FINAL TRANSCRIPT

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FBC - Q3 2011 Flagstar Bancorp, Inc. Earnings Conference Call

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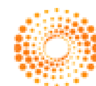

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CORPORATE PARTICIPANTS

Paul Borja
Flagstar Bancorp, Inc. - EVP and CFO

Joseph Campanelli
Flagstar Bancorp, Inc. - CEO

Matt Kerin
Flagstar Bancorp, Inc. - EVP

CONFERENCE CALL PARTICIPANTS

Jade Rahmani
Keefe, Bruyette & Woods - Analyst

Mark Steinberg
Dawson James Securities - Analyst

Julie Merge
Canaccord Genuity - Analyst

John Lux
IMS - Analyst

PRESENTATION

Operator

Good morning. My name is Tracey and I will be your conference operator today. At this time, I would like to welcome everyone to the third-quarter 2011 earnings conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator instructions).

Thank you. I would now like to turn the call over to Paul Borja, Chief Financial Officer. Please go ahead.

Paul Borja - *Flagstar Bancorp, Inc. - EVP and CFO*

Thank you. Good morning, everyone. I'd like to welcome you to our third-quarter 2011 earnings call. My name is Paul Borgia and I'm the Chief Financial Officer of Flagstar Bancorp.

Before we begin our comments, I'd like to remind you that the presentation today may contain forward-looking statements regarding both our financial condition and our financial results. These statements involve certain risks that may cause actual results in the future to be different from our current expectations. These factors include, among other things, changes in economic conditions; changes in interest rates; competitive pressures within the financial services industry; and legislative or regulatory developments or requirements that may affect our businesses.

For additional factors, we urge you to review the press release we issued last night; our SEC documents, such as our most recently filed 10-K and 10-Q; as well as the legal disclaimer on page two of our earnings call slides that we have posted this morning on our Investor Relations page at Flagstar.com.

With that, I'd like to now turn the call over to Joseph Campanelli, our Chairman and Chief Executive Officer.

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Joseph Campanelli - *Flagstar Bancorp, Inc. - CEO*

Thank you, Paul, and good morning, everyone. I'd also like to welcome you to our 2011 third-quarter earnings call. Last night, we reported a net loss to common shareholders of $14.2 million or $0.03 a share. That was a significant improvement of our second-quarter of 2010 results, and clearly marks progress on our path to sustainable profitability. We were well-positioned during the third quarter to capitalize on a robust banking business in an attractive interest rate environment, which were offset by the credit costs emanating from our legacy businesses.

This morning, I'd like to begin by providing you with some color on those credit costs, where we see them going over the next several quarters, and what steps we have taken to mitigate ongoing losses on our legacy portfolio, and why we are confident we have enough capital to execute our strategy and return the Company to sustainable profitability. Then I'll discuss the key financial highlights of our financial performance during the quarter before turning the presentation over to Paul, for a more detailed and in-depth financial review. Paul and I, along with the rest of the executive team, will then be available to answer any questions you may have.

In total, credit costs for the third quarter were $111 million -- excuse me, $111.7 million, relatively flat from prior quarter. Virtually all of those costs relate to loans originated prior to 2009. We have spent a great deal of focus and attention on putting those costs behind us while growing and diversifying our core revenue streams. In fact, excluding credit costs before taxes, we earned $102.5 million for the third quarter, which was the largest quarterly amount since the fourth quarter of 2009. Year-to-date, we have generated $206 million before taxes and credit costs.

Our third-quarter loan loss provision improved to $36.7 million as compared to $48.4 million the prior quarter. The improvement was primarily attributable to a lower provision related to our residential first mortgage portfolio, which has been in runoff since 2008. The decrease in residential provision reflected an improvement in historical loss rates in our allowance model. This improvement was consistent with the slowing pace of increase in our 90-plus day delinquent residential portfolio. The 90-plus day delinquent residential mortgages increased $341 million in the third quarter 2011 as compared to $286 million on a linked-quarter basis.

There are three points I'd like to make with respect to the residential portfolio. First, we sold virtually our entire non-performing residential mortgage portfolio in the fourth quarter of 2010. At that time, we essentially started over from a migration standpoint. One of the impacts in the sale was that it eliminated those loans that would have otherwise migrated through to foreclosure in the normal course. Now, nearly 12 months later, we are beginning to see nonperforming residential mortgages migrate out of the 90-day bucket at a meaningful rate.

Second, the pace of increase in our 90-plus day delinquent residential first mortgages has been slowing since March 2011. From December to March, given the low starting level of 90-plus day mortgages, following nonperforming loans sale in the fourth quarter of 2010, we saw a 66% increase in 90-plus residential first mortgages, which declined to 44% from March to June, and then in 19% from June to September. Within the third quarter, the pace of increase slowed from 10% in July to 5% in August, and 3.5% in September. You can see a graphical illustration of this trend on slide 17 -- excuse me, slide 15 of our earnings deck.

Third, our 30- and 60-day delinquent residential first mortgage levels have remained flat since June, indicating a lower level of inflows into those respective buckets. Looking at all the factors, we expect a 90-plus-delinquent residential mortgages to abate by mid-2012. We also believe that recently implemented initiatives will accelerate the resolution rate and improve the overall delinquency profile.

During the third quarter, in addition to converting to state-of-the-art mortgage servicing platform, we continue the restructuring of our residential loss mitigation default servicing areas. We implemented a number of meaningful process changes, and added a significant investment in staff, which we are confident will have a meaningful impact in reducing credit costs in future quarters.

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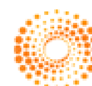

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Turning to the legacy commercial real estate portfolio, we have now experienced a decline in the commercial real estate-related provision for four straight quarters, as we continue to aggressively write-down and work out that portfolio. Our balance of these legacy loans at September 30, 2011 was roughly $1.3 billion, down significantly from a high point of $1.8 billion at the end of December 2008.

We also sold $15.4 million in commercial real estate and nonperforming assets during the quarter for a small gain, which reaffirms our mark on the portfolio. We expect to see continued improvements in a runoff of this portfolio, given the seasoned nature in the experienced team overseeing its resolution.

Secondary marketing reserve provision for the third-quarter 2011 increased to $39 million as compared to $21.4 million in the prior quarter. We increased our quarter-end reserve to $85 million. As others in the mortgage industry reported this quarter, the GSEs continued to be more aggressive in the number of loan files reviewed, in their interpretation of representation and warranty claims. These claims continue to be focused on pre-2009 residential first mortgage loan originations, as originations in 2009, '10 and '11 have had virtually no repurchase activity, which is directly attributable to increasingly robust underwriting guidelines.

We've been underwriting loans with a clean performance record for 11 straight quarters. Slide 16 provides a breakout of the agency repurchase demands by quarter.

Asset resolution expense for the third quarter 2011 was $34.5 million as compared to $23.3 million in the second quarter of 2011. The increase was driven by higher expenses related to legacy residential first mortgage and Ginnie Mae repurchase portfolios. Asset resolution expense for residential first mortgages was $9.2 million in the third quarter, up from $5.7 million in the second quarter, reflecting a continued weak housing market, and extended foreclosure and resolution timelines.

Asset resolution expense related to the Ginnie Mae portfolio was $22.8 million in the third quarter 2011, as compared to $12.8 million in the second quarter of 2011. The linked-quarter increase was primarily driven by a higher level of one-time, non-reimbursable expenses associated with the older loans coming through the pipeline to claims process. We believe we are now seeing the worst of the curtailment expenses come through. As previously mentioned, we have completely restructured our servicing platform, including new systems, enhanced leadership, and implementation of accelerated loss mitigation strategies. Additionally, we've established a dedicated team to service early-stage Ginnie Mae delinquencies, which we are confident will lead to a significant reduction in asset resolution expenses.

Turning to the mortgage origination business, our leading-edge mortgage platform and positioning in the mortgage space allowed us to take advantage of low rates and in the uptick in refinance volume. As some competitors are reassessing their commitment through the correspondent channel, and with the recent HARP announcement, we believe we have an opportunity to continue to maintain or gain market share, which will allow us to continue to generate solid mortgage banking revenues over the coming quarters.

Gain on loan sale income was $103.9 million with a margin of 153 basis points for the third quarter of 2011, as compared to $39.8 million with a margin of 91 basis points for the second quarter of 2011. We originated $6.9 billion in residential mortgage originations during the quarter, and saw our residential lot commitments climb to 13.1 billion, a 105% increase quarter-over-quarter.

While the refinance activity is expected to moderate from near-record levels, the outlook for continued low rates to 2013, and a continued strong pullthrough of our inventory of locked applications, leads us to believe there will be -- continue to be a healthy mortgage origination market, through at least the first quarter of 2012. Further, it's too soon to tell the overall impact of the recently announced enhancements to the President's Home Affordable Refinance Program, or HARP.

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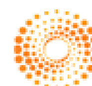

Early details of the program suggest it could be a significant catalyst for extended high levels of refinance activity. We believe our extensive origination network and demonstrated success during refinance waves leaves us well-positioned for any improvement or increase in the housing finance market.

We have also been originating jumbo mortgages on a selective basis. Year-to-date, we have originated approximately $194 million of jumbo mortgages, the majority of which we hold on our balance sheet. We continue to see jumbos as a promising opportunity to build a portfolio with attractive credit and profit fundamentals. These jumbo mortgages are high quality, well underwritten assets, with average FICO scores of 768 and average loan-to-value ratios of 66%.

Third-quarter bank net interest margin was 2.30, a 24% improvement from the prior quarter. The improvement was the result of continued meaningful loan growth, as well as an increase in the average yield on interest earning assets and a decrease in our funding costs. Our strong mortgage business, together with our mortgage warehouse business, and the success of our commercial banking efforts, contributed to a 3.4% quarterly increase in average interest earning assets. Additionally, our mortgage warehouse lending group continued to deepen its relationships with existing clients, and selectively added new customers, largely to feed our residential mortgage origination business.

The strategies to accelerate the run-off of our legacy assets and liabilities, and replace them with higher quality, more profitable ones, is gaining momentum. The average yield on interest earning assets increased to 4.09% during the third quarter, up from 3.82% in the second quarter.

If I could point you to slide seven, you could see our overall cost of funds declined to 2.09 in the third quarter of 2011 from 2.21 in the second quarter. Behind this result was a 13 basis point reduction in the cost of deposits, as we continue to replace maturing high cost certificates of deposit with lower cost core deposits. Retail core deposits rose to $2.5 billion and have increased for seven consecutive quarters.

Efforts to attract new customers and cross-sell existing customers are progressing well. We anticipate continued growth in the deposit side of our retail stores, as we continue to broaden our retail product offerings. Expanded features and functionality complement our best-in-class service levels, as recognized by our two consecutive J.D. Power awards.

While overall retail deposits were flat versus September 30, 2010, there was a significant improvement in deposit mix, leading to the improvement in cost of funds. Retail core deposits increased from the September 30, 2010 level by 34%, while retail certificates of deposits fell by 17%. This trend led to approximately a 60% improvement in our overall cost of funds from the third quarter of 2010.

We also refinanced $1 billion of long-term FHLB advances towards the end of the third quarter in 2011, extending their maturities beyond 2013, and reducing our funding costs and those borrowings by 41 basis points. We expect that this will save approximately $14.1 million in interest expense annually, beginning in the fourth quarter of 2011.

Looking at commercial banking, we continue to execute on the strategy we laid out early in 2011. Results so far have met or exceeded our expectations. During the recent quarter of 2011, we generated over $300 million in new core commercial loans, consisting of new commercial real estate of $178 million, which is predominantly to multifamily properties; and commercial and industrial loans of approximately $140 million. Additionally, we have developed our commercial lease financing portfolio, which had a balance of approximately $43 million at the end of September 30, 2011.

We are now well-staffed and fully operational, including our specialty lending group, in both New England and Michigan markets, with a seasoned management team, and experienced relationship and group managers. Commercial and specialty lending loans originated to date are well-balanced between our New England and Michigan markets.

The current pipeline continues to build nicely as anticipated, with new commercial relationships that utilize many of our noncredit fee-based products and services. New England and Michigan markets are ones that we know and understand well, and the

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associated revenues will contribute to a less volatile operating model, and helps us move along our path to profitability. Over the past two years, we have invested heavily in our risk management and compliance infrastructure, balancing our market approach with disciplined underwriting and pricing.

Turning to retail banking, if I can point you to slide 20, it shows our branch footprint in Michigan. As you can see, we have a significant presence in Southeast Michigan and a smaller presence in the western part of the state, particularly in growth areas such as Grand Rapids. We have 113 branches in Michigan and are ranked number six in total deposits, with approximately 4.43% of the market share, which evidences significant opportunity to continue to grow business levels. We feel our continued increase in core deposits is a strong indicator of the healthy customer relationships upon which we have built further business and drive higher levels of profitability.

It's typical of economic recoveries to be somewhat earlier and stronger for Michigan than for other regions of the country. That currently appears to be happening based on the information reported by the Michigan Department of Technology, Management and Budget. As we had previously announced, during the third quarter, we had entered into agreements to divest our retail franchises in Georgia and in Indiana. We made the strategic decision to focus our energy and capital on our Michigan market, where we have the most density, our best brand awareness, and the opportunity to generate the highest returns. We remain committed to the Michigan market and to our status as the largest bank headquartered in the state.

Before I turn the presentation over to Paul, I'd like to comment on capital liquidity. We closed the quarter with continued strong capital levels, with a Tier 1 ratio of 9.3% and a total risk-based capital ratio of 17.64. We have undertaken a number of stress tests on our capital levels, both at the bank and on a consolidated holding company basis, and are comfortable with our capital position. We continue to reallocate capital within the balance sheet, to support our transformation away from our legacy balance sheet to a super-community banking model. We also ended the third quarter with cash and cash equivalents equal to 6.6% of total assets, not including our marketable securities.

Before I ask Paul to take us through the details of the financial results, I'd like to emphasize a couple points. First, as I've outlined in my comments, we continue to be aggressive in putting our legacy credit costs behind us. Second, we have demonstrated the ability to generate significant earnings, and have a sound business model, and committed and experienced leadership team. We believe that these competencies will soon allow us to return to a stable level of profitability and generate long-term value for our shareholders.

After Paul's discussions, we'd be happy to answer any questions.

Paul Borja - *Flagstar Bancorp, Inc. - EVP and CFO*

Thank you, Joe. Good morning, everyone. As Joe mentioned, we lost $14.2 million during the third quarter, which was an 81% improvement in operating results from the second quarter. There were four key items we focused on during the quarter -- improving net interest margin; leveraging our mortgage banking business; reducing and mitigating credit costs; and controlling expenses. We expect to continue to focus on these items in the fourth quarter.

Our third-quarter 2011 bank net interest margin was 2.30%, up significantly from 1.86% in the second quarter. For the year, our bank net interest margin was 2.01%. The strength of our NIM was based upon the measured growth of our investment loan portfolio, as well as improvements in our funding costs, both in our deposit costs and FHLB advance costs.

During the fourth quarter, we expect to see a slight increase in our net interest margin and the level of average earning assets similar to that in the third quarter. While we expect to slightly lower volume of available for sale residential mortgage loans, we expect that this decline will be offset by new core commercial and industrial loans, and our established warehouse lending business. As a result, we do not expect any significant increase in overall yield and earning assets. However, we do expect to benefit from our continued focus on core deposit growth and from our September refinancing of our Federal Home Loan bank

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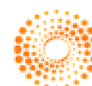

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debt. The refinancing is expected to reduce our interest expense by $14.1 million annually, as Joe mentioned, so it should reduce our fourth-quarter interest on that debt.

Assuming we're able to meet our lending goals for the fourth quarter, and mortgage volume industry-wide does not decline, that the level of nonperforming loans or troubled debt restructurings in our portfolio does not substantially increase, and that the current low interest rate environment remains stable, we would expect that our net interest income would increase by approximately 10% above that of the third quarter as a result in the fourth quarter.

Our mortgage business contributed a significant amount of revenue during the third quarter, due to the mortgage refinancing activity that began in earnest in August. This activity was prompted by the steep decline in mortgage rates to track the decline in the 10-year Treasury rate during the same period. With our seasoned mortgage banking structure and nationwide network, during the third quarter of 2011, we locked over $13 billion in mortgage loans and accounted for a gain on sale of 153 basis points.

With both the volume and margin increase, the gain on loan sale income increased over 2.5 times as compared to the second quarter to $103.9 million. For the fourth quarter, we do not expect the volume or margin to remain at the high levels experienced during the third quarter. However, we do expect that the refinance wave will continue through at least the end of the year, and we anticipate that gain on loans sale income for the fourth quarter to be closer to the midpoint of the range, between the gains realized in the second quarter and the third quarters of 2011.

Our estimate is based on a number of factors, including that there no significant increases or volatile movements in the current interest rate environment that could affect consumer demand or hedging costs; that the operating environment for mortgage banking activity does not significantly change; and that the expected trend in mortgage originations industry-wide for the fourth quarter does not decline. Please also note, as Joe mentioned, our estimate does not reflect any effect of the newly-announced HARP programs, as rules for that program are not even expected to be publicly released until mid-November. We hope to provide more guidance on our mortgage banking results later in the quarter after our review of those rules.

Our second biggest driver of mortgage banking revenue is our net servicing revenue, which is a combination of income we earned, servicing loans, and the net effect of the hedges on the mortgage servicing rights on our balance sheet. In total, our net loan administration income was $16.9 million for the third quarter, down from $30.5 million in the second quarter of 2011.

Our goal is to earn a 6% return on the value of that asset, and we have done a good job of that over the last eight quarters. We anticipate fourth-quarter 2011 net servicing revenue to be at or near the level of the third quarter. This assumption is predicated on the interplay between the 10-year treasury in mortgage rates, as well as the absence of significant volatility in the mortgage rates and interest rate curves.

Turning to our legacy credit costs, Joe covered these well in sufficient detail, so I'll not spend too much time on them. Loan loss provision expense decreased to $36.7 million in the third quarter 2011, consistent with the slowing pace of inflows of our over-90-day delinquent residential mortgage loans. We anticipate the pace of increase to continue to slow down, eventually abating on or before the first half of 2012.

Our assumptions do not take into account the process changes that Joe mentioned and which we are now putting in place. Early results of those efforts on stemming the growth of our over-90-day loans have been encouraging. However, we are still in a preliminary stage and would not expect to determine the sustainability of these results until later in the quarter.

Based on the trend we do see with the level of our over-90-day loans, we expect loan loss provision expense to continue to decline in the fourth quarter of 2011. This assumes that the trend of unemployment and housing prices remains unchanged, and thus a continuing decline in the trend of delinquencies. It also assumes that our historical loss rates, which we continually review for validity against current trends and historical experience, do not change significantly.

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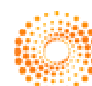

As Joe mentioned, secondary marketing reserve provision increased significantly from the prior-quarter level. As with many of our peers, the key component in assessing the potential expense arising from this area is the activity of the GSEs. Given the uncertainty and taking into account our historical losses, we increased our reserves during the third quarter. However, we will continue to evaluate our exposure in light of recent GSE activity.

Our asset resolution expense increased to $35 million. We anticipate the fourth-quarter level to remain close to its current third-quarter run rate. Both our estimates for provision, and our estimates for asset resolution expense, do not reflect the benefit of the improvements we anticipate getting on the restructure of our mortgage servicing area, as Joe discussed.

Lastly, non-interest expense, excluding asset resolution, was $116.2 million in third-quarter 2011 as compared to $107.6 million in the second quarter. The increase from the prior quarter was reflective of increased commissions and salaries associated with the uptick in our mortgage business. We anticipate fourth quarter of 2011's noninterest expense to remain flat for the third quarter. This assumes that the FDIC assessment rate remains unchanged and the mortgage volumes remain at elevated levels.

With that, I'll turn it back to Joe.

Joseph Campanelli - *Flagstar Bancorp, Inc. - CEO*

Okay, thank you, Paul. Tracey, why don't you open it up to questions and answers?

QUESTIONS AND ANSWERS

Operator

(Operator instructions). Bose George, KBW.

Jade Rahmani - *Keefe, Bruyette & Woods - Analyst*

This is Jade Rahmani from KBW on for Bose. A couple of questions. Have you seen any changes in behavior from the FHA in terms of reimbursing you for loans that they guarantee? And any signs of them curtailing payments?

Joseph Campanelli - *Flagstar Bancorp, Inc. - CEO*

No, I think that we had some older GSE repurchases at higher levels of curtailments that we've addressed through changing our servicing process. But to date, I'm not aware of any denial of a claim for any loans we put back to them. And it appears when you look at the flattening out of our GSE repurchase loans, the claims are being processed at a normal rate. We expect to see that position start to decline.

Jade Rahmani - *Keefe, Bruyette & Woods - Analyst*

Okay. And that's on the FHA?

Joseph Campanelli - *Flagstar Bancorp, Inc. - CEO*

Yes.

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Jade Rahmani - *Keefe, Bruyette & Woods - Analyst*

Okay. Secondly, the MBA refi index has slowed over the last couple of weeks. Wondering if that's consistent with trends you're seeing in the market right now?

Joseph Campanelli - *Flagstar Bancorp, Inc. - CEO*

Yes, I'll turn it -- before I ask Matt Kerin to give us his comments, because he's running our whole origination strategy, it's falling off of a record rate. I mean, obviously, August, September, October was pretty much of a surge in refinancing activity. And I'd say it's sort of moderated now from what was a fever pitch more down to just a robust level.

Matt Kerin - *Flagstar Bancorp, Inc. - EVP*

Yes, absolutely, Joe. This is Matt Kerin. We obviously had a very strong quarter, and the quarter began strong and got even stronger after Bernanke's announcement in [moving] the 10-year. As everybody got -- the demand really jump-started. People slowed up pretty quickly in terms of their production capability. And then as rates backed off a little bit and went from a -- probably around 2.15 to 1.70 for a few days, it was a big feeding frenzy, and then it backed off a little bit. But we have seen a pretty steady flow, and we believe there's a lot of demand at a 2.20 10-year. So we're optimistic for the future.

Jade Rahmani - *Keefe, Bruyette & Woods - Analyst*

Okay, and then finally on gain on sale margin trends, the full-quarter number relative to your mid-quarter update seems to imply improvement in August. How are -- can you comment on how those margins have been holding up so far this quarter?

Matt Kerin - *Flagstar Bancorp, Inc. - EVP*

This is Matt Kerin again. I guess what I would suggest to you is in a strong refinance market, the margin is holding up very nicely.

Joseph Campanelli - *Flagstar Bancorp, Inc. - CEO*

And I think Paul gave some guidance that we'd expect that a combination of volumes and our gain on sale execution to be somewhere between the midpoints of third and fourth -- second and third quarter.

Jade Rahmani - *Keefe, Bruyette & Woods - Analyst*

Okay. Thanks a lot.

Operator

Mark Steinberg, Dawson James.

Mark Steinberg - *Dawson James Securities - Analyst*

I had a question with regards to the New York Stock Exchange warning. And my question is, what immediate action is being taken now to keep the shares above $1.00?

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Joseph Campanelli - *Flagstar Bancorp, Inc. - CEO*

We're executing on our plan to return the Company to profitability. We're not engaged in trying to manipulate the price of our stock in the [Parker Place], obviously. It's (multiple speakers) --

Mark Steinberg - *Dawson James Securities - Analyst*

: No, no, no. I didn't mean to imply that, please don't take it that way. (multiple speakers) But my question is, is something like a reverse split on the table? What are you seeing?

Joseph Campanelli - *Flagstar Bancorp, Inc. - CEO*

Yes. We believe executing our plan to get to profitability will have the greatest impact on our market valuation. (multiple speakers) So the loss is moving to the -- when we start making money, I think the market will take care of our stock price.

Mark Steinberg - *Dawson James Securities - Analyst*

Okay. So may I assume at this point then that a reverse split is not on the table?

Joseph Campanelli - *Flagstar Bancorp, Inc. - CEO*

No, it's not on the table.

Mark Steinberg - *Dawson James Securities - Analyst*

Okay, thank you very much.

Operator

(Operator instructions). [Julie Merge, Canaccord].

Julie Merge - *Canaccord Genuity - Analyst*

I was wondering if there was any certain activity and if there was any stronger activity in certain states as far as loan originations that you're seeing?

Joseph Campanelli - *Flagstar Bancorp, Inc. - CEO*

I assume you're referring to the residential.

Julie Merge - *Canaccord Genuity - Analyst*

Yes, it is residential. I am in California which is why am curious.

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Matt Kerin - *Flagstar Bancorp, Inc. - EVP*

This is Matt Kerin. I think there is an exhibit in the presentation that speaks to the origination activity -- page 25 of the presentation where it shows our originations -- or the balances, I'm sorry. But I think that consistent with what you're reading from industry data, our originations are pretty much aligned with what the national origination percentages are.

You'll see California, which is obviously a very strong market; Florida, which is a strong market, largely off of the foreclosures that are going down there from a market valuation perspective.

Julie Merge - *Canaccord Genuity - Analyst*

Right, okay. All right. Yes, my parents just bought a foreclosure actually and you did their loan. And they were closed in three weeks and it was great.

Joseph Campanelli - *Flagstar Bancorp, Inc. - CEO*

(multiple speakers) Glad to hear they had a good experience -- that's what we try to do.

Julie Merge - *Canaccord Genuity - Analyst*

Yes, three weeks, it was done. So they're very happy. And thanks for answering my question.

Joseph Campanelli - *Flagstar Bancorp, Inc. - CEO*

My pleasure.

Operator

(Operator instructions). [John Lux, IMS].

John Lux - *IMS - Analyst*

Hello, I'm calling from Europe. I've seen your presentation and I've seen the previous ones also for a couple of quarters. I see that the Texas ratio on page four of the presentation non-performing assets were Tier 1 capital for (inaudible) has worsened a little bit from 34.5 to 38.5. And that's one thing.

And on the other hand, I read that you are planning to invest in BRIC for new branches. Could you comment on that -- is that somewhat too early, given the situation, given -- I see that the losses are diminishing, but we are still not in profits. So why estimate -- what are you thinking about investing in BRICs and how much do you reckon investing in those branches? Thank you.

Joseph Campanelli - *Flagstar Bancorp, Inc. - CEO*

I'm sorry, John. This is Joe Campanelli. There is no major strategy to go out and accelerate any type of de novo branch strategy. It's simply looking at the distribution channel we have in southeast Michigan, and looking for opportunities to reposition those as opportunities present themselves.

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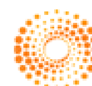

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It's a consistent with any type of retail strategy, as the leases mature; as demographic shifts occur, you move locations; you relocate branches or you add selectively in markets. where you feel you can get an accelerated return. That's really just going back to traditional retail banking strategies. It takes a long time to go through the entitlement process, site selection, all those types of things. So I wouldn't anticipate any large de novo or a branch expansion. It's more in the lines of looking for opportunities to round out the infrastructure we have.

You also have seen that we've really focused our investment in the greater Michigan marketplace, as we are contemplating or are looking forward to closing on the sale of our Indiana and Georgia branches. So hopefully, that addresses your concern about any type of major fixed asset investment in today's environment.

Paul Borja - *Flagstar Bancorp, Inc. - EVP and CFO*

If I could, this is Paul Borja -- on the Texas ratio question you asked, as you see, it's a function of nonperforming assets over our capital plus our internal reserves. Our nonperforming assets have increased, as we discussed earlier, with respect to the over-90-days. As those continue to season, we would expect the over-90's to abate in the near future, and therefore, our Tier 1 ratio -- or our Texas ratio to decline. Nonetheless, we believe that at below 50%, we have a rather strong Texas ratio and we're going to continue to make improvements in that area.

John Lux - *IMS - Analyst*

Okay.

Operator

(Operator instructions). [Jay Gohill, Market].

Unidentified Participant

Thanks for the call. I was just trying to understand, after the sale of the Indiana and Georgia branches, the realized profit, it's going to be realized in the Q4 earnings. So just trying to do some kind of math. So you have that as a gain and lower interest because of the refinancing that was happening, a lower SG&A. So is it fair enough to assume that the Company might return to profitability next quarter if the market's originations stays at the same level?

Joseph Campanelli - *Flagstar Bancorp, Inc. - CEO*

Yes, and Jay, you've heard me talk about really focusing on strategies that are consistent, sustainable. I think the reallocation of capital is a good move for the Company and a good move for shareholders, and result in a profitable quarter. But long-term, I think it's taking and implementing all the initiatives we talk about is really just going to be the catalyst for continued profitability as we move into 2012.

Unidentified Participant

Got it. And lastly on the TARP, since you have close to like $266 million under the TARP, we have preferred shares. So once you return to profitability, I believe you need to show about three to four quarters of profits in order to regain or like repay the TARP, and then gain the deferred tax assets?

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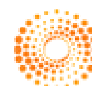

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Joseph Campanelli - *Flagstar Bancorp, Inc. - CEO*

Yes, they're somewhat separate in nature in the sense this is an accounting interpretation, it's not a bright line test. But clearly, you'd be looking at the sustainability of that profit curve and not relying on a one-time event. So, we would expect after several quarters of profitability that when you look at the reversal of the preferred tax asset allowance, was significantly larger than our liability or our preferred shares from TARP.

Paul, do you want to add?

Paul Borja - *Flagstar Bancorp, Inc. - EVP and CFO*

Sure. At September 30, our deferred tax asset was approximately $370 million. Our liability for the TARP preferred was about $267 million. After sustained profitability and discussion with our auditors, we would expect to reverse the preferred tax asset, thereby providing us with Tier 1 capital. And at that point, we'd have the opportunity to repay the TARP preferred, but not beforehand.

Unidentified Participant

Right, so is it fair enough to assume that both might occur at the same time and you might get a one-time gain of close to like $100 million?

Paul Borja - *Flagstar Bancorp, Inc. - EVP and CFO*

I think you would expect that they would happen in a series, I don't think you would expect them to happen on the same quarter. But it would be a serial kind of structure, because we would want to make sure that the preferred tax asset, as it is put back in, is not only accounted for capital from an accounting side, but also from a regulatory side. And there's certain regulatory rules that provide for a phasing in of that over a couple of quarters at least.

Unidentified Participant

Thanks. And sorry, finally, on the asset sale, is there anything else except Georgia and Indiana that you are looking forward in terms of selling?

Paul Borja - *Flagstar Bancorp, Inc. - EVP and CFO*

As far as our overall franchise network, I believe we're looking at Georgia and Indiana, and have indicated that we intend to focus on our core banking areas in Michigan as well as the emerging Northeast market.

Unidentified Participant

Great, thanks.

Operator

There are no further questions at this time.

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Joseph Campanelli - *Flagstar Bancorp, Inc. - CEO*

Okay, thank you, Trish, and thank you all for joining us this morning.

Operator

This concludes today's conference. You may now disconnect.

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