and manage its asset and liability structure. The Bank has established a line of credit for \$2.5 million with SunTrust, \$1 million with Independent Bankers Bank, and \$1.8 million with the Federal Reserve.

## Securities

The Bank's securities portfolio is comprised primarily of mortgage-backed securities. The securities portfolio is categorized as either "held to maturity" or "available for sale." Securities held to maturity represent those securities which the Company has the positive intent and ability to hold to maturity. These securities are carried at amortized cost. Securities available for sale represent those investments which may be sold for various reasons including changes in interest rates and liquidity considerations. These securities are reported at fair market value and unrealized gains and losses are excluded from earnings and reported in other comprehensive income.

The following table sets forth the amortized cost and fair value of the Bank's securities portfolio (in thousands):

	<b>Amortized Cost</b>	<b>Fair Value</b>
At December 31, 2013:		
Securities available for sale:		
Mortgage-backed securities	\$ 10,425	\$10,625
U.S. Government and agency securities	12,561	12,365
	\$ 22,986	\$22,990
At December 31, 2012:		
Securities available for sale:		
Mortgage-backed securities	\$ 16,325	\$15,629
U.S. Government and agency securities	2,097	3,019
	\$ 18,422	\$18,648

The following table sets forth, by maturity distribution, certain information pertaining to the securities portfolio (dollars in thousands):

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	<b>Within One Year</b>	<b>After One But Within Five Years</b>	<b>After Five Years Through Ten Years</b>	<b>After Ten Years</b>	<b>Total</b>	<b>Yield</b>
At December 31, 2013:						
Mortgage-backed securities	\$0	\$ 0	\$ 1,787	\$8,638	\$10,425	5.08 %
U.S. Government and agency securities	0	0	695	11,866	12,561	2.56 %
	\$0	\$ 0	\$ 2,482	\$20,504	\$22,986	
At December 31, 2012:						
Mortgage-backed securities	\$0	\$ 0	\$ 2,915	\$12,510	\$15,425	4.57 %
U.S. Government and agency securities	2,997	0	0	0	2,997	0.96 %
	\$2,997	\$ 0	\$ 2,915	\$12,510	\$18,422	

## Regulatory Capital Adequacy

Failure to meet minimum capital requirements can result in certain mandatory and, possibly, additional discretionary actions by federal and state regulators that, if undertaken, could have a direct material effect on the Bank's financial condition and results of operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. In addition, the Consent Order imposes increased minimum capital requirements on the Bank.

Quantitative measures established by regulation and by the Consent Order to ensure capital adequacy require us to maintain minimum amounts and ratios (set forth in the following table) of Total and Tier 1 capital to risk-weighted assets and Tier 1 capital to average assets. As of December 31, 2013, the Bank did not meet the minimum applicable capital adequacy requirements. See "Supervision and Regulation – Bank Regulation- Capital Adequacy Requirements" with respect to the required Tier 1 capital to total assets ratios of 8%.

The Bank's actual and required minimum capital ratios were as follows (in thousands):

## Regulatory Capital Requirements

	Actual		For Capital Adequacy Purposes		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions		Requirements of Consent Order	
	Amount	%	Amount	%	Amount	%	Amount	%
As of December 31, 2013:								
Total Capital to Risk- Weighted Assets	\$6,667	6.55 %	\$ 8,140	8.00 %	\$ 10,180	10.00 %	\$ 12,210	12.00 %
Tier I Capital to Risk- Weighted Assets	5,383	5.29	4,070	4.00	6,110	6.00	N/A	N/A
Tier I Capital to Total Assets	5,383	4.21	5,110	4.00	6,390	5.00	10,220	8.00
As of December 31, 2012:								
Total Capital to Risk- Weighted Assets	13,506	11.48	9,412	8.00	11,765	10.00	14,118	12.00
	12,035	10.23	4,706	4.00	7,059	6.00	N/A	N/A

Tier I Capital to Risk- Weighted  
Assets

Tier I Capital to Total Assets	12,035	8.12	5,932	4.00	7,415	5.00	11,864	8.00
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## Market Risk

Market risk is the risk of loss from adverse changes in market prices and rates. The Bank's market risk arises primarily from interest-rate risk inherent in its lending and deposit-taking activities. The Bank does not engage in securities trading or hedging activities and does not invest in interest-rate derivatives or enter into interest rate swaps.

The Bank may utilize financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. The measurement of market risk associated with financial instruments is meaningful only when all related and offsetting on- and off-balance-sheet transactions are aggregated, and the resulting net positions are identified. Disclosures about the fair value of financial instruments, which reflect changes in market prices and rates, can be found in Note 8 of Notes to Consolidated Financial Statements.

The Bank's primary objective in managing interest-rate risk is to minimize the potential adverse impact of changes in interest rates on its net interest income and capital, while adjusting its asset-liability structure to obtain the maximum yield-cost spread on that structure. The Bank actively monitors and manages its interest-rate risk exposure by managing its asset and liability structure. However, a sudden and substantial increase in interest rates may adversely impact its earnings, to the extent that the interest-earning assets and interest-bearing liabilities do not change or reprice at the same speed, to the same extent, or on the same basis.

The Bank uses modeling techniques to simulate changes in net interest income under various rate scenarios. Important elements of these techniques include the mix of floating versus fixed-rate assets and liabilities, and the scheduled, as well as expected, repricing and maturing volumes and rates of the existing balance sheet.

## Asset Liability Management

As part of its asset and liability management, the Bank has emphasized establishing and implementing internal asset-liability decision processes, as well as control procedures to aid in managing its earnings. Management believes that these processes and procedures provide us with better capital planning, asset mix and volume controls, loan-pricing guidelines, and deposit interest-rate guidelines, which should result in tighter controls and less exposure to interest-rate risk.

The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are "interest rate sensitive" and by monitoring an institution's interest rate sensitivity "gap." An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The interest-rate

sensitivity gap is defined as the difference between interest-earning assets and interest-bearing liabilities maturing or repricing within a given time period. The gap ratio is computed as the amount of rate sensitive assets less the amount of rate sensitive liabilities divided by total assets. A gap is considered positive when the amount of interest-rate sensitive assets exceeds interest-rate sensitive liabilities. A gap is considered negative when the amount of interest-rate sensitive liabilities exceeds interest-rate sensitive assets. During a period of rising interest rates, a negative gap would adversely affect net interest income, while a positive gap would result in an increase in net interest income. During a period of falling interest rates, a negative gap would result in an increase in net interest income, while a positive gap would adversely affect net interest income.

In order to minimize the potential for adverse effects of material and prolonged increases in interest rates on the results of operations, the Bank's management continues to monitor its assets and liabilities to better match the maturities and repricing terms of its interest-earning assets and interest-bearing liabilities. The Bank's policies emphasize the origination of adjustable-rate loans, building a stable core deposit base and, to the extent possible, matching deposit maturities with loan repricing timeframes or maturities.

The following table sets forth certain information related to the Bank's interest-earning assets and interest-bearing liabilities at December 31, 2013, that are estimated to mature or are scheduled to reprice within the period shown (dollars in thousands):

### Gap Maturity / Repricing Schedule

	<b>One Year or Less</b>	<b>More than One Year and Less than Five Years</b>	<b>More than Five Years and Less than Fifteen Years</b>	<b>Over Fifteen Years</b>	<b>Total</b>
Loans (1):					
Residential real estate loans	\$19,121	\$5,466	\$0	\$1,881	\$26,468
Multi-family real estate loans	2,986	543	76	0	3,605
Commercial real estate loans	13,918	10,456	3,509	0	27,883
Land and construction	1,587	4,872	0	0	6,459
Consumer loans	10,301	5,138	0	1,145	16,584
Consumer	56	25	0	0	81
<b>Total loans</b>	<b>47,969</b>	<b>26,500</b>	<b>3,585</b>	<b>3,026</b>	<b>81,080</b>
Securities (2)					
Federal Home Loan Bank stock	1,196	0	0	0	1,196
<b>Total rate-sensitive assets</b>	<b>49,165</b>	<b>26,500</b>	<b>13,948</b>	<b>15,649</b>	<b>105,262</b>
Deposit accounts (3):					
Money-market deposits	29,077	0	0	0	29,077
Interest-bearing checking deposits	1,074	0	0	0	1,074
Savings deposits	650	0	0	0	650
Time deposits	48,854	15,262	0	0	64,116
<b>Total deposits</b>	<b>79,655</b>	<b>15,262</b>	<b>0</b>	<b>0</b>	<b>94,917</b>
Federal Home Loan Bank advances					
Junior subordinated debenture	0	0	0	5,155	5,155
<b>Total rate-sensitive liabilities</b>	<b>92,395</b>	<b>25,262</b>	<b>0</b>	<b>5,155</b>	<b>122,812</b>
<b>GAP (repricing differences)</b>	<b>\$(43,230)</b>	<b>\$1,238</b>	<b>\$13,948</b>	<b>\$10,494</b>	<b>\$(17,550)</b>
<b>Cumulative GAP</b>	<b>\$(43,230)</b>	<b>\$(41,992)</b>	<b>\$(28,044)</b>	<b>\$(17,550)</b>	<b>\$(17,550)</b>

Cumulative GAP/total assets (33.57 )% (32.60 )% (21.77 )% (13.63 )%

In preparing the table above, adjustable-rate loans are included in the period in which the interest rates are next (1) scheduled to adjust rather than in the period in which the loans mature. Fixed-rate loans are scheduled, including repayment, according to their maturities.

(2) Securities are scheduled through the repricing date.

(3) Money-market, interest-bearing checking and savings deposits are regarded as readily accessible withdrawable accounts. All other time deposits are scheduled through the maturity dates.

The following table sets forth loan maturities by type of loan at December 31, 2013 (in thousands):

	<b>One Year or Less</b>	<b>After One But Within Five Years</b>	<b>After Five Years</b>	<b>Total</b>
Residential real estate	\$0	\$4,954	\$21,514	\$26,468
Multi-family real estate	0	544	3,061	3,605
Commercial real estate	1,099	11,780	15,004	27,883
Land and construction	0	1,918	4,541	6,459
Commercial	3,628	3,582	9,374	16,584
Consumer	56	25	0	81
<b>Total</b>	<b>\$4,783</b>	<b>\$22,803</b>	<b>\$53,494</b>	<b>\$81,080</b>

The following table sets forth the maturity or repricing of loans by interest type at December 31, 2013 (in thousands):

	<b>One Year or Less</b>	<b>After One But Within Five Years</b>	<b>After Five Years</b>	<b>Total</b>
Fixed interest rate	\$56	\$16,166	\$6,326	\$22,548
Variable interest rate	47,054	10,334	1,144	58,532
<b>Total</b>	<b>\$47,110</b>	<b>\$26,500</b>	<b>\$7,470</b>	<b>\$81,080</b>

Scheduled contractual principal repayments of loans do not reflect the actual life of such assets. The average life of loans is substantially less than their average contractual terms due to prepayments. In addition, due-on-sale clauses on loans generally give us the right to declare a conventional loan immediately due and payable in the event, among other things, that the borrower sells real property subject to a mortgage and the loan is not repaid. The average life of mortgage loans tends to increase, however, when current mortgage loan rates are substantially higher than rates on existing mortgage loans and, conversely, decrease when rates on existing mortgages are substantially higher than current mortgage rates.

Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amounts recognized in the consolidated balance sheet. The contractual amounts of those instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed-expiration dates or other termination clauses and may require payment of a fee. Since certain commitments expire without being drawn upon, the total committed amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary in order to extend credit, is based on management's credit evaluation of the counterparty.

As of December 31, 2013, commitments to extend credit totaled \$3,748,000.

The following is a summary of the Bank's contractual obligations, including certain on-balance sheet obligations, at December 31, 2013 (in thousands):

Contractual Obligations	Total	Payments Due by Period			More Than 5 Years
		Less Than 1 Year	1-3 Years	3-5 Years	
Federal Home Loan Bank advances	\$22,740	\$12,740	\$10,000	\$ 0	\$0
Junior subordinated debenture	5,155	0	0	0	5,155
Operating leases	84	84	0	0	0
<b>Total</b>	<b>\$27,979</b>	<b>\$12,824</b>	<b>\$10,000</b>	<b>\$ 0</b>	<b>\$5,155</b>

#### Deposits

Deposits traditionally are the primary source of funds for the Bank's use in lending, making investments and meeting liquidity demands. The Bank has focused on raising time deposits primarily within its market area, which is the tri-county area of Broward, Miami-Dade and Palm Beach counties. However, the Bank offers a variety of deposit products, which are promoted within its market area. Net deposits decreased \$2.9 million in 2013 and decreased \$6.4 million in 2012.

The Bank has used brokered deposits to facilitate mortgage loan fundings in circumstances when larger than anticipated loan volumes occur and there is limited time to fund the additional loan demand through traditional deposit solicitation. In general, brokered deposits can be obtained in one to three days. The rates paid on these deposits are typically equal to or slightly less than the high end of the interest rates in its market area. Brokered deposits amounted to \$0 and \$0.3 million as of December 31, 2013 and December 31, 2012, respectively. The Bank has reduced its reliance on brokered deposits which are considered a more volatile source of funding by no longer accepting or rolling over existing brokered deposits.

The following table displays the distribution of the Bank's deposits at December 31, 2013, 2012 and 2011 (dollars in thousands):

At December 31, 2013	% of	2012	% of	2011	% of
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	<b>Amount</b>	<b>Deposits</b>		<b>Amount</b>	<b>Deposits</b>		<b>Amount</b>	<b>Deposits</b>
Noninterest-bearing demand deposits	\$3,775	3.82	%	\$4,626	4.45	%	\$515	.48
Interest-bearing demand deposits	1,074	1.09		1,714	1.69		1,213	1.12
Money-market deposits	29,077	29.46		31,738	31.27		33,265	30.83
Savings	650	.66		701	.69		1,060	.98
<b>Subtotal</b>	<b>34,576</b>	<b>35.03</b>		<b>38,779</b>	<b>38.10</b>		<b>36,053</b>	<b>33.41</b>
<b>Time deposits:</b>								
0.00% – 0.99%	\$41,162	41.71	%	\$32,686	32.20	%	\$22,567	20.92
1.00% – 1.99%	20,012	20.28		23,398	23.05		38,290	35.49
2.00% – 2.99%	2,827	2.86		5,102	5.03		9,052	8.39
3.00% – 3.99%	115	.12		454	.45		592	.55
4.00% – 4.99%	0	0		1,192	1.17		1,341	1.24
5.00% – 5.99%	0	0		0	0		0	0
6.00% – 6.99%	0	0		0	0		0	0
<b>Total time deposits (1)</b>	<b>64,116</b>	<b>64.97</b>		<b>62,832</b>	<b>61.90</b>		<b>71,842</b>	<b>66.6</b>
<b>Total deposits</b>	<b>\$98,692</b>	<b>100.00</b>	<b>%</b>	<b>\$101,611</b>	<b>100.00</b>	<b>%</b>	<b>\$107,895</b>	<b>100.00</b>

(1) Included are Individual Retirement Accounts (IRA's) totaling \$5,565,000 and \$6,451,000 at December 31, 2013 and 2012, respectively, all of which are in the form of time deposits.



Deposits of \$100,000 or more, or Jumbo Time Deposits, are generally considered a more unpredictable source of funds. The following table sets forth the Bank's maturity distribution of deposits of \$100,000 or more at December 31, 2013 and 2012 (in thousands):

	<b>At December 31,</b>	
	2013	2012
Due three months or less	\$5,159	\$4,819
Due more than three months to six months	5,382	4,816
More than six months to one year	6,198	6,104
One to five years	5,000	11,717
<b>Total</b>	<b>\$21,739</b>	<b>\$27,456</b>

#### Analysis of Results of Operations

The Bank's profitability depends to a large extent on net interest income, which is the difference between the interest received on earning assets, such as loans and securities, and the interest paid on interest-bearing liabilities, principally deposits and borrowings. Net interest income is determined by the difference between yields earned on interest-earning assets and rates paid on interest-bearing liabilities ("interest-rate spread") and the relative amounts of interest-earning assets and interest-bearing liabilities. The Bank's interest-rate spread is affected by regulatory, economic, and competitive factors that influence interest rates, loan demand, and deposit flows. The Bank's results of operations are also affected by the provision for loan losses, operating expenses such as salaries and employee benefits, occupancy and other operating expenses including income taxes, and noninterest income such as loan prepayment fees.

The following table sets forth, for the periods indicated, information regarding (i) the total dollar amount of interest income from interest-earning assets and the resultant average yield; (ii) the total dollar amount of interest expense on interest-bearing liabilities and the resultant average cost; (iii) net interest income; (iv) interest rate spread; and (v) net interest margin. Average balances are based on average daily balances (dollars in thousands):

	Years Ended December 31, 2013			2012			2011		
	Average Balance	Interest and Dividends	Average Yield/ Rate	Average Balance	Interest and Dividends	Average Yield/ Rate	Average Balance	Interest and Dividends	Average Yield/ Rate
Interest-earning assets:									
Loans	\$85,145	4,433	5.21 %	\$88,968	4,040	4.54 %	\$104,227	4,625	4.44 %
Securities	20,951	783	3.74	25,247	1,038	4.11	43,575	1,729	3.97
Other interest-earning assets (1)	11,482	64	0.55	24,751	84	0.34	21,266	68	0.32
Total interest-earning assets/interest income	117,578	5,280	4.49	138,966	5,162	3.71	169,068	6,422	3.80
Cash and due from banks	4,831			1,945			290		
Premises and equipment	2,922			2,766			2,744		
Other assets	8,465			7,630			5,291		
Total assets	\$133,796			\$151,307			\$177,393		
Interest-bearing liabilities:									
Savings, NOW and money- market deposits	32,706	188	0.59	35,164	220	0.63	35,261	271	0.77
Time deposits	61,855	654	1.06	69,340	883	1.27	100,583	1,611	1.60
Borrowings (4)	29,727	1,077	3.62	35,170	1,478	4.20	36,855	1,545	4.19
Total interest-bearing liabilities/interest expense	124,288	1,919	1.54	139,674	2,581	1.85	172,699	3,427	1.98
Noninterest-bearing demand deposits	3,387			1,194			527		
Other liabilities	2,857			2,647			2,331		
Stockholders' equity	3,264			7,792			1,836		

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Total liabilities and stockholders' equity	\$ 133,796	\$ 151,307	\$ 177,393	
Net interest income	\$ 3,361	\$ 2,581	\$ 2,995	
Interest rate spread (2)	2.95 %	1.86 %	1.82 %	
Net interest margin (3)	2.86 %	1.86 %	1.77 %	
Ratio of average interest-earning assets to average interest-bearing liabilities	0.95	0.99	0.98	

(1) Includes interest-earning deposits with banks, Federal funds sold and Federal Home Loan Bank stock dividends.

(2) Interest rate spread represents the difference between average yield on interest-earning assets and the average cost of interest-bearing liabilities.

(3) Net interest margin is net interest income divided by average interest-earning assets.

(4) Includes Federal Home Loan Bank advances, junior subordinated debenture and securities sold under an agreement to repurchase.

## Rate/Volume Analysis

The following tables set forth certain information regarding changes in interest income and interest expense for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in rate (change in rate multiplied by prior volume), (2) changes in volume (change in volume multiplied by prior rate) and (3) changes in rate-volume (change in rate multiplied by change in volume) (in thousands):

	Year Ended December 31, 2013 versus 2012			
	Increases (Decreases) Due to Change In:			
			<b>Rate/ Volume</b>	<b>Total</b>
Interest-earning assets:				
Loans	\$596	\$ (174 )	\$ (29 )	\$393
Securities	(93 )	(177 )	15	(255)
Other interest-earning assets	52	(44 )	(28 )	(20 )
Total interest-earning assets	555	(395 )	(42 )	118
Interest-bearing liabilities:				
Savings, NOW and money-market	(14 )	15	(33 )	(32 )
Time deposits	(146)	(95 )	12	(229)
Other	(204)	(248 )	51	(401)
Total interest-bearing liabilities	(364)	(328 )	30	(662)
Net interest income	\$919	\$ (67 )	\$ (72 )	\$780

	Year Ended December 31, 2012 versus 2011			
	Increases (Decreases) Due to Change In:			
			<b>Rate/ Volume</b>	<b>Total</b>
Interest-earning assets:				
Loans	\$108	\$ (677 )	\$ (16 )	\$ (585 )
Securities	63	(727 )	(27 )	(691 )
Other interest-earning assets	3	12	1	16
Total interest-earning assets	174	(1,392)	(42 )	(1,260)

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Interest-bearing liabilities:				
Savings, NOW and money-market	(50 )	(1 )	0	(51 )
Time deposits	(331)	(501 )	103	(729 )
Other	(4 )	(71 )	9	(66 )
 Total interest-bearing liabilities	 (385)	 (573 )	 112	 (846 )
 Net interest income	 \$559	 \$(819 )	 \$ 154	 \$(414 )

### **Financial Condition as of December 31, 2013 Compared to December 31, 2012**

The Company's total assets decreased by \$14.9 million, to \$128.8 million at December 31, 2013, from \$143.7 million at December 31, 2012, due to the Company's strategy of downsizing in order to preserve its capital ratios. The Company reduced its loans and securities as well as its interest bearing time deposits.

The Company currently needs to increase its capital in order for the Company and the Bank to comply with their capital requirements under the Consent Order and the Written Agreement.

At December 31, 2013, the Bank had a Tier 1 leverage ratio of 4.21%, and a total risk-based capital ratio of 6.55%, both of which were below the 8% and 12%, respectively requirements of the Consent Order. At December 31, 2013, the Bank would have needed approximately \$5.5 million in additional capital in order to comply with the total risk-based capital ratio requirement of the Consent Order.

The Company will still need to sell additional shares of common stock to comply with the capital requirements through the end of 2014 and in subsequent years. At the present time, the Company has not received any commitments from any third parties to purchase any additional shares. Accordingly, it is uncertain whether the Company will be able to obtain the capital that is required or the price and terms of any capital that is obtained.

### **Results of Operations for Year Ended December 31, 2013 Compared to Year Ended December 31, 2012**

**General.** Net loss for the year ended December 31, 2013, was \$7.1 million or \$(.89) per basic and diluted share compared to a loss of \$4.7 million or \$(.69) per basic and diluted share for the year ended December 31, 2012. This \$2.4 million increase in the Company's net loss was primarily due to a \$1.5 million loss on early extinguishment of FHLB debt, as well as increases in foreclosed real estate expenses and provision for loan losses.

**Interest Income.** Interest income increased to \$5.3 million for the year ended December 31, 2013 compared to \$5.2 million for the year ended December 31, 2012. Interest income on loans increased by \$0.4 million. Interest on securities decreased by \$0.2 million.

**Interest Expense.** Interest expense on deposit accounts decreased to \$0.8 million for the year ended December 31, 2013, from \$1.1 million for the year ended December 31, 2012. Interest expense on deposits decreased primarily

because of a decrease in the average yield paid in 2013 and a decrease in the average balance of deposits. Interest expense on borrowings decreased by \$.4 million for the year ended December 31, 2013 from \$1.5 million for the year ended December 31, 2012.

***Provision for Loan Losses.*** The provision for loan losses for the year ended December 31, 2013, was \$2.2 million compared to \$1.7 million for the same period in 2012. The provision for loan losses is charged to operations as losses are estimated to have occurred in order to bring the total allowance for loan losses to a level deemed appropriate by management to absorb losses inherent in the loan portfolio at December 31, 2013. Management's periodic evaluation of the adequacy of the allowance is based upon historical experience, the volume and type of lending conducted by it, adverse situations that may affect the borrower's ability to repay, estimated value of the underlying collateral, loans identified as impaired, general economic conditions, particularly as they relate to its market areas, and other qualitative factors related to the estimated collectability of its loan portfolio. The allowance for loan losses totaled \$2.2 million or 2.73% of loans outstanding at December 31, 2013, compared to \$2.5 million or 2.81% of loans outstanding at December 31, 2012. The decrease in the allowance was due to the use of specific reserves for charge-offs of loans deemed uncollectible. Management believes the balance in the allowance for loan losses at December 31, 2013 is adequate.

**Noninterest Income.** Total noninterest income decreased to \$0.1 million for the year ended December 31, 2013, from \$0.3 million for the year ended December 31, 2012.

**Noninterest Expenses.** Total noninterest expenses increased by \$2.2 million, to \$7.7 million for the year ended December 31, 2013 from \$5.5 million for the year ended December 31, 2012, primarily due to loss on early extinguishment of Federal Home Loan Bank advances in order to replace longer term higher yielding advances with shorter term lower yielding advances as well as an increase in foreclosed real estate expenses.

**Income Taxes.** Income taxes for the years ended December 31, 2013 and 2012 were \$320,000 and \$0, respectively. The income tax expense for 2013 relates to an Internal Revenue Service audit regarding the Bank's 2009 income tax return, which is being contested.

#### Results of Operations for Year Ended December 31, 2012 Compared to Year Ended December 31, 2011

**General.** Net loss for the year ended December 31, 2012, was \$4.7 million or \$(.69) per basic and diluted share compared to a net loss of \$3.7 million or \$(3.28) per basic and diluted share for the year ended December 31, 2011. This \$1.0 million increase in the Company's net loss was primarily due to a \$1.8 million increase in the provision for loan losses.

**Interest Income.** Interest income decreased to \$5.2 million for the year ended December 31, 2012 compared to \$6.4 million for the year ended December 31, 2011. Interest income on loans decreased by \$0.6 million due primarily to a decrease in the average loan portfolio balance in 2012. Interest on securities decreased by \$0.7 million due primarily to a decrease in the average balance of the securities portfolio in 2012.

**Interest Expense.** Interest expense on deposit accounts decreased to \$1.1 million for the year ended December 31, 2012, from \$1.9 million for the year ended December 31, 2011. Interest expense on deposits decreased primarily because of a decrease in the average yield paid in 2012 and a decrease in the average balance of deposits.

**Provision (Credit) for Loan Losses.** The provision (credit) for loan losses for the year ended December 31, 2012, was \$1.7 million compared to \$(149,000) for the same period in 2011. The provision (credit) for loan losses is charged to operations as losses are estimated to have occurred in order to bring the total allowance for loan losses to a level deemed appropriate by management to absorb losses inherent in the loan portfolio at December 31, 2012. Management's periodic evaluation of the adequacy of the allowance is based upon historical experience, the volume and type of lending conducted by us, adverse situations that may affect the borrower's ability to repay, estimated value



of the underlying collateral, loans identified as impaired, general economic conditions, particularly as they relate to its market areas, and other qualitative factors related to the estimated collectability of its loan portfolio. The allowance for loan losses totaled \$2.5 million or 2.81% of loans outstanding at December 31, 2012, compared to \$2.3 million or 2.57% of loans outstanding at December 31, 2011. The decrease in the allowance was due to the use of specific reserves for charge-offs of loans deemed uncollectible. Management believes the balance in the allowance for loan losses at December 31, 2012 is adequate.

***Noninterest Income.*** Total noninterest income decreased to \$0.3 million for the year ended December 31, 2012, from \$0.4 million for the year ended December 31, 2011 primarily due to gains recognized on the sale of securities as part of the downsizing of the Company in the first quarter of 2011.

***Noninterest Expenses.*** Total noninterest expenses decreased by \$1.8 million, to \$5.5 million for the year ended December 31, 2012 from \$7.2 million for the year ended December 31, 2011, primarily due to a \$0.8 million decrease in expenses relating to foreclosed real estate, a \$0.5 million decrease in professional fees and a \$.4 million decline in regulatory assessments.

**Income Taxes.** Income taxes for the years ended December 31, 2012 and 2011 were \$0 and \$41,000, respectively.

#### Impact of Inflation and Changing Prices

The financial statements and related data presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America, which requires the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, substantially all of the Bank's assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on its performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services, since such prices are affected by inflation to a larger extent than interest rates.

### **Item 8. Financial Statements**

#### **Audited Consolidated Financial Statements**

**December 31, 2013 and 2012 and for the Years Then Ended**

**(Together with Report of Independent Registered Public Accounting Firm)**

**Report of Independent Registered Public Accounting Firm**

OptimumBank Holdings, Inc.

Fort Lauderdale, Florida:

We have audited the accompanying consolidated balance sheets of OptimumBank Holdings, Inc. and Subsidiary (the “Company”) as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive loss, stockholders’ (deficit) equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company at December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

HACKER, JOHNSON & SMITH PA

Fort Lauderdale, Florida

March 27, 2014

**OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY****Consolidated Balance Sheets****(Dollars in thousands, except share amounts)**

	December 31,	
	2013	2012
Assets		
Cash and due from banks	\$5,451	\$4,541
Interest-bearing deposits with banks	8,430	19,070
Total cash and cash equivalents	13,881	23,611
Securities available for sale	22,990	18,648
Loans, net of allowance for loan losses of \$2,211 and \$2,459	79,249	85,209
Federal Home Loan Bank stock	1,196	1,478
Premises and equipment, net	2,879	2,906
Foreclosed real estate, net	7,553	10,938
Accrued interest receivable	496	499
Other assets	539	454
Total assets	\$ 128,783	\$ 143,743
Liabilities and Stockholders' (Deficit) Equity		
Liabilities:		
Noninterest-bearing demand deposits	3,775	4,626
Savings, NOW and money-market deposits	30,801	34,153
Time deposits	64,116	62,832
Total deposits	98,692	101,611
Federal Home Loan Bank advances	22,740	27,700
Junior subordinated debenture	5,155	5,155
Advanced payment by borrowers for taxes and insurance	315	461
Official checks	344	581
Other liabilities	1,753	1,325
Total liabilities	128,999	136,833
Commitments and contingencies (Notes 4, 8, 13 and 15)		

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Stockholders' (deficit) equity:		
Preferred stock, no par value; 6,000,000 shares authorized, no shares issued or outstanding	0	0
Common stock, \$.01 par value; 50,000,000 shares authorized in 2013 and 2012, 8,011,077 and 31,511,201 shares issued and outstanding in 2013 and 2012	80	315
Additional paid-in capital	31,463	31,057
Accumulated deficit	(31,763 )	(24,688 )
Accumulated other comprehensive income	4	226
Total stockholders' (deficit) equity	(216 )	6,910
Total liabilities and stockholders' (deficit) equity	\$ 128,783	\$ 143,743

See Accompanying Notes to Consolidated Financial Statements.

**OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY****Consolidated Statements of Operations****(In thousands, except share amounts)**

	Year Ended December 31,	
	2013	2012
Interest income:		
Loans	\$4,433	\$4,040
Securities	783	1,038
Other	64	84
Total interest income	5,280	5,162
Interest expense:		
Deposits	842	1,103
Borrowings	1,077	1,478
Total interest expense	1,919	2,581
Net interest income	3,361	2,581
Provision for loan losses	2,194	1,653
Net interest income after provision for loan losses	1,167	928
Noninterest income:		
Service charges and fees	122	72
Other	42	186
Loss on sale of securities available for sale	(20 )	—
Total noninterest income	144	258
Noninterest expenses:		
Salaries and employee benefits	2,081	1,746
Occupancy and equipment	536	512
Data processing	310	229
Professional fees	1,082	1,114
Insurance	270	285
Foreclosed real estate expenses	1,262	550
Regulatory assessments	334	305
Loss of early extinguishment of debt	1,548	0

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Other	281	733
Total noninterest expenses	7,704	5,474
Other-than-temporary impairment on securities:		
Total other-than-temporary impairment losses	362	409
Portion of losses recognized in other comprehensive income	0	0
Net impairment loss	362	409
Loss before income taxes	(6,755)	(4,697)
Income taxes	320	0
Net loss	\$(7,075)	\$(4,697)
Net loss per share:		
Basic	\$(.89 )	\$(.69 )
Diluted	\$(.89 )	\$(.69 )

See Accompanying Notes to Consolidated Financial Statements.

**OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY****Consolidated Statements of Comprehensive Loss****(In thousands)**

	<b>Year Ended December 31, 2013    2012</b>	
Net loss	\$(7,075)	\$(4,697)
Other comprehensive income (loss)		
Unrealized gains (loss) on securities available for sale:		
Unrealized holding gains arising during the year	160	1,573
Reclassification adjustment for other-than-temporary impairment losses recognized	362	409
Loss on sale of securities available for sale	20	—
Net change in unrealized gain	(222 )	1,164
Comprehensive loss	\$(7,297)	\$(3,533)

See Accompanying Notes to Consolidated Financial Statements.



**OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY****Consolidated Statements of Stockholders' (Deficit) Equity****Years Ended December 31, 2013 and 2012**

(Dollars in thousands)

	<b>Common Stock Shares</b>	<b>Common Stock Amount</b>	<b>Additional Paid-In Capital</b>	<b>Accumulated Deficit</b>	<b>Accumulated Other Compre- hensive Income (Loss)</b>	<b>Total Stockholders' (Deficit) Equity</b>
Balance at December 31, 2011	22,411,108	\$ 224	\$ 27,491	\$ (19,991 )	\$ (938 )	\$ 6,786
Proceeds from sale of common stock	9,047,500	90	3,539	0	0	3,629
Stock compensation	52,593	1	27	0	0	28
Net change in unrealized loss on securities available for sale	0	0	0	0	1,164	1,164
Net loss	0	0	0	(4,697 )	0	(4,697 )
Balance at December 31, 2012	31,511,201	\$ 315	\$ 31,057	\$ (24,688 )	\$ 226	\$ 6,910
Reverse stock split 1-for-4	(23,633,164)	(236 )	236	0	0	0
Proceeds from sale of common stock	104,166	1	123	0	0	124
Stock compensation	28,874	0	47	0	0	47
Net change in unrealized loss on securities available for sale	0	0	0	0	(222 )	(222 )
Net loss	0	0	0	(7,075 )	0	(7,075 )
Balance at December 31, 2013	8,011,077	\$ 80	\$ 31,463	\$ (31,763 )	\$ 4	\$ (216 )

See Accompanying Notes to Consolidated Financial Statements.

**OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY****Consolidated Statements of Cash Flows****(In thousands)**

	<b>Year Ended</b>	
	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
Cash flows from operating activities:		
Net loss	\$(7,075 )	\$(4,697 )
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	198	128
Provision for loan losses	2,194	1,653
Stock compensation	47	28
Net amortization of fees, premiums and discounts	40	22
Loss from sale of securities available for sale	20	0
Decrease in accrued interest receivable	3	0
(Increase) decrease in other assets	(85 )	123
Loss on sale of foreclosed real estate	135	32
Provision for losses on foreclosed real estate	1,004	102
Increase (decrease) in official checks and other liabilities	191	(463 )
Other-than-temporary impairment of securities available for sale	362	409
Net cash used in operating activities	(2,966 )	(2,663 )
Cash flows from investing activities:		
Purchases of securities	(15,673 )	0
Principal repayments and calls of securities	8,718	11,007
Proceeds from sale of securities	1,969	0
Net decrease (increase) in loans	3,069	(2,320 )
Purchase of premises and equipment, net	(171 )	(343 )
Proceeds from sale of foreclosed real estate, net	2,943	1,291
Capital improvements on foreclosed real estate	0	(57 )
Redemption of Federal Home Loan Bank stock	282	681
Net cash provided by investing activities	1,137	10,259
Cash flows from financing activities:		
Net decrease in deposits	(2,919 )	(6,284 )
Proceeds from sale of common stock	124	3,629
Proceeds from Federal Home Loan Bank advances	22,740	0
Repayments of Federal Home Loan Bank advances	(27,700)	(4,000 )
Net decrease in advanced payment by borrowers for taxes and insurance	(146 )	(106 )

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Net cash used in financing activities	(7,901 )	(6,761 )
Net (decrease) increase in cash and cash equivalents	(9,730 )	835
Cash and cash equivalents at beginning of the year	23,611	22,776
Cash and cash equivalents at end of the year	\$13,881	\$23,611

(continued)

**OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY**

**Consolidated Statements of Cash Flows, Continued**

**(In thousands)**

	<b>Year Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	\$1,926	\$2,458
Income taxes	\$0	\$0
Noncash transactions:		
Change in accumulated other comprehensive income, net change in unrealized gain on securities available for sale	\$(222 )	\$1,164
Loans transferred to foreclosed real estate	\$697	\$4,660

See Accompanying Notes to Consolidated Financial Statements.

## OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

### Notes to Consolidated Financial Statements

#### December 31, 2013 and 2012 and the Years Then Ended

##### (1) Summary of Significant Accounting Policies

**Organization.** OptimumBank Holdings, Inc. (the “Holding Company”) is a one-bank holding company and owns 100% of OptimumBank (the “Bank”), a state (Florida)-chartered commercial bank. The Bank’s wholly-owned subsidiaries are OB Real Estate Management, LLC, OB Real Estate Holdings, LLC and OB Real Estate Holding 1503, LLC, all of which were formed in 2009, OB Real Estate Holdings 1695, OB Real Estate Holdings 1669, OB Real Estate Holdings 1645, OB Real Estate Holdings 1620 and OB Real Estate Holdings 1565, all formed in 2010; OB Real Estate Holdings 1443 and OB Real Estate Holdings Northwood, OB Real Estate Holdings 1596, OB Real Estate Holdings 1636 formed in 2011; and OB Real Estate Holdings 1655, OB Real Estate Holdings 1692, OB Real Estate Holdings 1704, OB Real Estate Holdings Rosemary and OB Real Estate Holdings Sillato formed in 2012 (the “Real Estate Holding Subsidiaries”). The Holding Company’s only business is the operation of the Bank and its subsidiaries (collectively, the “Company”). The Bank’s deposits are insured up to applicable limits by the Federal Deposit Insurance Corporation (“FDIC”). The Bank offers a variety of community banking services to individual and corporate customers through its three banking offices located in Broward County, Florida. OB Real Estate Management, LLC is primarily engaged in managing foreclosed real estate. This subsidiary had no activity in 2013 and 2012. All other subsidiaries are primarily engaged in holding and disposing of foreclosed real estate.

**Basis of Presentation.** The accompanying consolidated financial statements include the accounts of the Holding Company, the Bank and the Real Estate Holding Subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The accounting and reporting practices of the Company conform to U.S. generally accepted accounting principles and to general practices within the banking industry. The following summarizes the more significant of these policies and practices:

**Going Concern Status.** The Company has suffered losses from operations, continuing high levels of noninterest expenses and has a stockholders’ deficit at December 31, 2013. As discussed in Note 13, the Bank is subject to a Consent Order which requires the maintenance at a 12% total risk-based capital ratio. At December 31, 2013, the Bank’s recurring total risk-based capital ratio of 6.55% is significantly below the 12% level required to be a well-capitalized bank. As of December 31, 2013, the Bank would have needed approximately \$5.5 million in additional capital to comply with the 12% total risk-based capital requirement. In the opinion of management the Company has taken certain actions which are expected to substantially reduce operating losses as follows:

(continued)

46

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

**Notes to Consolidated Financial Statements, Continued**

**(1) Summary of Significant Accounting Policies, Continued**

**Going Concern Status, Continued.** The Company has identified certain structural or contract related expenses that adversely impacted the Company's ability to achieve core operational profitability. Specifically, there were \$20 million in long term Federal Home Loan Bank Advances with above market interest rates that were extinguished in December 2013 and replaced with lower interest rate advances. The Company recognized a \$1,548,000 loss on early extinguishment of debt in connection with this transaction. As a result of this restructuring, borrowings interest expense will be reduced annually by approximately \$1.1 million through the maturity of the new advances. In addition the Company's Directors and Officers insurance was replaced with a policy from another insurance carrier. Annual savings totaling approximately \$130,000 are expected with no change in deductible or areas covered. The contract for core system processing is also being reviewed with additional savings anticipated. Going further, as part of the Company's strategic planning process, other initiatives are being developed to achieve branch and operational efficiencies.

The Company is in the process of raising additional capital. It is anticipated that the first effort will raise between \$3 million and \$4 million in a combination of common and preferred shares to both existing and new investors. A subsequent capital raise along with organic capital generation will be required to meet the target of 8% tier 1 and 12% total risk based capital. A formal Plan, including necessary shareholder approval, to achieve the 8% and 12% targets will be completed in the second quarter of 2014. However, there can be no assurance that the Company will be successful in its efforts to raise capital.

Management forecasts the Company to be profitable for 2014 unless it incurs unforeseen loan loss provisions. Management has considered these factors in evaluating the Company's ability to continue as a going concern and believes the Company will be able to meet all of its financial obligations and continue to operate as a going concern at least through December 31, 2014.

**Use of Estimates.** In preparing consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP"), management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of foreclosed real estate, and the deferred tax asset.



***Cash and Cash Equivalents.*** For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks and interest-bearing deposits, all of which have original maturities of ninety days or less.

The Company may be required by law or regulation to maintain cash reserves in the form of vault cash or in accounts with other banks. There were no reserve balances required at December 31, 2013 and 2012.

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

**Notes to Consolidated Financial Statements, Continued**

**(1) Summary of Significant Accounting Policies, Continued**

**Securities.** Securities may be classified as either trading, held to maturity or available for sale. Trading securities are held principally for resale and recorded at their fair values. Unrealized gains and losses on trading securities are included immediately in operations. Held to maturity securities are those which management has the positive intent and ability to hold to maturity and are reported at amortized cost. Available for sale securities consist of securities not classified as trading securities nor as held to maturity securities. Unrealized holding gains and losses on available for sale securities are reported as a net amount in accumulated other comprehensive income in stockholders' (deficit) equity until realized. Gains and losses on the sale of available for sale securities are determined using the specific-identification method. Premiums and discounts on securities are recognized in interest income using the interest method over the period to maturity.

**Loans.** Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal, adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs.

Commitment fees and loan origination fees are deferred and certain direct origination costs are capitalized. Both are recognized as an adjustment of the yield of the related loan.

The accrual of interest on loans is discontinued at the time the loan is ninety days delinquent unless the loan is well collateralized and in process of collection. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

**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 operations. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to

the allowance. There were no changes in the Company's accounting policies or methodology during the years ended December 31, 2013 and 2012.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability 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.

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

**Notes to Consolidated Financial Statements, Continued**

**(1) Summary of Significant Accounting Policies, Continued**

***Allowance for Loan Losses, Continued.*** The allowance consists of specific and general components. The specific component relates to loans that are classified as impaired. For such loans, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loans are lower than the carrying value of those loans. The general component covers all other loans and is based on historical loss experience adjusted for qualitative factors.

The historical loss component of the allowance is determined by losses recognized by portfolio segment over the preceding three years. The historical loss experience is adjusted for the risks by each portfolio segment. Risk factors impacting loans in each of the portfolio segments include: economic trends and conditions; experience, ability and depth of lending management; national and local political environment; industry conditions and trends in charge-offs; and other trends or uncertainties that could affect management's estimate of probable losses.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for single-family and commercial real estate, land and construction and multi-family real estate loans, and consumer loans, by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral-dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment.

***Foreclosed Real Estate.*** Real estate acquired through, or in lieu of, loan foreclosure is to be sold and is initially recorded at fair value less estimated selling costs at the date of foreclosure establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of the new cost basis or fair value less cost to sell. Revenue and expenses from operations are included in the consolidated

statements of operations.

***Premises and Equipment.*** Land is stated at cost. Buildings and improvements, furniture, fixtures, equipment, and leasehold improvements are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization expense are computed using the straight-line method over the estimated useful life of each type of asset or lease term, if shorter.

(continued)

49

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

**Notes to Consolidated Financial Statements, Continued**

**(1) Summary of Significant Accounting Policies, Continued**

***Preferred Securities of Unconsolidated Subsidiary Trust.*** The Company owns all of the common stock of OptimumBank Holdings Capital Trust I (“Issuer Trust”), an unconsolidated subsidiary trust. The Issuer Trust used the proceeds from the issuance of \$5,000,000 of its preferred securities to third-party investors and common stock to acquire a \$5,155,000 debenture issued by the Company. This debenture and certain capitalized costs associated with the issuance of the securities comprise the Issuer Trust’s only assets and the interest payments from the debentures finance the distributions paid on the preferred securities. The Company recorded the debenture in “Junior Subordinated Debenture” and its equity interest in the business trust in “Other Assets” on the consolidated balance sheets (See Note 7).

The Company has entered into agreements which, taken collectively, fully and unconditionally guarantee the preferred securities of the Issuer Trust subject to the terms of the guarantee.

***Transfer of Financial Assets.*** Transfers of financial assets or a participating interest in an entire financial asset are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. A participating interest is a portion of an entire financial asset that (1) conveys proportionate ownership rights with equal priority to each participating interest holder (2) involves no recourse (other than standard representations and warranties) to, or subordination by, any participating interest holder, and (3) does not entitle any participating interest holder to receive cash before any other participating interest holder.

***Income Taxes.*** There are two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur. Deferred income tax expense results from changes in deferred tax assets and liabilities between periods.

(continued)

50

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

**Notes to Consolidated Financial Statements, Continued**

**(1) Summary of Significant Accounting Policies, Continued**

***Income Taxes, Continued.*** Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Company provides reserves for potential payments of tax related to uncertain tax positions. These reserves are based on a determination of whether and how much of a tax benefit taken by the Company in its tax filings or positions is more likely than not to be realized following resolution of any potential contingencies present related to the tax benefit. Potential interest and penalties associated with such uncertain tax positions is recorded as a component of income tax expense. See Note 10, below, for additional details.

The Company recognizes interest and penalties on income taxes as a component of income tax expense.

The Holding Company and the Bank file a consolidated income tax return. Income taxes are allocated proportionately to the Holding Company and the Bank as though separate income tax returns were filed.

***Advertising.*** The Company expenses all media advertising as incurred. Media advertising expense included in other noninterest expenses in the accompanying consolidated statements of operations was approximately \$54,000 and \$42,000 during the years ended December 31, 2013 and 2012, respectively.

***Stock Compensation Plan.*** The Company has adopted the fair value recognition method and expenses the fair value of any stock options as they vest. Under the fair value recognition method, the Company recognizes stock-based compensation in the accompanying consolidated statements of operations.



(continued)

51

## OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

**Notes to Consolidated Financial Statements, Continued****(1) Summary of Significant Accounting Policies, Continued**

**Loss Per Share.** Basic loss per share is computed on the basis of the weighted-average number of common shares outstanding. In 2013 and 2012, basic and diluted loss per share is the same due to the net loss incurred by the Company. Loss per share has been restated for all periods presented to reflect the one-for-four reverse common share split effective May 31, 2013. Loss per common share has been computed based on the following:

	<b>Year Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
Weighted-average number of common shares outstanding used to calculate basic and diluted loss per common share	7,913,585	6,840,668

**Off-Balance-Sheet Financial Instruments.** In the ordinary course of business the Company may enter into off-balance-sheet financial instruments consisting of commitments to extend credit. Such financial instruments are recorded in the consolidated financial statements when they are funded.

**Fair Value Measurements.** Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The hierarchy describes three levels of inputs that may be used to measure fair value:

Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities that are not active; and model-driven valuations whose inputs are observable or whose significant value

drivers are observable. Valuations may be obtained from, or corroborated by, third-party pricing services.

Level 3: Unobservable inputs to measure fair value of assets and liabilities for which there is little, if any market activity at the measurement date, using reasonable inputs and assumptions based upon the best information at the time, to the extent that inputs are available without undue cost and effort.

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

**Notes to Consolidated Financial Statements, Continued**

**(1) Summary of Significant Accounting Policies, Continued**

***Fair Value Measurements, Continued.*** The following describes valuation methodologies used for assets measured at fair value:

*Securities Available for Sale.* Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government bonds, certain mortgage products and exchange-traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. Examples of such instruments, which would generally be classified within Level 2 of the valuation hierarchy, include certain mortgage-backed securities and U.S. Government and agency securities.

*Impaired Loans.* The Company's impaired loans are normally collateral dependent and, as such, are carried at the lower of the Company's net recorded investment in the loan or fair market value of the collateral less estimated selling costs. Estimates of fair value are determined based on a variety of information, including the use of available appraisals, estimates of market value by licensed appraisers or local real estate brokers and the knowledge and experience of the Company's management related to values of properties in the Company's market areas. Management takes into consideration the type, location and occupancy of the property as well as current economic conditions in the area the property is located in assessing estimates of fair value. Accordingly, fair value estimates for impaired loans are classified as Level 3.

*Foreclosed Real Estate.* Estimates of fair values are determined based on a variety of information, including the use of available appraisals, estimates of market value by licensed appraisers or local real estate brokers and the knowledge and experience of the Company's management related to values of properties in the Company's market areas. Management takes into consideration the type, location and occupancy of the property as well as current economic conditions in the area the property is located in assessing estimates of fair value. Accordingly, the fair values estimates for foreclosed real estate are classified as Level 3.

***Fair Values of Financial Instruments.*** The following methods and assumptions were used by the Company in estimating fair values of financial instruments disclosed herein:

***Cash and Cash Equivalents.*** The carrying amounts of cash and cash equivalents approximate their fair value.

***Securities.*** Fair values for securities are based on the framework for measuring fair value established by GAAP.

***Loans.*** For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. Fair values for fixed-rate loans, including fixed-rate residential and commercial real estate and commercial loans, are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

**Notes to Consolidated Financial Statements, Continued**

**(1) Summary of Significant Accounting Policies, Continued**

*Fair Values of Financial Instruments, Continued.*

**Federal Home Loan Bank Stock.** Fair value of the Company's investment in Federal Home Loan Bank stock is based on its redemption value, which is its cost of \$100 per share.

**Accrued Interest Receivable.** The carrying amount of accrued interest approximates its fair value.

**Deposit Liabilities.** The fair values disclosed for demand, NOW, money-market and savings deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). Fair values for fixed-rate time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on time deposits to a schedule of aggregated expected monthly maturities of time deposits.

**Federal Home Loan Bank Advances and Junior Subordinated Debenture.** Fair values of Federal Home Loan Bank advances and junior subordinated debenture are estimated using discounted cash flow analysis based on the Company's current incremental borrowing rates for similar types of borrowings.

**Off-Balance-Sheet Financial Instruments.** Fair values for off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

**Comprehensive Loss.** GAAP generally requires that recognized revenue, expenses, gains and losses be included in net loss. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the consolidated balance sheets, such items along with net loss, are components of comprehensive loss. The only component of other comprehensive loss is the net change in the unrealized loss on the securities available for sale.

**Recent Pronouncements.** In January 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-01, *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*, which limits the scope of the new balance sheet offsetting disclosures in ASU 2011-11 to derivatives, repurchase agreements, and securities lending transactions to the extent that they are (1) offset in the financial statements or (2) subject to an enforceable master netting arrangement or similar agreement. The adoption of this guidance had no effect on the Company’s consolidated financial statements.

(continued)

OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

**Notes to Consolidated Financial Statements, Continued**

**(1) Summary of Significant Accounting Policies, Continued**

**Recent Pronouncements, Continued.** In February 2013, the FASB Issued ASU No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, which requires entities to present information about reclassification adjustments from accumulated other comprehensive (loss) income in their annual financial statements in a single note or on the face of the financial statements. This guidance is effective prospectively January 1, 2014. Upon adoption, this guidance is not expected to impact the Company's consolidated financial statements.

In February 2013, the FASB Issued ASU No. 2013-04, *Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date*. ASU 2013-04 provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for obligations within the scope of this ASU, which is effective January 1, 2014. Upon adoption, this guidance is not expected to impact the Company's consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-10, *Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes*. ASU No. 2013-10 permits the use of the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge account purposes. The amendment is effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The adoption of this guidance had no effect on the Company's consolidated financial statements.

In July 2013, the FASB issued ASU 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*, which among other things, requires an unrecognized tax benefit, or a portion of an unrecognized tax benefit, to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as denoted within the ASU. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Upon adoption, this guidance is not expected to impact the Company's consolidated financial statements.

(continued)





## OPTIMUMBANK HOLDINGS, INC. AND SUBSIDIARY

**Notes to Consolidated Financial Statements, Continued****(1) Summary of Significant Accounting Policies, Continued***Recent Regulatory Developments*

**Basel III Rules.** On July 2, 2013, the Federal Reserve Board (“FRB”) approved the final rules implementing the Basel Committee on Banking Supervision’s capital guidelines for U.S. banks. Under the final rules, minimum requirements will increase for both the quantity and quality of capital held by the Bank. The rules include a new common equity Tier 1 capital to risk-weighted assets ratio of 4.5% and a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. The final rules also raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% and require a minimum leverage ratio of 4.0%. The final rules also implement strict eligibility criteria for regulatory capital instruments. On July 9, 2013, the FDIC also approved, as an interim final rule, the regulatory capital requirements for U.S. banks, following the actions of the FRB. The FDIC’s rule is identical in substance to the final rules issued by the FRB.

The phase-in period for the final rules will begin for the Bank on January 1, 2015, with full compliance with all of the final rule’s requirements phased in over a multi-year schedule. The Company is currently evaluating the provisions of the final rules and their expected impact on the Bank and potential impact on the Holding Company.

**(2) Securities**

Securities have been classified according to management’s intent. The carrying amount of securities and approximate fair values are as follows (in thousands):

	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
<b>At December 31, 2013:</b>				
<b>Securities Available for Sale</b>				
Mortgage-backed securities	\$ 10,425	\$ 269	\$ (69 )	\$ 10,625
U.S. Government and agency securities	12,561	37	(233 )	12,365

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Total	\$ 22,986	\$ 306	\$ (302 )	\$ 22,990		
<b>At December 31, 2012:</b>						
<b>Securities Available for Sale-</b>						
Mortgage-backed securities	\$ 15,425	\$ 283	\$ (79 )	\$ 15,629		
U.S. Government and agency securities	2,997	22	0	3,019		
Total	\$ 18,422	\$ 305	\$ (79 )	\$ 18,648.7	12.2	5.9
Other income (expense), net	1.0	2.5	(0.1 )	0.2	(1.8)	
Income before income taxes	16.0	14.3	4.6	12.4	4.1	
Income tax provision	(1.5 )	(2.7 )	(0.3 )	(1.0 )	(0.8)	
Net income	14.5	11.6	4.3	11.4	3.3	
Net (income) loss attributable to noncontrolling interests	(5.0 )	(3.4 )	(0.7 )	(3.8 )	(1.0)	
Net income attributable to Photonics, Inc. shareholders	9.5	% 8.2	% 3.6	% 7.6	% 2.3	%

Note: All of the following tabular comparisons, unless otherwise indicated, are for the three months ended July 29, 2018 (Q3 FY18), April 29, 2018 (Q2 FY18) and July 30, 2017 (Q3 FY17) and for the nine months ended July 29, 2018 (YTD FY18) and July 30, 2017 (YTD FY17), in millions of dollars.

Index

## Revenue

The following tables present revenue changes by product type and technology level:

	Q3 FY18 Compared with Q2 FY18			Q3 FY18 Compared with Q3 FY17			YTD FY18 Compared with YTD FY17		
	Revenue in Q3 FY18	Percent Change	Increase (Decrease)	Percent Change	Increase (Decrease)	Revenue in YTD FY18	Percent Change	Increase (Decrease)	
<u>IC</u>									
High-end	\$ 46.1	11.2 %	\$ 4.6	94.2 %	\$ 22.4	\$ 120.9	76.3 %	\$ 52.3	
Mainstream	61.2	0.6 %	0.4	(0.4 )%	(0.3 )	184.3	(0.7 )%	(1.3 )	
Total IC	\$ 107.3	4.9 %	\$ 5.0	25.9 %	\$ 22.1	\$ 305.2	20.1 %	\$ 51.0	
<u>FPD</u>									
High-end	\$ 17.0	(6.4 )%	\$ (1.2 )	1.8 %	\$ 0.3	\$ 54.1	6.5 %	\$ 3.3	
Mainstream	12.1	17.4 %	1.8	24.9 %	2.4	31.3	26.7 %	6.6	
Total FPD	\$ 29.1	2.2 %	\$ 0.6	10.3 %	\$ 2.7	\$ 85.4	13.1 %	\$ 9.9	
Total Revenue	\$ 136.4	4.3 %	\$ 5.6	22.2 %	\$ 24.8	\$ 390.6	18.5 %	\$ 60.9	

In the first quarter of fiscal 2018, we changed the threshold for the definition of high-end IC, from 45 nanometer or smaller to 28 nanometer or smaller, to reflect the overall advancement of technology in the semiconductor industry. All comparisons to prior period results in this MD&A reflect this modification. Our definition of high-end FPD products remains as G8 and above and active matrix organic light-emitting diode (AMOLED) display screens. High-end photomasks typically have higher ASPs (“average selling prices”) than mainstream products.

Our quarterly revenues can be affected by the seasonal purchasing tendencies of our customers. As a result, demand for our products is typically negatively impacted during the first, and sometimes the second, quarters of our fiscal year by the North American, European, and Asian holiday periods, as some of our customers reduce their development and/or their buying activities during those periods.

The following tables compare revenue in Q3 FY18 with revenue in Q2 FY18 and Q2 FY17, and revenue YTD FY18 with YTD FY17 by geographic area:

	Q3 FY18 with Q2 FY18			Q3 FY18 with Q3 FY17			YTD FY18 with YTD FY17		
	Revenue in Q3 FY18	Percent Change	Increase (Decrease)	Percent Change	Increase (Decrease)	Revenue in YTD FY18	Percent Change	Increase (Decrease)	
Taiwan	\$ 62.1	10.8 %	\$ 6.0	41.1 %	\$ 18.1	\$ 174.7	31.6 %	\$ 42.0	
Korea	37.2	3.1 %	1.1	16.3 %	5.2	106.3	14.1 %	13.1	
United States	27.7	(5.0 )%	(1.5 )	6.6 %	1.7	81.9	8.4 %	6.4	
Europe	8.6	(2.4 )%	(0.1 )	(4.2 )%	(0.4 )	25.8	(2.2 )%	(0.6 )	
Other	0.8	18.5 %	0.1	20.4 %	0.2	1.9	0.8 %	-	

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\$ 136.4    4.3    %    \$ 5.6            22.2    %    \$ 24.8            \$ 390.6    18.5    %    \$ 60.9

Revenue increased 4.3% in Q3 FY18 compared with Q2 FY18, as a result of high-end IC and mainstream FPD growth. High-end IC revenue increased 11.2% from Q2 FY18, due to growth in both logic and memory from healthy foundry and captive demand across Asia. We believe this trend will continue into Q4, and demand will keep revenues at least at current levels. FPD revenue increased 2.2% from Q2 FY18 due to increased demand from masks used for displays on mobile applications, specifically LTPS and AMOLED displays. We classify LTPS as mainstream due to the mask size, even though the circuit geometries are similar to AMOLED. Our LTPS revenues are on the rise because of recent widespread adoption of LTPS by smart phone manufacturers. LTPS currently offers most of the performance at one third the price of AMOLED, and as a result has gained significant market share. We believe that as the price gap between LTPS LCD and AMOLED narrows, LTPS equipped phones will eventually transition to AMOLED. Meanwhile, AMOLED for mobile also increased as that market grew and we began to ship product from our new P-800 mask writer in Korea, fortifying our technology leadership in this sector. Despite improved AMOLED revenue, high-end was down sequentially as we pivot away from G8.5 panels used for large-format TVs.

23

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Index

Revenue increased 22.2% in Q3 FY18 compared with Q3 FY17, primarily as a result of high-end IC growth nearly doubling from the prior year's quarter, as well as a significant increase in revenue from mainstream FPD products. Total IC revenue increased 25.9% from Q3 FY17, due to growth in both logic and memory, from the healthy foundry and captive demand across Asia. IC mainstream decreased 0.4%, as demand was slightly softer. FPD revenue increased 10.3% from Q3 FY17 due to better demand across our products and markets, particularly mobile displays.

Revenue increased 18.5% in YTD Q3 2018 compared with YTD Q3 2017, primarily as a result of high-end IC growth. High-end IC revenue increased 76.3% from YTD 2017, due to growth in both logic and memory from the healthy foundry and captive demand across Asia. IC mainstream decreased 0.7%, as demand was slightly softer. FPD revenue increased 13.1% due to better demand across our products and markets.

We believe there is potential for the favorable demand trend we have experienced throughout 2018 to continue through the fourth quarter, as we expect growth to continue across most of our high-end IC and mainstream markets. Our two China facilities are expected to begin production in the first half of 2019, and we anticipate that our sales and revenue will increase when they come online

## Gross Profit

	Three Months Ended			Q3 FY17	Percent Change	Nine Months Ended		
	Q3 FY18	Q2 FY18	Percent Change			YTD FY18	YTD FY17	Percent Change
Gross profit	\$35.6	\$ 32.8	8.5 %	\$ 21.7	63.9 %	\$96.1	\$ 64.9	48.1 %
Gross margin	26.1 %	25.1 %		19.5 %		24.6 %	19.7 %	

The increases in gross profit and gross margin in Q3 FY18 from Q2 FY18 were predominantly the result of increased revenue. A modest (2.9%) increase in cost of goods sold was primarily the result of increased material costs (including costs incurred from contracted manufacturers) associated with the increase in revenue.

Unit sales increases of high-end and mainstream IC and FPD products in Q3 FY18 increased gross profit and gross margin from the prior year's quarter, with increased volume of high-end IC products being the greatest contributor to the increase. Cost of goods sold increased 12.2%, primarily as a result of increased material costs (including costs incurred from contracted manufacturers) and increased compensation expenses that were the result of the increased sales volume.

Unit sales increases of high-end and mainstream IC products YTD FY18 increased gross profit and gross margin from YTD FY17. Cost of goods sold increased 11.2%, primarily as a result of increased material costs (including costs incurred from contracted manufacturers) and increased compensation expenses associated with the increased sales volume. As we operate in a high fixed cost environment, increases or decreases in our revenues and utilization generally positively or negatively impact our gross profit and gross margin.

## Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased by \$1.1 million, or 8.3%, to \$12.5 million in Q3 FY18, from \$13.6 million in Q2 FY18, primarily due to performance-related compensation expenses incurred in Q2 FY18 and decreased selling expenses. Selling, general and administrative expenses increased in Q3 FY18 by \$0.9 million, or 7.4%, from \$11.6 million in Q3 FY17, primarily as a result of increased freight expenses and increased travel expenses which primarily resulted from activities related to our expansion into China. On a year-to-date basis, selling, general and administrative expenses increased \$4.5 million, or 13.4%, to \$37.9 million from \$33.4 million. This

increase was primarily the result of: increased performance-related compensation costs, freight expenses, professional services fees, and travel expenses, most of which increased as a result of activities related to our expansion into China.

#### Research and Development

In the U.S., research and development expenses consist of development efforts related to high-end process technologies for 28nm and smaller IC nodes. In Asia, in addition to the focus on high-end IC technology nodes, G8 and above FPD and AMOLED applications are also under development.

Index

Research and development expense decreased \$1.2 million, or 30.5%, from Q2 FY18, primarily as a result of decreased expenditures and related activities in both the U.S. and Asia. Research and development decreased \$2.2 million, or 44.9% from Q3 FY17, primarily driven by decreased expenditures in the U.S., which was somewhat offset by increased expenditures in Korea, with the increase primarily relating to FPD products. On a year-to-date basis, research and development expense decreased \$1.4 million, or 12.0%, as increased expenditures in Korea somewhat offset decreased spending in the U.S. and Taiwan.

## Other Income (Expense), net

	Three Months Ended			Nine Months Ended	
	Q3			YTD	
	FY18	Q2 FY18	Q3 FY17	FY18	YTD FY17
Interest income and other income (expense), net	\$2.0	\$ 3.9	\$ 0.4	\$ 2.3	\$ (4.2 )
Interest expense	(0.6)	(0.6 )	(0.5 )	(1.7 )	(1.6 )
Other income (expense), net	\$1.4	\$ 3.3	\$ (0.1 )	\$ 0.6	\$ (5.8 )

Interest income and other income (expense), net decreased from Q2 FY18 by \$1.9 million primarily due to less favorable foreign currency exchange gains in Q3 FY18, in addition to gains of \$0.6 million recognized on the sale of certain assets in Q2 FY18. Foreign currency exchange gains in Q3 FY18 also contrasted with losses experienced in the prior year quarter, with a favorable net effect of \$1.3 million on this element.

On a year-to-date basis, interest income and other income (expense), net increased as a result of \$4.4 million of more favorable foreign currency exchange effect, Q3 FY18 gains on the sale of certain assets, and incentives of \$0.3 million we received related to construction of our new FPD facility in China.

## Income Tax Provision

	Three Months Ended			Nine Months Ended		
	Q3			YTD		
	FY18	Q2 FY18	Q3 FY17	FY18	YTD FY17	
Income tax provision	\$2.1	\$ 3.5	\$ 0.3	\$ 3.8	\$ 2.8	
Effective income tax rate	9.4%	18.8 %	6.5 %	7.8 %	20.7 %	

The effective income tax rate is sensitive to the jurisdictional mix of earnings, due, in part, to non-recognition of tax benefits on losses in jurisdictions with valuation allowances.

The effective income tax rate in Q3 FY18, compared with Q2 FY18, decreased primarily due to the Q3 FY18 nonrecurring tax benefits (\$0.9 million) related to a settlement with the tax authority in a non-U.S. jurisdiction and the expiration of the statute of limitations (\$1.1 million) in the same jurisdiction, and an increased benefit (\$1.1 million) from the tax holiday in Taiwan. The effective income tax rate increased in Q3 FY18, compared with Q3 FY17, primarily due to a lower percentage of income before taxes generated in jurisdictions where the Company incurs losses for tax purposes that, due to offsetting valuation allowances, did not result in the recognition of tax benefits. The increase was partially offset by the previously noted Q3 FY18 nonrecurring tax benefits related to the settlement with the tax authority, statute of limitations expiration, and increased tax holiday.

The effective income tax rate decreased in YTD FY18, compared with YTD FY17, primarily due to nonrecurring tax benefits (\$4.2 million) related to tax reform in the U.S. and Taiwan, increased nonrecurring tax benefits (\$0.5 million)



related to a settlement with the tax authority in a non-U.S. jurisdiction and the expiration of the statute of limitations (\$0.3 million) in the same jurisdiction, and an increased benefit (\$1.6 million) from the previously mentioned tax holiday in Taiwan, which were partially offset by a lower percentage of income before taxes generated in jurisdictions where the Company incurs losses for tax purposes that, due to valuation allowances, did not result in the recognition of tax benefits.

#### Net (Income) Loss Attributable to Noncontrolling Interests

Net income attributable to noncontrolling interests was \$6.8 million in Q3 FY18, an increase of \$2.3 million and an increase of \$6.0 million from Q2 FY18 and Q3 FY17, respectively. Year-to-date, noncontrolling interests' share increased \$11.9 million from YTD FY17. The changes from all comparative periods were due to changes in net income at our IC manufacturing facility in Taiwan, in which we hold a 50.01% ownership interest.

Index

## Liquidity and Capital Resources

Our working capital at the end of Q3 FY18 was \$346.1 million, compared with \$367.3 million at the end of fiscal year 2017. The decrease is primarily attributable to the reclassification of our \$57.5 million principal amount senior convertible notes as current status, which was somewhat offset by increased accounts receivable and inventory balances, reflecting the increased operations activity from the end of fiscal year 2017. Cash and cash equivalents increased in fiscal year 2018 by \$24.7 million from \$308.0 million at October 29, 2017. Net cash provided by operating activities was \$87.0 million in YTD FY18, compared with \$73.8 million in YTD FY17. Increased net income exceeded decreases resulting from changes in operating accounts. Increased accounts receivable balance resulting from increased revenue in fiscal year 2018 was the most significant contributor to the change. Noncash expenses did not change significantly from the prior year. Net cash used in investing activities was \$63.9 million in YTD FY18, an increase of \$19.5 million from the \$44.5 million used in YTD FY17. The increase was primarily attributable to increased capital expenditures of \$25.6 million principally related to our expansion into China; the increase attributable to higher capital expenditures was partially offset by cash of \$5.4 million used to acquire a business in YTD FY17 that was not repeated in YTD FY18. Net cash flows from financing activities increased from funds used of \$9.9 million in YTD FY17 to \$2.7 million provided in YTD FY18, primarily due to the receipt of \$18.0 million from a noncontrolling interest for their investment in our recently established joint venture in China and increased proceeds received from share-based arrangements, partially offset by the payment of a dividend to the noncontrolling interest of our IC facility in Taiwan of \$8.2 million and \$6.8 million used to acquire our common stock under a share repurchase program.

As of July 29, 2018 and October 29, 2017, total cash and cash equivalents included \$204 million and \$190.0 million, respectively, held by our foreign subsidiaries.

Our credit facility, which expires in December 2018, has a \$50 million limit with an expansion capacity to \$75 million, and is secured by substantially all of our assets located in the United States and common stock we own in certain of our foreign subsidiaries. The credit facility stipulates that we may not pay cash dividends on Photronics, Inc. stock, and contains the following financial covenants: minimum interest coverage ratio, total leverage ratio and minimum unrestricted cash balance, all of which we were in compliance with at July 29, 2018. We had no outstanding borrowings against the credit facility at July 29, 2018, and \$50 million was available for borrowing. The interest rate on the credit facility (3.59% at July 29, 2018) is based on our total leverage ratio at LIBOR plus a spread, as defined in the credit facility. In April 2018, our credit facility was amended to change the definition of "Specified Capital Expenditures", which is used to calculate the interest coverage ratio, and in August 2018 the credit facility was amended to allow the Company to sell, transfer, lease or otherwise dispose of its assets to a Subsidiary Guarantor.

As of July 29, 2018, we had capital commitments outstanding of approximately \$181 million, nearly all of which related to building and equipping of our China facilities (discussed below). We intend to finance our capital expenditures with our working capital, cash generated from operations, and, if necessary, additional borrowings. We have entered into a joint venture that is constructing an IC facility in China with an estimated total investment of \$160 million. Our remaining funding commitment for the joint venture is approximately \$62 million which we will fulfill over the next several quarters. We have also commenced construction of an FPD facility in China, in which, to date, we have invested \$26 million, and will invest an additional \$134 million over the next several years. We believe that our cash on hand, cash generated from operations and amounts available to borrow will be sufficient to meet our cash requirements for the next twelve months. We regularly review the availability and terms at which we might issue additional equity or debt securities in the public or private markets. However, we cannot assure that additional sources of financing would be available to us on commercially favorable terms, should our capital requirements exceed our existing cash, cash generated by operations, and cash available under our credit facility.

Our liquidity, as we operate in a high fixed cost environment, is highly dependent on our revenue, cash conversion cycle, and the timing of our capital expenditures (which can vary significantly from period to period). Depending on

conditions in the semiconductor and FPD markets, our cash flows from operations and current holdings of cash may not be adequate to meet our current and long-term needs for capital expenditures, operations and debt repayments. Historically, in certain years, we have used external financing to fund these needs. Due to conditions in the credit markets and covenant restrictions on our existing debt, some financing instruments we have used in the past may not be available to us when required. Consequently, we cannot assure that additional sources of financing would be available to us on commercially favorable terms, should our long-term cash requirements exceed our existing cash and cash available under our credit facility.

## Index

### Off-Balance Sheet Arrangements

In January 2018, Photronics, through its wholly-owned Singapore subsidiary, and DNP, through its wholly-owned subsidiary, “DNP Asia Pacific PTE, Ltd.” entered into a joint venture under which DNP obtained a 49.99% interest in our IC business in Xiamen, China. The joint venture, known as “Photronics DNP Mask Corporation Xiamen” (“PDMCX”), was established to develop and manufacture photomasks for leading edge and advanced generation semiconductors. Under the Joint Venture Operating Agreement of Photronics DNP Mask Corporation Xiamen (“the Agreement”), DNP is afforded, under certain circumstances, the right to put its interest in PDMCX to Photronics. These circumstances include disputes regarding the strategic direction of PDMCX that arise after the initial two year term of the Agreement that cannot be resolved between the two parties. In addition, both Photronics and DNP have the option to purchase, or put, their interest from, or to, the other party, should their ownership interest fall below 20% for a period of more than six consecutive months. Under all such circumstances, the sales of ownership interests would be at the exiting party’s ownership percentage of the joint venture’s net book value, with closing to take place within three business days of obtaining required approvals and clearance. Should DNP exercise an option to put their, or purchase our, interest in PDMCX we may, depending on the relationship of the fair and book value of the net assets of PDMCX, incur a loss. As of July 29, 2018, Photronics and DNP each had net investments in PDMCX of \$16.1 million.

We lease certain office facilities and equipment under operating leases that may require us to pay taxes, insurance and maintenance expenses related to the properties. Certain of these leases contain renewal or purchase options exercisable at the end of the lease terms.

### Business Outlook

A majority of our revenue growth is expected to continue to come from the Asian region, predominantly in China. In response to this expectation, we have entered into a joint venture that will complete the construction of an IC research and development and manufacturing facility in Xiamen, China, in late 2018. Production is anticipated to begin at this facility during the first half of 2019. In addition, in August 2017, we entered into an investment agreement to construct an FPD manufacturing facility in Hefei, China. Construction of this facility commenced in Q1 FY18, and production there is anticipated to begin during the first half of 2019.

We continue to assess our global manufacturing strategy and monitor our revenue and related cash flows from operations. This ongoing assessment could result in future facility closures, asset redeployments, impairments of intangible or long-lived assets, workforce reductions, or the addition of increased manufacturing facilities, all of which would be based on market conditions and customer requirements.

Our future results of operations and the other forward-looking statements contained in this filing involve a number of risks and uncertainties. While various risks and uncertainties were discussed in Part 1, Item 1A in our Annual Report on Form 10-K for the year ended October 29, 2017, a number of other unforeseen factors could cause actual results to differ materially from our expectations.

### Effect of Recent Accounting Pronouncements

See “Item 1. Condensed Consolidated Financial Statements – Notes to Condensed Consolidated Financial Statements – Note 13 – Recent Accounting Pronouncements” for recent accounting pronouncements that may affect the Company’s financial reporting.

## Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Foreign Currency Exchange Rate Risk

We conduct business in several major international currencies throughout our worldwide operations, and our financial performance may be affected by fluctuations in the exchange rates of these currencies. Changes in exchange rates can positively or negatively affect our reported revenue, operating income, assets, liabilities, and equity. The functional currencies of our Asian subsidiaries are the South Korean won, the New Taiwan dollar, the Chinese renminbi and the Singapore dollar. The functional currencies of our European subsidiaries are the British pound and the euro. In addition, we have transactions and balances in Japanese yen.

We attempt to minimize our risk of foreign currency transaction losses by producing products in the same country in which the products are sold (thereby generating revenues and incurring expenses in the same currency), and by managing our working capital. However, in some instances, we sell and collect for products in a currency other than the functional currency of the country where the products are produced, or purchase products in a currency that differs from the functional currency of the purchasing entity. For example, we are currently shipping a significant quantity of photomasks into China, while our China facilities are under construction. There can be no assurance that this approach will protect us from the need to recognize significant foreign currency transaction gains and losses, especially in the event of a significant adverse movement in the value of any foreign currency in which we conduct business against any of our functional currencies, including the U.S. dollar.

Index

As of July 29, 2018, a 10% adverse movement in the value of currencies different than the functional currencies of our subsidiaries would have resulted in a net unrealized pre-tax loss of \$6.0 million, which represents a decrease of \$1.1 million from April 29, 2018. The decrease is primarily the result of decreased exposures of the U.S. dollar to the New Taiwan dollar, which was somewhat offset by increased exposures of the U.S. dollar to the South Korean won. As of July 29, 2018, the same adverse movement would represent a decrease of \$6.9 million from October 29, 2017, which is primarily the result of decreased U.S. dollar and Japanese yen denominated exposures in Taiwan, and decreased exposure to U.S. dollar denominated exposures in China.

Interest Rate Risk

At July 29, 2018, we did not have any variable rate borrowings. A 10% change in interest rates would not have had a material effect on our consolidated financial position, results of operations, or cash flows in the three month or nine month periods ended July 29, 2018.

Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We have established and currently maintain disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), designed to provide reasonable assurance that information required to be disclosed in its reports filed under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Our management, under the supervision and with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective at a reasonable assurance level as of the end of the period covered by this report.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting during the third quarter of fiscal year 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Index

## PART II. OTHER INFORMATION

## Item 1A. RISK FACTORS

The General Data Protection Regulation (GDPR), which went into effect in the European Union (EU) on May 25, 2018, applies to the collection, use, retention, security, processing, and transfer of personally identifiable information of residents of EU countries. The GDPR created a range of new compliance obligations, and imposes significant fines and sanctions for violations. It is possible that the GDPR may be interpreted or applied in a manner that is adverse to us, unforeseen by us, or otherwise inconsistent with our practices; or that we may otherwise fail to construe its requirements in ways that are satisfactory to the EU authorities.

Any failure or perceived failure by us to comply with the GDPR, or with any applicable regulatory requirements or orders, including but not limited to privacy, data protection, information security, or consumer protection-related privacy laws and regulations, in one or more jurisdictions within the EU or elsewhere, could: result in proceedings or actions against us by governmental entities or individuals; subject us to significant fines, penalties, and/or judgments; require us to change our business practices; limit access to our products and services in certain countries, or otherwise adversely affect our business, as we would be at risk to lose both customers and revenue, and incur substantial costs.

There have been no other material changes to risks relating to our business as disclosed in Part 1, Item 1A of our Form 10-K for the year ended October 29, 2017.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

## Issuer Purchases of Equity Securities

In July 2018, the Company's Board of Directors authorized the repurchase of up to \$20 million of its common stock, to be effectuated in open-market transactions or in accordance with a repurchase plan under rule 10b5-1 of the Securities Act of 1933 (as amended). The share repurchase program commenced on July 10, 2018, and will expire no later than July 7, 2019. As of July 29, 2018, we had repurchased 0.8 million shares at a cost of \$6.8 million (or \$8.72 per share), \$0.9 million of which was pending settlement at that date. The table below presents activity under this share repurchase program.

<u>Period</u>	Total Number of Shares Purchased (in millions)	Average Price Paid Per share	Total Number of Shares Purchased as Part of Publicly Announced Program	Dollar Value of Shares That May Yet Be Purchased (in millions)
July 10, 2018 – July 29, 2018	0.8	\$ 8.72	0.8	\$ 13.2

Index

Item 6. EXHIBITS

(a) Exhibits

Exhibit

Number Description

10.37 Amendment No.4 dated as of August 17, 2018 to the Third Amended and Restated Credit Agreement dated as of December 5, 2013.

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Photronics, Inc.  
(Registrant)

By: /s/ JOHN P. JORDAN  
JOHN P. JORDAN  
Senior Vice President  
Chief Financial Officer  
(Principal Accounting Officer/  
Principal Financial Officer)

Date: September 6, 2018



