Triumph Financial, Inc. Q4 Earnings Call | January 26, 2023

Luke Wyse:

Good morning. It's seven o'clock sharp. Thank you for being with us. It's time for our fourth quarter earnings call. Since the last time we spoke, we rebranded the company to Triumph Financial and changed our ticker to TFIN. As a result, some of the backgrounds and logos may be a little different today, but it's all part of aligning where we're going with what we're doing.

We're joined this morning by Tim Valdez, president of Triumph, Brad Voss, our Chief Financial Officer of Triumph Financial. Aaron Graft, the Chief Executive Officer of Triumph Financial, Melissa Forman, president of Triumph Pay, and Todd Ritterbusch, president of TBK Bank.

I'd like to open today by thanking you for the feedback following the call last quarter. It's so helpful to hear from you. Most of your thoughts were overwhelmingly positive. However, this is a new format for us, so we'll continue to tweak things here and there as we go forward.

So let's get to the business of the day. Triumph Financial had a solid quarter, and while there are freight headwinds, we are also seeing a lot of opportunity. Last evening, we published our quarterly shareholder letter. That letter and our quarterly results will form the basis of our call today. However, before we get started, I would like to remind you that this conversation may include forward-looking statements. Those statements are subject to risks and uncertainties that could cause actual unanticipated results to differ. The company undertakes no obligation to publicly revise any forward-looking statement.

For details, please refer to the Safe Harbor statement in our shareholder letter published last evening. All comments made during today's call are subject to that Safe Harbor statement. With that, I'd like to turn the call over to Aaron for a welcome and to kick off our Q and A session. Aaron?

Aaron P. Graft:

Thank you, Luke. Good morning everyone, and thank you for joining us. I have just a few comments and then as has been our practice since we've been publishing this letter, we're going to turn it over for questions. The first comment is to welcome Tim Valdez to our call. Tim, I've known for several years. He has been part of Triumph for the last year and a half, and we're very grateful to have him in the role he's in at Triumph, and leading our factoring segment. Another thing I want to just touch on before we turn it over for questions was, is as a result of reviewing some of the notes that were published last evening, specifically questions about expense growth throughout the year. What I think analysts and investors should understand is that a material amount of our projected expense growth is tied to Triumph Pay. And as we called out in the letter, we expect Triumph Pay's margins to improve by 50% during the year.

In other words, if that expense growth does show up, you should assume it's going to be accompanied by revenue growth at a higher level than any expenses we include in that segment. And there's of course other expenses across the enterprise tied to inflation and reinvestment, but that expense growth

will come, if it comes, with corresponding revenue growth. Two other things to point out that were in the letter, investors and the market should not overlook the fact that conforming transactions, what we used to call conforming transactions, that we now call network transactions, which are the promise of the network itself. We went from zero on January 11th, 2022 to over 1 billion on January 10th of this year.

That is no easy feat to go from zero to a billion in anything in one year. The other thing that I was especially excited about is that Triumph Pay was self-funding for the quarter. That has long been part of our plan. And in this rate environment, it's a very good thing to see that business continue to generate float to support its own activities, as well as contribute money back to the parent. And so with those opening comments out of the way, we're ready to turn it over to analysts and investors for questions.

Moderator:

We'll now go to Q and A. If you have dialed into Zoom and would like to ask a question, please use the raise hand feature at the bottom of your Zoom window. Once called upon, please feel free to unmute and ask your question. Our first question comes from Jared Shaw from Wells Fargo. Jared, please go ahead.

Jared Shaw:

Hey, good morning guys. Thank you. Maybe just sticking with the expense question, how should we be thinking about the ramp of expenses over the year? Over the course of '23? How much of that is going to be invested in advance of the revenues coming in, versus how much of that will just be an immediate reaction to higher revenue? So if you could tell us, is that based on hiring? Should it be comp expense, is it technology expense? And how much of that is in advance of revenue?

Aaron P. Graft:

I'll start with that generally, and then Brad can add his specific thoughts. The expense is going to largely mirror the expense that all of Triumph has, which roughly 60% is going to be people. I mean, it's not going to materially deviate from that. I think you should expect to see the expense growth weighted towards the back half of the year rather than on a linear quarter by quarter base. Brad, anything else you would add to that?

W. Brad Voss:

I would say that we do have projections for the first quarter already in the letter, and that's relatively flat relative to where we are today. So I would agree it will be weighted toward the back half of the year. We do compensation adjustments for our team in March, so you'll see a little bit of a lift there in the second quarter. Beyond that, it will be heavily dependent on the pace at which the revenue comes in.

Jared Shaw:

Okay. And then Aaron, in the letter you talk about net earnings growth may be muted for a time of transportation costs... Or sorry, if transportation reverses course from the last few weeks. Is that growth is muted? Or how should we be thinking about that sort of specific comment around earnings tied to trajectory of transportation cost overall?

Aaron P. Graft:

Sure. That comment frankly should be in every earnings presentation we do in a business like ours, which is exposed to a cyclical business like transportation. So the most profitable thing we do and the most profitable thing we've done for a long period of time has been our factoring business. I have no idea. I don't think Tim has any idea. I'm not sure anyone in the industry has an idea of what the freight market is going to do going forward. What we're seeing right now is some strengthness off of the November lows, and our hope is that we'll continue, but it is just that it is a hope. So if the freight market weakens as has been projected, and if it weakens materially, you should expect we will be profitable. We've built this business to not live and die on transportation alone. And so I can't foresee any scenario in which we are not a profitable enterprise.

But given that the transportation factoring contributes to our earnings, as we've said, a hundred dollar move in invoice prices is generally tied to 10 million of pre-tax income. It's very difficult for us to put a specific point on where we will be at the end of the year.

So we're excited about the strength we're seeing right now. We have no idea whether that strength will continue and whatever may come, we're going to be profitable as an enterprise. And if a freight recession does get worse, then we're going to use our balance sheet position, our market position to take advantage of that, even if it is negative for short-term earnings.

Jared Shaw:

Okay. And then just finally for me, your deposit funding costs are extremely low. You've done a great job of keeping costs down. I guess one, how have you been able to do that, and why not expand the balance sheet if you're able to bring in... Even if you doubled your deposit costs, why not expand the balance sheet and try to drive a little more incremental NII earnings in the near term while you have that funding advantage?

Todd Ritterbusch:

So I'll take that one. Thank you for the question. What we haven't done with respect to deposits is we have not raised published rates, and we haven't quit out any special promotions related to high rate CDs or anything else. What we have done is we've managed our deposit pricing on an exception basis. So every day I get 10 to 15 requests from the field and we have to decide on the basis of that relationship whether it makes sense to make that exception or not. And that's how we've managed our pricing through the quarter. That's how we plan to manage it going forward. And yes, we are out in the market looking for more deposits every day.

Aaron P. Graft:

And Todd, the other part of the question was related to growth in the bank as opportunities present themselves, maybe you could talk about what you're seeing there?

Todd Ritterbusch:

Yes. So obviously we're not constrained. We can grow where we'd like to grow. We are seeing more attractive risk adjusted returns in some lending areas than we've seen in some time. And so we're going to pursue those and you will see more growth in lending than you've seen in the past.

Jared Shaw:

Great. Thanks a lot.

Moderator:

Our next question comes from Brady Gailey from KPW.

Brady Gailey:

Hey, thanks. Good morning guys.

Aaron P. Graft:

Morning Brady.

Brady Gailey:

So I just wanted to start with, it's been a while since we've talked about what the overall long-term like bull case scenario profitability could be like for Triumph for T-Pay. And I know it feels like it's multiple years away, but how do you think about the maximum amount of EPS power that this company could eventually have? And I know it's probably a wide range, but what are the biggest variables that change that ultimate EPS power?

Aaron P. Graft:

Yeah, fantastic question. So let's just look at it from each of the three parts of the business. So we have the community bank. The community bank, we have been disciplined over the last few years. As you see, we called it out in the letter because we didn't think the risk-adjusted opportunities were appropriate to grow our balance sheet. This year we think they are. We love our cost of funds, we know it's going to go up, but we love the work we've done there. And we're frankly seeing the ability to price community bank loans at a place that hits our internal ROE hurdles, which are higher. They must be higher than most banks.

And so if you looked at the community bank on a standalone basis, it's going to earn by itself over a 1% ROA for sure. Second, and you've got a lot of historical data on this, is what does Triumph contribute, our factoring segment? Over a long period of time, that business has generated between a 5 to 6.5% pre-tax ROA, and the delta between those two is tied to what we've talked about with Jared's call.

What is the transportation market doing? We work just as hard to buy a $1,600 invoice as we do to buy a $2,200 invoice. And so if we look at just normalized, if we can call anything normalized, that business should generate roughly two times the ROA results of the community bank, if not more. And so if you just had those two businesses together, and this goes back to what I called out of the projection we made back in the second quarter of 2019 that I thought our business would run at above a 2% ROA and a 20% ROE.

The underlying thesis to that was if factoring is 40% of your loan book and the rest of the community bank loan book is doing well, you're easily going to exceed those projections. The reason we didn't, we delivered great results, but we didn't hit those very lofty goals was because we chose to reinvest in Triumph Pay. So you can do the math of if Triumph Pay [inaudible] break even as a segment, where would we be as a company? We'd be much closer to that 2% ROA number. But our goal for Triumph Pay is not just to break even. Our goal for Triumph Pay is to deliver the kind of operating margins that a payments network or a SaaS business should deliver. So if Triumph continues to deliver consistent with how it has done, our community

Aaron P. Graft:

... community bank continues to deliver consistent with how it has done in the past, and the opportunities we see at least in front of us right now, and we get TriumphPay to its long-term goals, then we should, on an ROA and an ROE basis, be at the very top of any competitive peer set for the returns we deliver to our shareholders.

Brady Gailey:

All right. Any stab on what the very top could look like from a specific ROA number or ROCE number?

Aaron P. Graft:

I think were I to give that projection right now, Brad Voss might reach over and punch me because that's out in the future. But I would say walk the math forward of TriumphPay hitting its goals of where we want it to operate on an EBITDA margin basis, if all things being equal, it should be in excess of those goals that we laid out for you back in the second quarter of 2019. It should be in excess of 2% of ROA and 20% of ROE if all three segments of our business are operating at their potential.

Brady Gailey:

If you look at the A, so if you look at the asset base, this time last year, it was almost $6 billion. Now it's down to about $5.3 billion. Should the asset base continue to decline here? How should we think about what that A should be?

Aaron P. Graft:

The first thing you need to understand is, I think I speak collectively for we, but for I, I couldn't really care less about our asset base. We don't measure ourselves by how big we are. We measure ourselves by are we creating durable profitability. Our asset base three years from now very well could be lower. If it's larger, it's only because we think we can generate the operating leverage through that growth. I don't know what it will be.

What I'm way more concerned about is the nature of the income that comes off the asset base. I'm way more concerned about TriumphPay generating the float that it's generating going up significantly. I'm concerned about it generating interest income as we meet the borrowing needs of some of our clients. But I'm even more interested in it generating fee income as network transactions grow.

For Triumph Business Capital, we are approximately, if you look at the factoring market, the transportation factoring market as a whole, Triumph Business Capital, or Triumph as it's now called, is roughly 15% of that market. It is not our goal to dominate that market. It is our goal to be a material player in that market, and we want that market to do well as a whole because that's good for TriumphPay.

As that market grows, we could grow with it. But I don't think you'll see material asset growth in our factoring segment, which leaves us with our community bank segment. I happen to like the fact that the President of our community bank, Todd Ritterbusch, can get involved in deposit pricing exceptions because we've stayed small enough that we're close to our customers. I don't think that's true of us at $15 billion. We don't have an aspiration to make the balance sheet bigger or smaller. We just want to be more profitable and more defensible, and that's really what drives us.

Brady Gailey:

Then just the last question for me. It feels like you guys are nowhere close to topping $10 billion in assets. If anything, you're headed in the box direction. But does the business model work over $10 billion in assets? I know Durbin comes into play and you're growing interchange. What's the dynamic or the impact if Triumph were to go over $10 billion, or is that even a possibility?

Aaron P. Graft:

As long as I sit in the seat, I sit in here, we will never go over $10 billion in assets. I don't think we could generate more. Why would we go over $10 billion if we can hit top 1% profitability marks at smaller than $10 billion? It just doesn't make sense to me. I think the business model of TriumphPay and the payments network can work in a much larger organization. But Triumph, as it's currently constituted, we will not, in any scenario that I can foresee at this time, even get close to that number.

Brady Gailey:

Say Triumph sells one day to a bank over $10 billion, is the profitability diminished because it did cross tender? Is there a big earnings headwinds of over $10 billion in assets for TPM?

Aaron P. Graft:

No, because the nature factoring wouldn't change. That's not anything affected by the Durbin Amendment. The community bank wouldn't change other than you would add on a whole bunch of regulation. The nature of the fees we generate inside of TriumphPay would not be materially affected by the Durbin Amendment. That's not how it's constructed. It's a subscription service we provide to factors, freight brokers, and carriers. That can live in any size of bank.

Brady Gailey:

Okay. Great. Thanks for the color, Aaron.

Operator:

Our next question comes from Gary Tenner from DA Davidson. Gary, please go ahead.

Gary Tenner:

Thanks, guys. Good morning. A couple of follow-up questions for these questions, but wanted to ask about the commentary in the letter regarding enhancing technology usage at TBC. I'm just wondering, if you pivot to use more technology at TBC, how quickly can you do that? Is there existing infrastructure at TPay that you could pull over to use just to reduce the embedded cost at TBC, reduce head count, et cetera, potentially at that part of the business if freight were to slow meaningfully?

Tim Valdez:

From my position at TPay prior to joining the factoring division, I had really good visibility into the technology that was available on the platform. I see that as a tremendous boost to not only the industry but to what we do today.

Aaron P. Graft:

Yeah. Just echoing on top of what Tim said, one of the benefits that we saw, and I think you're seeing it in, take our deposit portfolio, for example, the reason we haven't experienced the same level of beta is

when you don't just grow super fast, you're able to make sure you have quality growth. One of the things Tim and I have talked about is it's less important for Triumph, our factoring segment, to just put up ever-increasing numbers or double-digit growth. It's more important for us to improve efficiency and profitability of what we have.

That is largely driven by its integration with TriumphPay, but it's also Tim has some initiatives he's working on that is going to make customer service that much better, because the last reason that we want to drive our growth, and we called this out in the letter, is just because we can undercut the market on pricing. We are going to defend margin as much as is possible and improve the business through efficiency. In other words, less FTE growth as the total volume goes up, and that will lead to greater profitability in that segment.

Gary Tenner:

I guess to ask it again in a different way, maybe, Aaron, you and I have talked in the past about the legacy factoring business being more of an earnings risk kind of business than a credit risk type of business. As you think about trade slowing, is there a way to quickly apply anything that would be an offset to that earnings risk issue in a freight slowdown? Or is that nothing you would be able to do that rapidly?

Aaron P. Graft:

No, I understand the question better, Gary. I don't think that would be wise is my answer to you. 65% of our expense, more or less, inside of our factoring segment is people. We have hundreds of people who are really, really good at understanding our systems and understanding the industry. To just go through and start making cuts of very talented people, you always want to cut underperformers, but to just make cuts because you're seeing some headwinds in freight, to me, is the exact wrong thing to do. It's not that we want to just go spend more to spend more, but we want to go get the best talent available.

Away and apart from any short-term headwinds in freight, we are on a march, as I think any successful factoring company is going to do, to have technology do more and more processes that used to be done by people. On a longer arc of time, that business gets more efficient, no question. There's tons of investments being made. But we are not going to pull levers and push buttons that have long-term implications in that business in the short term just because we're seeing a moderate slowdown in freight.

Gary Tenner:

Appreciate that. Then an adjunct to that, have you seen any signs at this point, and maybe it's still early in the cycle, but obviously a bit of a slowdown in the fourth quarter, any signs of changes in the collection time on invoices purchased in the factoring business? I noticed the yield on factor receivables was down a little bit in the quarter. I don't know if that's maybe an indicator that you're seeing some extension over the collections.

Tim Valdez:

At this point, we have not seen that slowdown. Matter of fact, we've seen an improvement. We do get an opportunity to collect more in January than we do in December. The volume drops off and our collection ratio does improve. But we have not seen an erosion of how our customers pay.

Gary Tenner:

Then last question for me. As you were talking, Todd, about lending opportunities, is this where you're seeing better risk-adjusted returns? Is this traditional community bank lending? Is it the liquid credit group? Where are you really looking at those opportunities?

Todd Ritterbusch:

Yes, it is more of the traditional lending opportunities. Three or four years ago, we shied away from traditional commercial real estate loans. We just didn't feel that the risk-adjusted returns were attractive over the term that we are required to provide. Now we see more attractive risk-adjusted returns there, and we are looking for some term fixed rate financing. We have to be careful in that space. We will be careful in that space, but we are seeing some interesting opportunities.

Gary Tenner:

Thank you.

Operator:

Our next question comes from Matt Olney from Stephens. Matt, please go ahead.

Matt Olney:

Hey, thanks. Good morning. Aaron, thanks for all the commentary in that letter. Always appreciate your insights there. I want to dig more into TPay and some of the updated goals that are out there. I appreciate the EBITDA margin guidance you gave exiting '23. I think that's going to help out our forecast. I want to check in on some other TPay goals that we've talked about, the $40 billion of annualized payments exiting '23. I think last time we spoke, you had pretty good line of sight based on some onboarding process that you saw in the coming months. Is this still a reasonable goal that we should assume even with the headwinds in the industry?

Melissa Forman:

Yep. Matt, I would say it's still our goal. We still have that path in place and are looking for some of those Tier 1s that we talked about in the last quarter coming on board in the first half of this year. We're tracking right along.

Aaron P. Graft:

Matt, what Melissa and the team are doing and the pipeline and these integrations, as you've heard us say, take a long period of time. The amount of work they have done and the excellence is just outstanding. I would say this. Giving you an exact number of is it going to be $40 billion at the end of the year, tell me what the size of invoices will be and I can tell you what the exact number will be. What we're way more

Aaron P. Graft:

... more focused on, is bringing in more tier 1 brokers, because that reinforces the power of the network. That's the long-term win. The goal is still out there around 40 billion, but it would be that specific number is highly correlated to where the market will be at the end of the year.

Matt Olney:

Yeah, okay. Thanks for the commentary. Definitely appreciate it. It's a tough number to get specific on. I guess the other number we've talked about in the past exiting '24, what I think was more of a stretch goal in the past of the $75 billion of payments. I guess my assumption is that would still require some additional tier 1s to sign up that are not on the list today or have not signed on and are not being integrated yet. Any additional thoughts on that, that goal exiting 24?

Aaron P. Graft:

Well... Go ahead. I'll start and then she can clean it up because she actually knows way better than me. The only thing I want to point out to you about that goal is, that was tied to another number. 75 billion was the volume, 100 million was the revenue. We're, as you might expect, way more interested in the revenue side of that equation. One of the good things that we're seeing is we're monetizing the network at a greater rate per million than we were a few years ago, which gives us the opportunity to achieve the revenue that we're after, short of even the volume we're after. What else would you say, Melissa?

Melissa Forman:

That's exactly what I was going to speak to Aaron, so that's perfect.

Matt Olney:

Okay. Thanks for the commentary. And then I guess just lastly, I think you, in the payment section of that letter, you disclosed the number of freight break brokers and the number of factors in the Tpay network. It looks like we've moved somewhat sideways over the last few quarters. Any comments on just the momentum of Tpay and how come that's not maybe reflected in that specific disclosure?

Melissa Forman:

I can take that, Aaron. So the volatility you're seeing in that number specifically on the broker side has to do with, we had three brokers that were inactive during the quarter, doesn't mean that they're gone, and we had another one that consolidated with another one of our clients. So you're seeing some movement specifically just through those factors.

Matt Olney:

Okay guys, thanks a lot.

Aaron P. Graft:

Thank you.

Speaker 1:

Our next question comes from Brad Milsaps from Piper Sandler Companies. Brad, please go ahead.

Brad Milsaps:

Hey, good morning.

Aaron P. Graft:

Good morning.

Brad Milsaps:

Thanks for taking my questions. Aaron, just wanted to go back to the EBITDA margin improvement you expect a year from exiting 2023. It certainly implies at least a minimum of doubling of revenue. Does that come more from charging existing users more on the platform or from, as Melissa mentioned, more of the tier 1 brokers kicking in, and do you expect that to manifest itself more in fee revenues or net interest income? In the letter you alluded to increasing your fee revenue growth, just wanted to get a sense of how you see that playing out over the next year.

Aaron P. Graft:

Melissa's the expert on this, so we'll let her take this question.

Melissa Forman:

Thank you Brad. I would say it's both. We have given our network away for free for several years and allowed our customers to see the value of it. So we're able to now come back to that and be able to charge those fees associated with the value that they're getting. It's new business, obviously that's our goal to keep going out and gaining market share, but it's also the repricing of some of the business that we have on the network today.

Speaker 2:

And it is largely fees.

Melissa Forman:

Yes, it is largely fees. Thank you.

Aaron P. Graft:

And just to drill down on that a little bit, Brad, is if you go back last year or two years ago when money cost was zero and you could get leverage wherever you wanted it, it made sense to really focus on fee income growth because anyone can, not anyone, but substantially anyone could get leverage in the market. So as we think about where we are today and where TriumphPay is in this journey, yes, the goal is fee income growth. Network transactions are the future.

To the extent we can use our balance sheet to help clients in their growth, well that's going to come in as net interest income, but if you look at the yields we generate on that net interest income, they're exceptionally high. So it's a blend, it's everything Melissa said, but we are a bank for a reason, and if being a bank can help our clients and help us win business, then we're going to use that advantage that we have.

Brad Milsaps:

I don't know if this is the right way to measure it, Aaron, but I look at Tpay revenue over the dollar amount of invoices that you're processing. It's been running about 12 or 13 basis points. Should we be pushing that number up based on the comments you've made, as you start charging more? And if so, what's the right percentage to think about?

Aaron P. Graft:

I would say, the answer to your question is the historical revenue per transaction is well below where we are pricing things now. You have to understand and the difficulty in answering this question is, as

we've laid out for you, we monetize things in different ways. But the revenue per million that we expect to generate going forward versus where we were historically is materially higher. I'm not going to give you a specific percentage today, because I want to bring on the rest of this volume that Melissa and team are working on and then we can really point you to it. But the simple answer to your question is, if you're modeling 12 to 13 basis points, that is low for where we are planning to drive the business, and frankly where we're booking new business now.

Brad Milsaps:

Okay. Thank you for that. And then maybe finally on capital, you've talked a lot in the past about the excess capital you have. You don't need a lot of capital to run your business. Is it safe to assume the accelerated share repurchase will all be completed in calendar year '23? And then secondly, you've got some high cost trust preferreds out there. I know they're on the books at a discount, but I'm just curious, thoughts on taking those out and then maybe bigger picture, why even be so aggressive with the buyback? It seems there are a lot of unknowns. You don't know where transportation's headed and none of us do. Again, I know you don't need a lot of capital, but why are you so focused on pushing so much back right now when there are many unknowns out there. Who knows what opportunities might be coming? And I get that you feel like your stocks undervalued based on where it's going, but it just seems like you're really focused on pushing a lot out and just curious, you're thinking there.

W. Brad Voss:

Well Brad, that 70 million accelerated share purchase program that we talked about will certainly be done in this calendar year, probably by the end of the second quarter. As far as our capital base overall and our desire to shrink the share base, we believe that what we're building with our payments business and the way that it all fits together is not fully reflected in our current share price. So as long as that remains true, we would love to continue to retire our own shares with some of that excess capital.

Aaron P. Graft:

And if I can add, and you've gotten to know Brad and the whole team, we're not approaching share repurchases in a cavalier manner. Hopefully you see the discipline we've shown in our balance sheet over the last few years. First of all, no matter what kind of repurchase opportunities are out there, we maintained some pretty significant buffers over any regulatory thresholds because we bought a failing bank in 2010, or a near failing bank. I've seen that movie. I have no desire to see that movie again when we came in and cleaned it up. So we're always going to make sure we have a margin of safety.

But to your point, it's the very thing, the very uncertainty that exists is what creates the opportunity. If we waited until it was certain, I can assure you our stock would not be priced where it is today. So we're not going to pile in all upfront, but I do think you can expect once this 70 million ASR is done, we will be back in the market if our share prices are at a level at which we think does not reflect the long-term intrinsic value of what we're doing. We don't pay a dividend. We're not going to grow just for growth's sake and we're not going to do M&A unless it has a very specific purpose. So that being the case, the fact that we have buffers above the thresholds that we need to maintain, we think it's a good use of our funds to return capital to shareholders and reduce our share count.

Brad Milsaps:

Great. Any thoughts on taking out some of those trust preferreds? I think your cost was 9% and a quarter. That's my final question.

W. Brad Voss:

Those are floating rate trust preferreds, as you know. We're not going to be taking those out anytime soon. They provide valuable capital to us. It would be a hit to common equity tier 1 capital to take those out. They're not going anywhere.

Speaker 1:

Our next question comes from Joe Yanchunis from Raymond James. Joe, please go ahead.

Joe Yanchunis:

Good morning. You previously got into Triumph Business Capitals one Q23 volume being down 10% quarter over quarter due to seasonality. Given you're starting to see signs of strength in the market and then with the relatively steep decline in 4Q volumes, do you still expect that to happen, that 10% decline?

Tim Valdez:

The interesting thing about our business is it's a very dynamic business, and as we look at the performance going forward, it's very difficult to predict, but we look at the average invoice amount. We look at how it impacts our carriers and notice as stated in the shareholder letter, that there is a new baseline being built, so we don't anticipate any further erosion, but we can't predict the future.

Aaron P. Graft:

And as you know, it's two things. It's average invoice size plus utilization. We've established the baseline of what we think... There's a baseline by which we don't think carriers will go below because it's not in their economic interest, what's hard for us to predict is utilization. As of right now, it's a little better than we thought it would be, but that can change by the end of today. So that's as good a prediction as we can make at this time.

Joe Yanchunis:

Understood. And then with respect to Tpay and just looking at what you can control, if invoice prices were to remain static at, say, current rates at 2000, what type of transaction volume would you need to be EBIT of breakeven and do you still hope to achieve that in 2024?

Melissa Forman:

I can't calculate it down to you to the level of the transaction volume off the top of my head right here, but what I can say is that we do expect the average invoice price to differ. And one thing you have to understand is the difference between TriumphPays average invoice and the difference between Triumph Factorings average invoice is quite different. In Triumph Pay, ours is $1,250. And that's because we see transactions from our brokers and the payments that we're making that are all inclusive of their modes. Factoring typically has more specialized focus on full truckload and in the spot market. And so those are going to be higher. On our side, we get the combination of contract and spot.

And so with that and with the volatility that we see, again, it's hard to predict, but we do intend, I think again, the most

Melissa Forman:

The most important thing is to focus on that EBITDA margin improvement and understanding that EBITDA margin improvement will come with higher revenue and a slower expense climb. Want to add to that?

Aaron P. Graft:

Well, the only thing I'd say, and Joe, this is why we called it out. TriumphPay does many things and it's not just a unilateral, this is the offering. We do audit, we do payment. The most valuable thing we do are network transactions. We called that out. It's a billion dollars we did in this year and because it's the most valuable thing, it also generates the most revenue for us. It's not just as simple as saying it's this level of volume of payments we're making, it's what is the nature of engagement with the network constituents to the extent we can grow network transactions faster than everything else. We get to that revenue number long before we get to the total volume number, that's why we're pointing it out to you, and one of the things that we're excited about is in the face of a slowing freight market, we grew network transactions almost 9% quarter over quarter. That's exciting.

That means factoring companies or any payees are seeing the value in what we're offering. The other danger in just talking about total addressable market or the total volume is that moves around. When we put out a number a couple years ago of 170 billion being the total addressable market in brokered freight. Today, that's probably closer to 150 billion. What changed? Average invoice sizes fell. We think about that in ranges and that could trend down to 125 billion. Doesn't make brokered freight less attractive, it just means the market's moving. The thing to focus on, if you want to think about the long-term value proposition for TriumphPay is yes, of course volume growth, yes, of course tier one factors and brokers joining the network. But those are just the seeds to grow what really is what we're after, which is network transactions, because that's what delivers the most value to both sides of the network. That's what makes it sticky. That's where the fees come from, and that's what is transforming the efficiency of how invoices are being presented, audited, and paid in trucking. That's where I would be focused.

Melissa Forman:

Right.

Joe Yanchunis:

If I could actually go back to those seeds you were talking about. In light of the current market, are you seeing either brokers or factoring companies being more receptive to your value proposition?

Melissa Forman:

Yeah, I would say certainly recessionary periods require everybody to look for operational efficiencies, and so as they do that, they're looking to technology to solve those problems for us. Certainly we believe that TriumphPay is that answer, and so the open doors are there, the conversations are happening, and we continue to grow. We're excited about that and the opportunities we have ahead of us.

Joe Yanchunis:

Got it. Then if I could just sneak in one last one. No, your commentary, and then earlier on this call, you talked about your expectation for fee income to represent a larger share of revenue. Well, I understand

a lot of this is going to come from T-Pay. If we're one to two years out, what does that revenue composition look like for you? What would you consider to be a success?

Aaron P. Graft:

If we're talking in that short of order, I would consider a success just seeing that number..

Joe Yanchunis:

Just any range that you think would be appropriate.

Aaron P. Graft:

Yeah, so good question. The caveat, I'm not hesitating because I'm afraid to make a call, but tell me what the size of the bank balance sheet is at that time, because that's going to affect things. The bank balance sheet, we've already established, we're not in this to grow our bank balance sheet or even our factoring balance sheet materially. We want to be efficient and we want to have smart growth. If you assume that both of those are true, that there's not material movement in either the banking segment or the factoring segment, then what I would look at is look at what TriumphPays revenue run rate is now, and look at where we're calling for it to move. Understand that revenue it has a mix currently between net interest income and fee income and understand we're telling you that network transactions are where we want to grow, which is more on the fee income side.

If you put all that together, I think it would be still probably a single digit movement, but if it were a higher single digit movement, I would call that a win on a longer term journey because there's an inflection point in the curve coming when TriumphPay establishes this business concept is not just a concept, but it's now a valuable business and we try to give a timeline for that. As we start to achieve that, we have to think about now how does the whole balance sheet work together? Right now, how the balance sheet works together is to support this investment we're making, but there's a day in which TriumphPay is going to be accretive to what we're doing, just like our other segments. Then we think about the overall nature of the revenue we generate because revenue's great, profitability's even better, and defensible profitability is the greatest of all. It's a journey. I'm not trying to talk around the question, I'm just trying to help you see all the angles that come into play as we think about that. That's my best shot at answering your question.

Joe Yanchunis:

All right. Well, I appreciate it. Thank you for taking my questions.

Speaker 3:

There are no further questions on this line at this time. We'll now move over to the phone line for further Q&A. Thank you.

Speaker 4:

Thank you. At this time, if you would like to ask a question, please press the star and one on your touch tone phone. You may remove yourself from the queue at any time by pressing star two. Once again, that is star and one to ask a question. We will pause for a moment to allow questions to queue. Our first question comes from Hall Gosh, with Loop Capital.

Gary Tenner:

Hey, thanks for taking my question. My question relates to PPA pricing, and one way to think about it is you have a lot of business on there and cohorts from a year ago or more and some today, and some are using maybe one of the services, payment, audit, or network. One way to think about it is the back book, the first people on the network are priced one way and new people are being priced another way, different mixes. What is the effective yield or take rate on someone who's doing network transaction, payment, audit, or basically the whole cafeteria of value provided by the network. What kind of take rate are you getting from that kind of customer you're adding today? Thanks.

Melissa Forman:

Yeah, I mean it ranges certainly based on the size of the customer, the volume that they're putting through, and like you said, if they're doing all the services, that matters as well. You see anywhere from, like you said today, the 13 basis points up to 25 to 30. It's really hard to say, it just depends on the situation, the relationship, and the amount of integration that they're doing and the pieces that they're leveraging from the network. Keep in mind, most large brokers have proprietary systems that mean that they might use pieces and use TriumphPay differently than the next. Every one of those situations in conversations that we have are typically customized, and so it changes.

Aaron P. Graft:

Just point of clarification there. A customer signs up for audit or payment, they don't sign up for network. If you're both enabled on audit and payment and the person on the other end of the transaction is enabled for audit and payment, then it automatically becomes a network transaction. I think, and Melissa correct me on this, but the fairway, if you will, of revenue on the payer side of the transaction, freight broker or shipper, is roughly between a thousand per million and 1600 per million.

Melissa Forman:

Yeah, that's right.

Aaron P. Graft:

Okay. We're walking that higher. That'll depend on size and a lot of factors, but that's on the payer side. Also, understand the payer bears less of the economic burden than the payee because the payee is able to increase efficiency more materially. I would say for network transactions, roughly $3 and 50 cents. Does that sound right? It's going to again, depend on pricing and sizing, but that gives you some direction to work around and that is materially different then what we were doing three years ago because we didn't even know to call them that then. There's a little bit of, we're discovering as we go, and what else? Anything else you would add?

Melissa Forman:

I would just say that as we have gone to our payee customers and looked at adding the network transactions in there, they are very receptive, they're seeing the value. We have proven this test. We know that TriumphPay network transactions are meaningful to the participants in the transaction and so we're getting very good responsiveness on the term sheets that we're putting in front of people right now.

Gary Tenner:

Thank you.

Speaker 4:

Thank you. Once again, if you would like to ask a question, please press star one at this time. At this time we have no further questions from the phone line.

Aaron P. Graft:

Thank you all for joining us. Have a great day and we'll see you soon.