

OceanFirst Financial Corp. NasdaqGS:OCFC

Shareholder/Analyst Call

Wednesday, May 20, 2020 2:00 PM GMT

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Call Participants

EXECUTIVES

Christopher D. Maher
Chairman, President & CEO

Jill Apito Hewitt
Senior VP & Investor Relations Officer

**Matthew McCue; Vice President and
Assistant Corporate Secretary**

Steven J. Tsimbinos
*Executive VP, General Counsel &
Corporate Secretary*

ATTENDEES

Peter Friz; Inspector of Election

Unknown Attendee

Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the OceanFirst Financial Corp. Annual Meeting. At this time, I would like to turn the conference over to your speaker for today, Mr. Christopher Maher. Sir, you may begin.

Christopher D. Maher
Chairman, President & CEO

Thank you. Good morning, ladies and gentlemen. I'm Christopher Maher, Chairman of the Board, President and Chief Executive Officer of OceanFirst Financial Corp. It's my pleasure, on behalf of the Board of Directors and the officers of OceanFirst Financial Corp. and OceanFirst Bank to welcome you to our 2020 Annual Meeting of Stockholders.

In order to comply with state health guidance and executive orders and for the health and safety concerns related to COVID-19 pandemic, we are holding this annual meeting virtually for the first time in our company's history.

I would like to express our appreciation for your participation at this meeting, which I will chair. I look forward to seeing all of you again in person once the current pandemic has passed. A copy of the agenda and rules of conduct for today's meeting is available on the virtual meeting platform.

A press release issued on May 7, 2020, confirmed the company's plan to hold a virtual-only meeting. Broadridge Financial Solutions is the host of this meeting and will also tabulate the stockholder votes. As shown on the agenda, we will first conduct the formal business of this meeting. Then I will report on recent operations and developments at OceanFirst and share our view on the future of your company. Following that, we'll entertain the general question-and-answer session.

I'd like to introduce our fellow members of the Board of Directors who are participating in the virtual meeting remotely: Angelo Catania, Anthony Coscia, Michael Devlin, Jack Farris, John Lloyd, Kimberly Guadagno, Nicos Katsoulis. Bill Moss, former President and CEO of Two River Community Bank who was appointed to the Board in January following the acquisition of Two River; Joseph Murphy, Jr. former President and CEO of Country Bank who was also appointed to the Board in January following the acquisition of Country Bank; Steven Scopellite, former Chief -- Global Chief Information Officer at Goldman Sachs, who joined the Board in June; Grace Torres; Grace Vallacchi, the Chief Risk Officer of the bank and the company; John Walsh.

At this time, I would also like to introduce Director, Steve Brady, who has announced his plans to conclude his service effective at the conclusion of this meeting. Mr. Brady joined the Board in 2016 following the acquisition of Ocean City Home Bank and recently served in the Risk Committee. On behalf of all the stockholders and employees of OceanFirst, I want to thank Mr. Brady for his service to the bank and wish him all the best in the future.

Also joining me to conduct the meeting this morning is our Corporate Secretary and General Counsel, Steven Tsimbinos as well as Jill Apito Hewitt, Senior Vice President and Director of Investor Relations and Corporate Communications; and Matt McCue, Vice President and Assistant Corporate Secretary.

There are other officers of the bank participating remotely that I'd like to acknowledge at this time. Michael Fitzpatrick, Executive Vice President and Chief Financial Officer; Joseph Lebel, Executive Vice President and Chief Operating Officer; Michele Estep, Executive Vice President and Chief Administrative Officer; Karthik Sridharan, Executive Vice President and Chief Information Officer, who joined the Bank last year. Anthony Giordano, Executive Vice President and Chief Retail Banking Officer; David Howard, President of Digital Strategy and Innovation; George Destafney, President of the Central Region; Vincent D'Alessandro, President of the Southern Region; Dan Harris, President of the New York Metro Region; Susanne Svizeny, President of the Greater Philadelphia Region; Kathy Durante, Executive Director of the OceanFirst Foundation. We also have representatives from our independent registered public accounting firm, KPMG LLP, participating. I'd like to recognize Elias Lambros, a partner with KPMG LLP.

Now we will proceed with the formal business of the annual meeting. Each stockholder has already been supplied with a copy of the company's 2020 proxy statement and 2019 annual report. Copies of these documents are also available on the virtual meeting site for any stockholder who requires them.

There are 4 items for business at this annual meeting: First, the election of 14 directors for terms of 1 year each; second, an advisory vote on the compensation of the company's named executive officers, as described in our proxy statement. This is commonly known as a say-on-pay vote; third, the approval of the OceanFirst Financial Corp. 2020 stock incentive plan; finally, the ratification of the appointment of the independent registered public accounting firm for the fiscal year ending December 31, 2020.

Mr. Tsimbinos, would you report on the mailing of the notice of this meeting that has been sent to all stockholders entitled to vote at this meeting?

Steven J. Tsimbinos
Executive VP, General Counsel & Corporate Secretary

Yes, Mr. Chairman. I have an affidavit, that I have duly sworn to and signed, stating that the notice of this meeting has been mailed to each stockholder as required under the bylaws.

Christopher D. Maher
Chairman, President & CEO

The affidavit is accepted.

Steven J. Tsimbinos
Executive VP, General Counsel & Corporate Secretary

In addition, Mr. Chairman, Resolutions were adopted at the January 22, 2020 meeting of the Board of Directors of OceanFirst Financial Corp., providing for the meeting to be held today, May 20, 2020, and directing that notice be given as provided in the bylaws. The Board also set the record date as April 3, 2020, for determining persons entitled to notice of and to vote at this annual meeting of stockholders.

A notice of these actions was provided to the public by press release, dated January 27, 2020.

Finally, the complete list of stockholders of record as of April 3, 2020, who are titled to vote, showing their respective addresses and the number of shares held by each is available on the virtual meeting platform in accordance with the bylaws and applicable law.

Christopher D. Maher
Chairman, President & CEO

Thank you, Mr. Tsimbinos. Please file a copy of the notice, the affidavit as to the mailing of the notice, and the resolutions from the January 22, 2020 Board meeting with the minutes of this meeting.

Ladies and gentlemen, I would now like to introduce you to Mr. Peter Hagberg (sic) [Friz] representing CT Hagberg LLC. Mr. Hagberg (sic) [Friz] has been appointed to serve as the inspector of election. Mr. Hagberg, (sic) [Friz] will you please present your report on the number of shares present in person, by proxy or by attorney of this meeting so that we can determine whether a quorum is present.

Peter Friz;Inspector of Election

Yes, Mr. Chairman, there are 59,145,815 shares entitled to vote as of the April 3, 2020 record date. The proxy committee of the Board of Directors is acting as proxy and representative of the holders of record of not less than 52,119,859 shares of the common stock of the company. There are not less than 53,271,770 shares present in person, by proxy or by attorney. Accordingly, a quorum is present.

Christopher D. Maher
Chairman, President & CEO

Thank you, Mr. Hagberg (sic) [Friz] . On the basis of the report of the Corporate Secretary and the Inspector of Election, the chair finds that proper notice has been given and that a quorum has been properly convened. I shall now proceed with the matters on the agenda for the meeting.

Mr. Tsimbinos, I know that you are prepared to read the minutes of the last Annual Meeting of Stockholders held on May 29, 2019, but perhaps in the interest of time, we could have a motion from our stockholders to dispense with the reading.

Steven J. Tsimbinos

Executive VP, General Counsel & Corporate Secretary

I would make that motion.

Jill Apito Hewitt

Senior VP & Investor Relations Officer

I second the motion.

Christopher D. Maher

Chairman, President & CEO

All those in favor of the motion waiving the reading of the minutes of the 2019 Annual Meeting signify by saying yes.

Unknown Attendee

Yes.

Unknown Attendee

Yes.

Unknown Attendee

Yes.

Christopher D. Maher

Chairman, President & CEO

Any opposed? The motion carries. The polls for voting on all matters are hereby open to this time, 9:09 a.m. on May 20, 2020. If you've already voted, you do not need to vote again during the meeting. If you have not voted or if you would like to change your vote, you may do so by clicking the "Vote Here" button located in the bottom right of your screen.

The proxies solicited by the Board of Directors can be tallied at one time, even though they contain 4 matters for consideration. Likewise, any ballot that a stockholder seeks to cast virtually, at this time, can be handled the same way.

Accordingly, I intend to proceed to discuss each matter separately. And when the discussion of each item is finished, we will move on to the next. At the conclusion of the discussion of the fourth item, we will take the votes.

Mr. Tsimbinos were there any stockholder nominations or proposals for business for this meeting properly filed with you as Corporate Secretary?

Steven J. Tsimbinos

Executive VP, General Counsel & Corporate Secretary

No, Mr. Chairman.

Christopher D. Maher

Chairman, President & CEO

Because no stockholder nominations or proposals were properly filed with Mr. Tsimbinos in advance of this meeting, as provided in the bylaws, the business of this meeting is limited to the foregoing formatters. In accordance with the provision of the bylaws, further information on each proposal and the recommendations of the Board of Directors may be found in the proxy statement.

The first proposal we will consider is the election of 14 directors. The Board of Directors has nominated Angelo Catania, Anthony Coscia, Michael Devlin, Jack Farris, Kimberly Guadagno, Nicos Katsoulis, John Lloyd, Christopher Maher, William Moss, Joseph Murphy, Jr, Steve Scopellite, Grace Torres, Grace Vallacchi and John Walsh to serve 1 year terms as directors, which would expire at the Annual Meeting of Stockholders to be held in the year 2021 or at such time their successors are elected and qualified. All nominees are presently directors of both the company and the bank.

Information concerning the principal occupations of the nominees, their service with OceanFirst Financial Corp. and OceanFirst Bank and other matters which may be of interest are contained in the proxy statement. Is there any discussion

with respect to the nominations for Directors? If so, please type your question into the "Ask a Question" field and click "Submit." Just pause for a second while we wait to see if there are any questions.

Okay. Hearing none, we'll move on to the second proposal for consideration. The advisory vote of the compensation of the company's executive officers is disclosed in the proxy statement, the "Say on Pay" vote. Is there any discussion with respect to the "Say on Pay?" If so, please type your question to the "Ask a Question" field and click "Submit." Again, we'll pause for a minute to collect any questions.

Okay. Seeing none, we'll move on to the third proposal for consideration. The approval of the OceanFirst Financial Corp. 2020 Stock Incentive Plan. Is there any discussion with respect to the approval of the 2020 Stock Incentive Plan? If so, please type your question into the "Ask a Question" field and click "Submit." Again, we'll pause to see if there are any questions.

And seeing none, we'll move to the fourth and final proposal for consideration. The ratification of the appointment of KPMG LLP as independent registered public accounting firm of OceanFirst Financial Corp. for the fiscal year ending December 31, 2020. I've already introduced the representative that is here today to answer any questions of the stockholders. Is there any discussion with respect to the ratification of KPMG LLP as the independent registered public accounting firm for 2020?

If so, please type your question into the "Ask a Question" field and click "Submit." Again, we'll pause for a minute to see if there are any questions.

Okay. Seeing no questions, I believe this concludes the discussions on all matters. I will now reintroduce each item individually and call for the vote.

Again, if you have already voted, you do not need to vote again during the meeting. If you have not voted or if you would like to change your vote, you may do so by clicking the "Vote Here" button located at the bottom right of your screen.

The nominations for directors are already before the meeting by virtue of the report of the Board. So no further action with respect to them is required. We shall now proceed to call the vote for the election of directors.

[Voting]

Christopher D. Maher
Chairman, President & CEO

As to the second matter, the "Say on Pay" proposal. So I hear a motion for the approval on an advisory basis of the compensation of our named executive officers described in the proxy statement.

Jill Apito Hewitt
Senior VP & Investor Relations Officer

I am Jill Hewitt, a stockholder of OceanFirst Financial Corp., and I move that the following resolution be adopted, resolved, that the nonbinding approval of the compensation of the company's named executive officers as described in its 2020 proxy statement having been presented to be considered at this meeting be and hereby is granted in all respects.

Christopher D. Maher
Chairman, President & CEO

Does anyone care to second this motion?

Steven J. Tsimbinos
Executive VP, General Counsel & Corporate Secretary

I second the motion.

Christopher D. Maher
Chairman, President & CEO

The motion on the "Say on Pay" vote has been made and seconded and the vote will now be taken.

[Voting]

Christopher D. Maher
Chairman, President & CEO

As to the third matter, do I hear a motion on the approval of the OceanFirst Financial Corp. 2020 Stock Incentive Plan?

Matthew McCue; Vice President and Assistant Corporate Secretary

I am Matthew McCue, a stockholder of OceanFirst Financial Corp., and I move that the following resolution be adopted, Resolved, that the approval of the OceanFirst Financial Corp. 2020 Stock Incentive Plan having been presented to and considered at this meeting, be hereby ratified and approved in all respects.

Christopher D. Maher
Chairman, President & CEO

The motion on the approval of the 2020 Stock Incentive Plan has been made. Is there a second?

Jill Apito Hewitt
Senior VP & Investor Relations Officer

I second.

Christopher D. Maher
Chairman, President & CEO

Now that the seconded plan has been -- a motion has been made and seconded, the vote will now be taken.

[Voting]

Christopher D. Maher
Chairman, President & CEO

As to the fourth and final matter, do I hear a motion on the ratification of the appointment of our independent registered public accounting firm?

Jill Apito Hewitt
Senior VP & Investor Relations Officer

I'm Jill Hewitt, the stockholder of OceanFirst Financial Corp., and I move that the following resolution be adopted, Resolved, that the appointment of KPMG LLP, as independent registered public accounting firm of OceanFirst Financial Corp. for the fiscal year ending December 31, 2020, having been presented to and considered at this meeting is hereby ratified and approved in all respects.

Christopher D. Maher
Chairman, President & CEO

Do I have a second for this motion?

Unknown Attendee

I second the motion.

Christopher D. Maher
Chairman, President & CEO

The motion on the ratification of the appointment of KPMG LLP, as the independent registered public accounting firm of OceanFirst Financial Corp. for the fiscal year ending December 31, 2020, has been made and seconded and the vote will now be taken.

This is the last opportunity for any stockholder who has not already voted to cast their votes using the virtual meeting platform now. If you have already voted, you do not need to vote again during the meeting. If you have not voted or if you would like to change your vote, you may do so by clicking the "Vote Here" button located to the bottom right of your screen.

[Voting]

Christopher D. Maher
Chairman, President & CEO

Mr. Tsimbinos, will you please collect the master Ballot, which is being cast by the proxy committee. Polls for voting on the matters before this meeting are hereby closed.

Steven J. Tsimbinos
Executive VP, General Counsel & Corporate Secretary

I see the vote tally is complete. Mr. Hagberg, (sic) [Friz] would you please present your report on the vote.

Peter Friz; Inspector of Election

Thank you, Mr. Chairman. The preliminary vote report shows that each of the 14 directors has received the majority of the votes cast in favor of their election and each nominee has been duly elected to the Board. The compensation of the named executive officers has been approved by advisory vote. The OceanFirst Financial Corp. 2020 Stock Incentive Plan has been approved and the appointment of KPMG LLP as the company's independent registered public accounting firm for the fiscal year ending December 31, 2020, has been ratified.

Christopher D. Maher
Chairman, President & CEO

The report of the inspection of election as presented is accepted. Mr. Tsimbinos, please safeguard the ballots, proxies as well as the oath certificate and report of the inspector of election and maintain them among the records of the company.

This brings us to the end of the formal business agenda of our meeting. I thank you for your attention and for the votes you cast. On behalf of the Board of Directors, let me express our appreciation for your support of the Board's recommendations on all 4 proposals, again, this year. As promised, I will now report in the past year recent developments and share our view on the future of your company. Let me call your attention to our forward-looking statement disclosure. Please take careful note of the caution we make regarding the forward-looking statements, which allows us to speak with you openly and candidly today.

All right. So now I appreciate the formality of those discussions. We'll be a little less formal now and maybe talk a little bit about the future of the company. You should see on your screens, a presentation that we've compiled that is an excerpt of materials that we've released in prior investor presentations.

I'll move you to Slide 3 to just give you an overall view of the growth of the company. I know many shareholders have been shareholders for quite some time. For those just joining us this year, our company was founded as the building -- the Point Pleasant Building & Loan Association of Point Pleasant Beach in 1902. And over the course of the last 118 years, we've had quite a history. I would just note that in 2020, we had -- 2019 and 2020, we had a couple of really important milestones. Obviously, we're pleased to add Capital Bank to our portfolio in January of 2019. We also recorded record GAAP in core earnings in 2019. And then crossing over on January 1, 2020, we had the opportunity to acquire Two River Bancorp and Country Bank Holding Company expanding our franchises even further and crossed the important \$10 billion regulatory threshold.

Moving to Slide 4. For those of you not familiar with the current state and breadth of our business, we operate a fully integrated commercial and retail bank throughout the state of New Jersey with a focus in Central and Southern New Jersey. We also have expanded our presence into metropolitan Philadelphia and New York. Both of those expansions took place in 2019. And then following the expansion of commercial lending capabilities in both of those markets, we took the opportunity to acquire Country Bank in New York to augment our growth plans in the New York metropolitan area. We closed that transaction on January 1, and are pleased to add the Country shareholders to our business. The same time, we deepened our market share and presence in Central New Jersey with the acquisition of Two River Bancorp and that was also completed on January 1. And as I'll talk later, we were able to integrate the Two River operation into OceanFirst just this past weekend.

As you see here, about \$10.5 billion of assets, as of the end of the first quarter, with a market cap of around \$1 billion. We do note 75 branches here, as of this weekend. With the Two River integration, that number is now 62 branches. And importantly, and I'll touch on this later, the efficiency of the bank is driven by the amount of retail distribution we've got to support for our customers. And we've now built our average branch deposits to over \$125 million each, and that's a really important point going forward into a challenging environment.

Moving to Slide 5. To talk more specifically about the last year or so. First, our acquisition strategy continued. We have completed 7 acquisitions in the last 5 years. And the importance for this is, as we move into a digital future, the resources the company requires in technology and digital banking products, require significant investments. We also require significant investments in our regulatory infrastructure and in order to keep up with that, you simply need scale. So the acquisitions of these banks in connection with our own internal organic growth brought us the regional scale to be efficient and profitable and to make the investments needed into digital banking. That digital culture was particularly important as we get to the pandemic and our response to the pandemic and in particular with the PPP program.

So let me move to Slide 6, talk just a minute about the first quarter. First quarter had core net income of \$27 million, core diluted earnings per share of \$0.45, a strong net interest margin of 3.52%, that's in a very difficult interest rate environment. A strong core return on assets, which exceeded 1% and a return on tangible equity of 12.25%.

Importantly, those results include a very significant provision for credit losses, which is money we set aside with the expectation that the pandemic will increase our credit costs.

So we set aside a provision in the range of \$10 million in the first quarter and continued to post very strong financial results. Our efficiency ratio decreased again and that's including more than \$1 million of expenses in the first quarter that were related entirely to the -- to COVID-19. We also ended the quarter with a record loan pipeline of \$525 million and that has grown substantially as we've broadened our business in both New York and Philadelphia.

Operationally, we talked about the 2 acquisitions and the branch consolidations. We also adopted a new accounting provision for loan losses, commonly known as CECL. And as I mentioned before, that increased our credit expense by about \$10 million. I'll talk for a minute about our COVID response. And I think this is really important. We were early to take steps to protect the bank, our employees, our customers and our community. So beginning in February, we instituted plans to activate our pandemic response. On February 28, we suspended common share repurchases to preserve capital. In the beginning of March, on March 3, we began social distancing among our own employees. And by March 16, we were in a position to close our branch lobbies and divert traffic to drive ups in order to further protect our customers and our employees. We were leaders in that regard. And we were also leaders in the offering of deferral programs to both consumers and businesses to help them get through this difficult time. So those COVID-19 initiatives have allowed us to continue to operate the bank efficiently and effectively. We've had some of our largest loan production months since the pandemic started and we're able to operate with a significant amount of our staff positioned remotely and working from their homes.

So we'll move to Slide 7. I just want to catch this in very important light. This is the -- our results on the SBA's PPP program. So the Payroll Protection Program. And just to give you a little background here. OceanFirst was not an SBA lender in the past. That's not a business that we've had. So when the CARES Act was passed on March 27, we did not have the capability to go in and make SBA loans. We had to respond very quickly. We knew that providing cash to our constituents, our customers and in our community, was going to be critically important. And our staff worked around the clock so that we could simultaneously build out a digital application process for our customers and appeal with the SBA to reactivate an SBA license that we had acquired through the Two River acquisition on January 1.

I'm very pleased to report that we were among the first bank collecting -- first banks collecting applications on April 3. And our efforts over the course of that first weekend allowed us to begin to get SBA approvals on April 5. We were again, one of the first banks in our market to be dispersing loans the following week. And in aggregate, we have dispersed approximately or just under, we expect to produce about \$500 million worth of PPP loans or just under that. That helps our customers, but it also helps our community. Those loans represent funding for over 55,000 jobs in our community. And we're very pleased with the efforts of our staff, our IT staff, our credit staff, our branch staff, working as a team, and I can tell you, we were working 3 shifts and straight through the nights to make sure that we're able to support our customers. We do expect to earn significant fees related to this program. The maximum fee that we would earn is about \$17 million. The actual realization of that will probably be a little bit lower as some of these loans may pay off early. And the earnings -- those fees will come into earnings likely in the third and fourth quarters of this year because there's a lot of administrative work we have to do before we've earned that fee.

Moving to Slide 8. I want to talk a little bit about our returns, our shareholder returns and the returns on capital. As you can see, we've worked hard over the last 5 years to build our return profile, as measured in both the core return on assets and the core return on tangible common equity. You can see that in the first quarter of 2020, both of those numbers dipped. Those are exclusively related to pandemic issues. And I think, you can expect that as we go through the next few quarters, the pandemic will continue to weigh on our operating results. It will lay on the results in terms of net interest

margin compression, potentially heightened expenses to deal with operations during a pandemic and of course, the credit losses that I talked about earlier.

Moving to Slide 9. I talked about digital earlier and this is a critically important part of our business. The most important comment I can make here is, we are following our customers' preferences. So this is not a case where we are trying to convince customers to go digital. This is a case where our customers are going digital more and more every day, and we have to make sure that we're allocating the resources to be able to serve them the way they want to be served. As you can see, we built our digital bank group from 7 FTE or full-time equivalents in 2016 to over 82 today. We expect that growth to continue. Since the pandemic began, we've seen a 34% decrease in in-person branch transactions and most of the digital metrics show a 100% increase, including online account openings and other digital offerings. So we can see here that our customers are shifting their needs and every single day want to interact with us more on the digital platforms. We need to make sure that we apply our company's resources so that we're there to support them in the way they want to do business.

Moving to Slide 10. I just want to talk for a second about capital allocation and capital in general. Over the last several years, we've returned \$192.2 million to our shareholders. We recognize our responsibility to provide a return to you, both through a dividend and we're applicable to do things like share repurchases. I mentioned earlier that we suspended share repurchases in February of this year. That suspension was based on an unclear outlook for the economic future. As we work through the pandemic, the return to work and understand what the pressures and issues are, we wanted to preserve capital so that we can grow the bank as needed through the pandemic. There's a lot of historical precedents that banks that are very well capitalized and grow strongly following events, whether that's the great recession, 9/11 or events like that, perform disproportionately better than banks that are unable to grow through those periods.

In addition to that, we decided to bolster our capital, and we went out to the markets a few weeks ago and raised approximately \$180 million worth of new regulatory capital. And we did that to strengthen the company and allow us to serve dual purposes. It will allow us to meet the needs of our existing clients who may need payment deferrals, they may need to be in workout, they mean to restructure their businesses. But at the same time, to remain open for business, to continue to lend and to continue to support our communities. There's a very real possibility that in the coming quarters, our communities are going to need access to credit in a way they haven't needed in quite some time, and we want to make sure that we have the balance to be able to deliver that.

With that addition of cash from those -- the equity raise, we have approximately \$200 million in reserve at the holding company which we will use in the coming quarters and years to support the business.

Going to move to Page 11. One of the unique parts of the OceanFirst story is our decision in 1996, to allocate a certain portion of our initial public offering to the OceanFirst Foundation. I'm very pleased to report that our cumulative grants since that date have now crossed \$40 million of grants to organizations serving OceanFirst markets. That includes a \$250,000 special grant allocation that has been paid out to organizations that are helping our neighbors deal with the coronavirus pandemic. We continue to run such important programs as the initiative for supporting students in our community, attending local colleges. And this year, we will -- we anticipate providing 2.6 -- I'm sorry, over the course of that program, we provided \$2.6 million to more than 1,800 students to pursue higher education. That concludes my formal remarks for today's meeting. At this point, we're happy to pause and take some questions from stockholders.

Question and Answer

Christopher D. Maher
Chairman, President & CEO

All right. The first question we have relates to the number of banks in New Jersey and the pressure on mergers -- and whether that pressure will result in more mergers and acquisitions over time.

Certainly, the broader economy has seen a consolidation in the banking industry over the last 30 years. And that consolidation, I think, reflects that there are a lot of banks, a lot of institutions trying to serve the same customers. But more importantly, I think, it also reflects the pressures in running a business like ours today. And that pressure shows itself in regulatory compliance and in the need to keep up on digital fronts. So our expectation is that, that long-term trend of consolidation in the industry will continue at some point after the pandemic passes. We don't think it's the right time to be pursuing mergers and acquisitions today while the economic future is unclear, while it's very difficult to assess the balance sheet of financial services companies. But we do think the long-term trend will be back. We can't tell you when, that may be in the third, fourth quarter -- I'm sorry, the fourth quarter of this year, first quarter of next year, maybe it's 2022. But we think that our credentials as a proven acquirer will help us in that regard. So we're going to keep focused on our organic business, on our existing customers for the time being, but we expect M&A will be an important -- play an important role going forward.

The second question we received is about our planning for the pandemic. Some of this I covered in our earlier comments, but I can assure all of our stockholders that the company has not missed a beat. We had strong business continuity plans. We were able to quickly shift workers remote and protect our employees and our customers. At no time, did we have more than 3% of our employee base impacted by [Technical Difficulty] issues, which I think is a testament to the steps we took to try and protect our employees and our customers. We do expect in the coming weeks in compliance with Governor Murphy and other public health officials orders to be reopening our business to more traditional services, but we're going to take it slow and conservatively and make sure that the health and safety and welfare of our employees, our customers and our communities is at the forefront. We're also proud that we've been able to continue to advance programs like the PPP program despite having so many people working from home.

Jill Apito Hewitt
Senior VP & Investor Relations Officer

So Chris, we do have a couple of other questions. One is how does your bank handle lower interest rates, the negative rates? Is book value a good way to look at the progress of the bank?

Christopher D. Maher
Chairman, President & CEO

I'll take those in 2 separate questions. Let me talk about negative rates, first. Negative rates present an extraordinary challenge for any financial institution like ours. The first comment I would make is that there is not a lot of evidence that negative interest rate policy will help an economy. And in fact, most of the evidence that's out there about economies that have gone into negative rates, does not demonstrate much help. It's kind of pushing on string and it doesn't really result in the economic growth you'd like. So we're hopeful that the prospects of negative rates in United States is pretty low. That said, it's possible that we'll have to deal with negative rates in the coming quarters. The most important thing, I think, to keep in mind is that while we may outperform our peers in a negative rate environment because of our interest rate planning, at the end of the day, negative rates are bad for everyone. I think what that means is, you've got to look at other levers to create value in your business and not be as dependent on your net interest margin. And for us, I think that means a focus on continuing to optimize operating expenses and to complete that transition to being the digital bank our customers want reserve.

So in an environment where your revenue is likely to be pressured, you must go to the expense side. But not at the cost of being able to grow and develop new customers and new relationships. The way we'll do that is the way we've been doing it for the past 5 years, which is making careful, but significant investments into digital banking and being able to increase the operating efficiency of our company. I mentioned the \$125 million average branch size before. That's critically important. If we can keep that average branch size up, we will be more efficient than our peers.

Second way is, is book value a good way to look at progress of the bank? We certainly -- we look at book value and more importantly, tangible book value as a really important metric at the bank. And you should protect and see that grow over time. You also want to look at the total shareholder return where you want to look at dividend yields, you want to look at returns on equity. So there are a lot of different ways to look at it. I will repeat comments we made on our April 24 -- I'm sorry, our March 24 meeting regarding the pandemic. We do a variety of stress testing around adverse economic events. And we use the kind of government guidance of what's called the CCAR process or the DFAST process to use a severe adverse credit stress, run it through the bank and see what that means for the bank. In our case, over the next 9 quarters, if things got particularly bad, our balance sheet has the ability to withstand. And I want to make sure I'm clear about this. This is not what we expect credit losses might be. But we have the ability to withstand over \$300 million worth of credit costs, which would be the building of our loan loss reserve, foregone interest on loans that aren't paying us on timely basis and net charge-offs of bad credits and remain well capitalized by both our internal measures and by regulatory guidance.

So I think we've got a very significant buffer here because of the level of profitability of the company so that we're looking at the pandemic as a drag on earnings, but not something that we currently anticipate would hit book value. So I think, just maintaining your book value in a market like this is an achievement of its own.

Jill Apito Hewitt

Senior VP & Investor Relations Officer

Chris, we have another question from Carla Dashen, one of our shareholders. Carla had several questions. She says, does the bank have a good playbook for handling credit during COVID-19?

Christopher D. Maher

Chairman, President & CEO

Well, I think, fortunately, we had a significant stress event in our markets several years back when Hurricane Sandy came through the market. And this is a very different event and I'm not trying to prove without a doubt that the pandemic challenges would be similar to Sandy. However, at that time, we had an instant shock in our markets. We were probably one of the most exposed financial institutions to that storm. Our market area at that time was just Ocean County. And we had a very significant number of borrowers impacted. In fact, to give you a frame of reference, FEMA's numbers showed about 50,000 structures in our markets were either completely destroyed or substantially destroyed. And we had thousands of loans that had enough damage to require an insurance company payout that had to be cosigned by the bank. So it was a very big event for us. What we learned in Sandy is that good borrowers that have a stress event, that are put on deferral, can heal quickly, come back to pay you just fine and really don't present the significant risk to the company. It was that experience that led us to be in the forefront of offering deferrals to our customers. We obviously had conversations with our regulators, the OCC at the bank level and the Federal Reserve at the holding company level about those policies and practices. But we were one of the first banks in the country to go out and to announce a customer deferral program. And I'll give you some very interesting parallels here.

The FICO score, the weighted average FICO score of a residential loan that has asked us for a deferral was 742. So these are customers, and almost 90% of these customers have not made a late payment over the entire course of their history with us. So when we look at our playbook and look at our experience, we look back to Sandy and we look at how we can defer payments, work with borrowers and give them a hand to come through this. The last thing I would say about Sandy and the experience is that, we had a net charge-off rate, so net loss rate of about 1.2% of the loans that were under deferral throughout Sandy, which is a very low loss rate considering the stress.

And I know that, as I said before, the events were very different. Although in some ways Sandy was more severe because you had property damage where people had their properties destroyed and it took them, especially on the commercial side, it took, in some cases, a season or 2 before they could come back, rebuild the facility to even accept patrons back into there. So we use the Sandy playbook. I think, we're -- we feel really good about where we are now with deferrals. And I think, we're going to work through it in an orderly manner.

Jill Apito Hewitt

Senior VP & Investor Relations Officer

Great. One more question. And Chris, if you don't mind, I'll take this one since I've got access to this information. The question is how many shareholders are attending this virtual meeting and I want to thank everybody for their participation today. I know this is a little bit unusual and different for us. We do have 32 shareholders that have logged in with their

control number and participating. We also provided the guest option for people to -- who are not shareholders or who did not have their control number with them to be able to participate. Unfortunately, they're not able to ask questions. But yes, we do have 54 guests participating in the meeting.

Chris, we do have several more questions. This one is, is the dividend secure in this environment?

Christopher D. Maher
Chairman, President & CEO

So I'll reiterate the comments we made in our first quarter earnings call, which is, well, we didn't expect pandemic. I don't think anyone -- well, actually, there were a few people that I think were thoughtful about it. We should have listened more to them, like Bill Gates. We were not planning for such a significant credit event. But we knew that the expansion that we were in, was getting very long and that the record of expansions would lead you to believe there could be a credit event, maybe a more ordinary course recession. Given that expectation, we were particularly careful about the credits we chose to be involved in. So for example, we're not involved in credit card lending or automobile lending or we don't do a thing called leverage loans. So we've tried hard to make sure that our balance sheet is in really good shape. We've also kept our dividend payout ratio modest and in some cases, much more modest than our peers. So last year was in the low 30% range of core earnings. That gives us extraordinary flexibility and takes kind of pressure off the dividend and the earnings capacity. At this time, we continue to be strongly profitable. We think, the dividend was appropriate in the first quarter. There's no reason for us to believe that it would be impacted going forward. But I think, you always have to be thoughtful about this. I don't think any of us know exactly what the outcomes are going to be in the pandemic. And we're going to look at conditions at each quarter and look at both the economic conditions, our earnings capacity, the level of the dividend. So we don't foresee any change at this time, but we can't offer any guarantees about the future.

Jill Apito Hewitt
Senior VP & Investor Relations Officer

Okay. And Carline, I see your comments about commenting the OceanFirst team for an A+ virtual shareholder meeting. No response necessary for that one, but thank you very much for all of your questions and for participating. Chris, we do have another question. This one is from John Shibles, Triad Wealth Advisors. John, thanks so much for joining us today.

He says, I hope you were all safe and healthy. When you did the COVID update in March, you discussed about stress testing the bank on net charge-offs at 200 basis points and that you would still be able to pay your dividend. Have you conducted further stress tests? And do you have any clarity on that number being less than 200 basis points going forward? Or can you shed any light on the portfolio going forward?

Christopher D. Maher
Chairman, President & CEO

Well, John, we don't -- we update our stress test annually. So we've not updated it since then. And I'm not sure that we have any information that would materially change the way we would stress it in any event. So we continue to think that, that severe adverse stress test is a good proxy of what the balance sheet can withstand. And we're hopeful that the actual economic issue is going to be more modest than that. I think, one of the most significant differences between our stress test and what's going on right now is the level of physical stimulus. And to put that in perspective, the government has already done more stimulus now than we did through the 2008 recession. And it's not quite clear how that stimulus will affect different industries. So I guess, what I would say in summary is that, based on the deferrals we see, the conversations we're having with our customers, we're cautiously optimistic. People are preparing to reopen, get back to work. The PPP program provided an absolutely critical amount of cash to these businesses to kind of bridge the gap while they were closed. And we expect -- look, there's going to be a credit event. We don't think, it's going to be severe on -- as it relates to our balance sheet at present. But we're going to keep our eyes and ears open. So at this point, I don't think there's any -- we don't see any pressure on the dividend. As I said before, we're not going to make any forward-looking commitments around the dividend just because there's not enough clarity in the economic forecast to be able to do so.

Jill Apito Hewitt
Senior VP & Investor Relations Officer

Just a reminder for the shareholders who are on the call, you are able to ask questions by typing the question in the bottom. Happy to read any questions that people have.

We do have another question. This is from Joe Tuzzio, an employee of OceanFirst Bank. Chris, as you know, many of our employees are also shareholders. The question is, given current market condition, how has our stock performed compared to our competitors?

Christopher D. Maher
Chairman, President & CEO

Well, there are several indexes you could use to compare OceanFirst against the KBX index or whatever you may choose. For the most part, if you look at all those indexes, our decline in share price mirrors what's going on in the sector. So it's really nothing unusual going on. There is a phenomenon that happens in markets like this, I think, we have to be aware of and that is generally a retreat to pricing your stock off to your tangible book value as opposed to pricing it off earnings. So traditionally, in good times, your stock is valued at an earnings multiple and in challenging times it's measured as it relates to your tangible book value. For companies that were lower-performing and had less earnings, they may have had a little bit less of a decline because their price earnings ratio was already fairly muted, and they were trading at maybe book value or just over book value. Because we were trading off earnings, we may have traded down a little bit more than some of those peers. But there's nothing unusual about our performance that is different than the sector we compete in and our geographic peers as well. So looking at New York, New Jersey area, we're pretty much all in the same boat right now. I think as you will see in good times and bad, sectors trade together, meaning, so even after the 2016 election, every bank stock kind of went up, but then over time, as the earnings capability, the franchises became clear, there were winners and losers after that point. And I think the point we're at today is the entire sector has traded down, and now it's up to us to outperform our peers and earn back that multiple. And we are absolutely focused on doing that.

Jill Apito Hewitt
Senior VP & Investor Relations Officer

Great. Just a reminder for shareholders who have insert the control numbers, you are able to ask questions, you can just go to the bottom portion of the screen, type in your question and I'm happy to read any questions.

We'll give it another minute to survey and see if there are any more questions at this time.

Christopher D. Maher
Chairman, President & CEO

All right. Since there appear to be no other questions, I'll now entertain a motion to adjourn.

Jill Apito Hewitt
Senior VP & Investor Relations Officer

I move that the meeting be adjourned.

Christopher D. Maher
Chairman, President & CEO

All right. All in favor, say aye.

Jill Apito Hewitt
Senior VP & Investor Relations Officer

Aye.

Steven J. Tsimbinos
Executive VP, General Counsel & Corporate Secretary

Aye.

Christopher D. Maher
Chairman, President & CEO

Opposed. Okay. The motion carries. Being no objections, I declare the motion carried. In doing so, I again express my thanks for your virtual participation today. I look forward to our next stockholders meeting and hope that we're able to do

it in person. In the meantime, we thank you and hope that you and your families remain safe and well. We continue to appreciate your support and cooperation. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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