Triumph Bancorp 2Q 2022 Earnings Call

July 21, 2022

Luke Wyse:

Good morning, welcome to the Triumph Bancorp conference call to discuss our second quarter, 2022, financial results. Before we get started, I would like to remind you that this call may include forward-looking statements. Those statements are subject to risks and uncertainties that could cause actual and anticipated 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 and earnings release published last evening. All comments made during today's call are subject to that safe harbor statement.

I'm joined this morning by Triumph vice chairman and CEO, Aaron Graft, our chief financial officer, Brad Voss, Todd Ritterbusch, president of TBK Bank, Geoff Brenner, our CEO of Triumph Business Capital, and Melissa Forman, our president of TriumphPay. With that housekeeping out of the way, I'd like to turn the call over to Aaron.

Aaron Graft:

Good morning, everyone. We hope that the shareholder letter we published last evening was helpful for you in preparing for this call. At this time, we're ready to open the call up for any questions.

Operator:

All right. If you have any questions, feel free to use the raise hand feature and activate your camera. Our first question comes from Michael Rose from Raymond James. Michael, feel free to ask your question.

Michael Rose:

Hey, thanks. Good morning, everyone. Thanks for taking my question. Obviously, a lot of moving parts this quarter, a lot of repositioning efforts, would love to get some context there, but first just wanted to dig into the average invoice size. It definitely held up better than I think we were modeling, and I think there's been a lot of chatter in the trucking space about invoice prices and trade costs and things like that. Can you walk us through the dynamics and maybe what you might expect for invoice prices as we move forward? It doesn't seem like they're going to get back down to where they had been pre-COVID, just given structurally higher fuel prices and labor costs. But we just love any insights into the nearer term direction of TBC. Thanks.

Geoff Brenner:

Hey Michael, this is Geoff. I'll take that one. I think we've benefited from heightened diesel prices, and as you know, that factors into the average invoice size, and we think the imputed higher diesel prices and these invoices has held them up from what we had called for, which is a gradual return to normal. So, that dynamic certainly occurred in Q2, and looking into Q3 if diesel prices stay at or about their current levels and if utilization stays at or about its current level, which is about 96%, we would anticipate cautiously optimistic return or holding flat and then an eventual opt return back to what you'd seen several years ago.

Michael Rose:

Okay. Thanks. And then maybe as a follow-up, on the network side, I think the trends there may be a little bit weaker than what we'd modeled, but just as we think about the intermediate term, is there any updates to when you guys expect for the network to really break even, and then begin to generate some profitability? Because it does look like the ramp is perhaps a little bit slower than at least I was expecting, but we just love any updated color there. Thanks.

Aaron Graft:

Yeah. Great question. I'll take that. And if I say anything wrong, Melissa will correct it.

As we've tried to focus the market on there is a steady drip every quarter of clients coming into the TriumphPay ecosystem. It's just that the ones that really move the needle are the ones we describe as tier ones because they control such a large amount of business, each one of them individually and certainly collectively. We pointed out in the letter, we have over 15 billion in volume in the pipeline, and those are chunky because they come associated with large names. That's just the identifiable pipeline. So given where we are in the year where we are in the integration schedule, I would actually expect for Q3 the gross payment volume to be flat to perhaps down slightly, just if invoice prices do moderate even more.

We expect there to be a big spike upwards in Q4 when we go live with the first part of this group of new clients who are in the pipeline. And it's going to be chunky from there, or it'll be a step function each time a new one comes on just because of their size. And so revenue will move right along with that. And ultimately we believe we are on track to exit 2024 with a business that's doing over 75 billion in payment volume, an ever-growing portion of that being conforming transactions upon which we charge network fees. And we think at that pace or at that scaled size that gross revenues will be a hundred million, and this will be a business that generates positive EBITDA. So, that timing is still intact. You're just seeing the first quarter in a while where we didn't bring someone live onto the system, but that pause won't last very long.

Michael Rose:

Okay. Helpful. And then maybe finally for me, any updates on... You talked about the potential for the contract shipper market at some point. I didn't see much in the shareholder letter about that. I know there was some, but we just love an update there. You previously had slides, and I think you were 2% to 3% by your math of the volume there. What's the outlook there, and should we be thinking about that? And then just with the repositioning efforts, a lot of moves this quarter, could we expect moving forward much cleaner results because I think there has been a lot of noise in the numbers. Thanks guys.

Aaron Graft:

The shipper?

Melissa Forman:

Yeah. I think on the shipper market, we did have one tier one shipper come onto the platform in Q2. And so we've seen some growth in that business. We also made an additional investment in Intelligent Audit, which is a freight audit company, in that space to further our initiatives in that segment of the market. And so there's significant total addressable market available in the shipper space. When you look at the contract shipping, we size it around a $250 billion opportunity, so we're continuing to invest there. And the additional investment with IA has allowed us to really reposition our relationship there and then our strategy within the market to be more in line with our open network that we're building out for TriumphPay. So you'll see more coming soon on that side.

Aaron Graft:

Yeah. Mike, I wouldn't overlook that Intelligent Audit investment as being consistent with what we've always said of there is another market yet to go get more of. We have a couple billion of it, but there's a lot more to go get. And so things are happening. And then in response to your last question about expecting clean quarters, I can never predict quarter to quarter what opportunities are going to present themselves. But I think it is likely that the next few quarters won't have anywhere near this amount of noise. But as you said, and we want everyone to understand, we are still in a period of strategically turning this business towards where we want it to go. And as a result, there's going to be things along the way where we reallocate parts of what we're doing to things that are consistent with our future strategy. So there may be noise in quarters to come, but I don't expect it to be anything like this one.

Michael Rose:

Appreciate all the color. Thanks for taking my questions.

Aaron Graft:

You got it.

Operator:

And our next question comes from Matt Olney from Stephens.

Matt Olney:

Hey guys, good morning.

Aaron Graft:

Good morning, Matt.

Matt Olney:

I also want to dig more into TPAY. I thought most of Q2 metrics showed some improvement or at least similar to what I was forecasting. We saw higher number of invoices, higher dollar amount of invoices, but the dollar amount of receivables was down linked quarter. And I'm not clear if the turn times increased or the discount rate declined any color you can give us on why the average dollar amount of the receivable declined in TriumphPay.

Melissa Forman:

Yeah, that would be in direct alignment with the average invoice price going down. The receivables themselves are tied to the amount of the invoice. And so as that has softened within the portfolio, we'll see that revenue drop.

Matt Olney:

Okay. And then within, TriumphPay also curious about the investment spend there. Appreciate that it's vital what you're trying to achieve, but help us appreciate the ramp of the expense in that TriumphPay segment. When do you expect that ramp to moderate? How close are we to that?

Melissa Forman:

So right now, our investment is primarily in our operations folks. So as we continue to grow the payment volume on the platform, it requires support and contact center support for the customer service side of that. As we look at our future growth and what's in our pipeline, as Aaron mentioned, we have $15 billion that's kind of stacked up ready to come onto the platform. That is a significant increase. And so we are in preparation of that volume, staffing our teams up so that we're prepared for it and have the training, et cetera, in place to be able to handle that smoothly for our customers. So you'll continue to see us invest operationally to support the growth and that will continue to go out through 2024.

Aaron Graft:

Yeah, I think, Matt, to your question on whether the glide slope is probably flattening a little bit. We did a significant amount of hiring and building with TriumphX, bringing in some very expensive, but very valuable team members to help us shape this strategy. So the go forward investments are always to update the software ecosystem. I mean, that's a living breathing thing, but most of the ads are in operational support. So it'll be a flatter growth from here.

Matt Olney:

Okay. That's helpful. Thank you for that. And then just I guess lastly, we've talked in the past about eventually doing some syndications within TriumphPay. Just remind us how close are we to seeing these syndications? Is this something we could see towards the end of this year or this more of an initiative that we'll see more impactfully in 2023?

Aaron Graft:

I think it's going to be more of a 2023 issue, Matt. We're not balance sheet constrained as you know, from all the repositioning that has been done. And so we're not in a position where we need to be selling those assets to make room for the balance sheet allocation we have for it. We think that's a future state problem when we have significantly more volume coming across the system. But nevertheless, just like we wanted to create the plumbing for equipment finance syndication opportunities, the syndication inside of TriumphPay, it would be wise of us to do one in 2023, just to demonstrate that the plumbing works for ourselves and our counterparties and investors. So I think even if we have the balance sheet room to hold it all, you'll see us do the first one of those next year.

Matt Olney:

Okay. Thanks. I'll set back in the queue.

Operator:

Our next question comes from Steve Moss from B. Riley.

Steve Moss:

Sorry about that guys. Morning.

Aaron Graft:

Good morning.

Steve Moss:

Just on the pipeline here, you guys mentioned that there's $15 billion in annualized payment volume here come online. Is all that just what is in integration or is some of that also include like contracted, but not yet started in terms of API integration?

Aaron Graft:

Yeah, it's a both and, right? This is volume that is in the contracting phase and we have already started integration, but we haven't signed the final contract or completed the integration.

Steve Moss:

Okay. And-

Aaron Graft:

It's not as linear of a process as you would expect. By the time you get into the point where you're working on the contract, that means you're also working on integrations just because the pipeline is so long.

Steve Moss:

Okay. And then in terms of just the conforming volumes here, just conforming transactions, your end of quarter numbers imply a healthy step up. How do we think about conforming transaction growth as we go here over maybe the second half of the year?

Melissa Forman:

Yep. So as we step up that volume on the payments network, the payment volume where we have those share ones come in, they will be conforming enabled brokers. And then as in the last quarter, we spent a lot of time reengineering the plumbing for our existing clients to get them to a conforming level as well, so fully integrated, conforming capable.

So there's still a lot of work to do with our existing clients to get them there. Those take reengineering and reintegrating existing plumbing for them. But the team has spent significant amount of time making that happen. So you'll see us to continue to grow that. We're continuing to add factors into that network as well, so that they can receive that data. So we have a team that is completely focused on just reengineering the existing clients to get them there. It does take some development efforts on our customer side as well. So we're a little bit at the mercy of their availability to make those changes, but we're making significant progress.

Aaron Graft:

And Steve, just to take it from just that to a more granular level, it's which side goes first. You need a certain number of large freight brokers to be on the ecosystem for this to make sense for the factoring universe, right? They have to believe that they're going to see 20% of their payments come through as conforming transactions in order to change their business models and take advantage of the network.

On the flip side, the large freight brokers want to see more factors on this system because that creates a more efficient way for them to work together. If you look at the market right now, 15% of the payments that Triumph Business Capital receives, they receive from TriumphPay. So that's our penetration of the market, as it's going to factors. About 5% of that volume is coming through as conforming because there's a lag in making sure all of those freight brokers are fully integrated. When you add the $15 billion that's in the pipeline, plus what other things we're working on, the day is going to be here before the end of 2024 when we make far more than 20% of all payments to the factoring industry and we can deliver almost that same amount in conforming transactions, at which point, if you don't join the network for conforming transactions, your business model is going to struggle to compete with the efficiencies that the other players will have.

Steve Moss:

Okay. That's helpful. Appreciate that color. And then just one question on expenses here. I hear you guys on the stable expense side quarter over quarter, but maybe just kind of curious, are you seeing any additional inflationary pressures as [inaudible] more about the beyond the third quarter?

Aaron Graft:

Steve, I lost the second half of your question, but I think you were asking about just inflationary pressures on our expense base overall. We have definitely seen wage competition as we're bringing new people aboard. That's clearly been happening and is continuing. It feels as though it may be moderating a little bit at this point, especially on the technical side. We tell our team all the time that we're in a very good position relative to a lot of other folks who would be bringing on technical talent because we're not beholden to that next round of venture funding. And a lot of the startup type companies out there are pulling back in a pretty material way, just given market conditions. And we don't have to do that, but I wouldn't say that it's anything accelerating or anything like that, but we're definitely feeling it to an extent.

Steve Moss:

All right. Thank you very much. Appreciate the time.

Aaron Graft:

Thanks, Steve.

Operator:

And our next question comes from Brad Milsaps from Piper Sandler.

Brad Milsaps:

Hey, good morning guys.

Aaron Graft:

Morning, Brad.

Brad Milsaps:

Aaron, thanks for the shareholder letter. That was very helpful. Just kind of wanted to ask around the timing of some of the actions that you took this quarter. I think the factoring sale was at the end of the quarter and then was unsure the timing on the sale of the equipment loans, but just curious how both impacted maybe Q2 results. I know you got us on there, if you don't voice some of that would be kind what it means for earnings, but just wanted to talk about your ability to replace those lost assets. Looks like you were sitting on more than $700 million in cash at the end of the quarter, so just kind of wanted to think through some of those moving parts.

Brad Voss:

Yep. Brad, both of those transactions closed in the back half of June. So that cash balance that you see is definitely inflated relative to where we would normally have it be. As far as the opportunities to reinvest, there are several ways that we could go with that. We've already started some of that. The market has given us an opportunity to invest in some more liquid market investments. Think top of the stack, CLO securities, liquid loans, things like that. We'll continue to do that, but we're going to do it at a measured pace. We kind of have to think about our excess capital, and in a few different buckets, and re-levering is one of those buckets. Looking at our own shares is another, and holding capital back for another day for a variety of purposes, is another. We look at all of that in totality. As far as what we're giving up, I think we mentioned in our shareholder letter that the net interest margin given up on the equipment portfolio, and as a reminder, that is a fully amortizing set of loans. That's a bit of a melting ice cube and we retain those customer relationships and will continue to originate more assets with those same customers.

But we're giving up about a little over $3 million in net interest margin over the balance of this year, another $4 million over the totality of 2023 from the equipment sale. General factoring is a little bit harder to pin down, because those balances fluctuate quite a bit more, and they're not quite as scheduled out so to speak, but just rough numbers. We're probably looking at about $7.5 million of net interest margin that will not receive on those assets.

Aaron Graft:

Brad, it's probably a safe and conservative assumption to assume that we will replace a portion of that revenue over the next few quarters. I think the balance sheet will stay roughly around the size it is. So you'll see some loan growth, to the extent we believe in opportunities, but there's going to be a period, certainly this period and next period, where there's some margin that hasn't been back filled.

If we backfill it, when we backfill it, it's going to be consistent with the strategy. So it's very likely going to be either quick pay balances that come from this additional volume coming into TriumphPay, or the continued growth of Triumph business capital in its core transportation markets. Everything else around the edges in the community bank and otherwise, we'll do if it's appropriate, and as it makes sense. So it's okay for us to have the excess capital during this period of time when we are evaluating other ways to invest in TriumphPay, to accelerate its growth in freight audit and pay. And we're looking at the opportunity to buy our own stock back, should the market pull back to a level where we believe that the TriumphPay call option is priced close to zero, and we think that's a good use of that excess capital. So we're not going to be led to do a less than excellent decision just to protect margin over the next two quarters. I mean, if we give back a few cents in earnings, because we maintain optionality, we are very comfortable with that.

Brad Milsaps:

Now that's helpful. So kind of in the interim, you might see a step back in traditional factoring revenue, but then you start to kind of back build out with more TPAY revenue towards the end year, even the next.

Aaron Graft:

Correct.

Brad Milsaps:

And I know it's not cool to talk about the bank on these calls, but I'll ask the question. Just curious, you're profiting more assets at the bank than you ever have been, just given the improvements in your deposit base, pretty much lift, sort of ex the impact of the assets that you sold. Do you expect to see it in that interest income at the banking segment as you move through 2023 and 24?

Brad Voss:

I think that, bear with me, just looking at the rate environment and our deposit base, about 85% of our deposit base now is what I would consider to be very high quality, non-maturity deposits that are not particularly rate sensitive. We've not really seen any intense price competition for those deposits so far. Other banks remain fairly liquid as well. We are responding to specific situations as we feel is appropriate. But as far as what the impact of rate changes would be, we're looking at about, probably about $3 or $4 million, if I recall, relative to what the markets would over the balance of this year in a flat rate environment. So we're projecting another 175 basis points or so of increases on the short end of the curve. And that should produce $3 or $4 million over the balance of this year. And then looking at it be $10 million, if I recall, what the modeling would suggest.

Brad Milsaps:

Okay, great. Thank you guys. I'll hand it back to you.

Operator:

And our final question comes from Gary Tenner from D.A. Davidson.

Gary Tenner:

Thanks, morning, everybody. I'm going to ask another mundane bank question. Noticed in the quarter, the provision was up quite a bit, obviously a tiny bit related to the cancellation of the plan to sell the branches. And it looks like the provision was mostly in the bank segment. So, just wondering if you could talk about changes you may have made to your ACL model, otherwise the ACL's the highest it's been since probably early stages of COVID. Thanks.

Brad Voss:

Yes, we did recalibrate our economic model that drives a lot of those ACL results, and we've got a higher probability of a recessionary type of environment and higher unemployment, and that's what drove the increase in this period.

Gary Tenner:

Thank you.

Operator:

All right. We'll take one more question on this line, and then we'll go to the phone line. This one comes from Matt Olney from Stephens.

Matt Olney:

Thanks. To follow up, I want to dig more into the equipment lending portfolio, equipment lending is an asset class I think a lot of investors are becoming more cautious on, due to some of the economic headwinds, but you guys announced a loan sale that resulted in a nice premium, and you hinted that it could be more such sales in this asset class. So we'd just love to dig in more into this portfolio and what else should you have planned for the future for this?

Todd Ritterbusch:

Yeah, I'll take this one. Thanks Matt, for the question. So we definitely intend to do more of these sales in the future. This is completely consistent with our desire to continue to serve our transportation clients with equipment finance solutions without necessarily growing overall balance sheet. The plan would be for us to continue to originate at least our current pace, and maybe a faster pace going forward. And then as we accumulate balance to continue to either sell to other banks or securitize, whatever the best execution would be. In this case, the execution was a sale to another bank. That bank was just very eager for earning assets, so they were willing to pay a higher price than anyone else. It was a competitive process, We thought it was a really good move for us to be able to take that gain, basically reload the equipment finance sales team, send them back out to originate more, which allows us to stay within our internal credit limits for our existing clients, and also potentially go out to market for other clients that we haven't pursued in the past.

We have pretty high hurdle rates and expectations for what we make for the assets that we keep on our own balance sheet, but we could go after higher quality, lower rate clients with the idea that we would sell those assets in the future, and that would open up new markets for us as well. So we're just as committed to equipment finance as a tool to serve transportation clients as we ever were. And with the way we've structured this and our ability to retain the relationships, with this being completely transparent to the borrower, I think positions us really well to do so.

Aaron Graft:

And Matt, it should probably be just so that you have clarity. The equipment finance, obviously for us is largely in and around Class 8 trucking, over the road trucking, whether it's trucks, trailers, any type of that equipment. There is construction lending in there for heavy construction equipment, and there is also for waste hauling. We don't do subprime lending in our equipment finance portfolio. And that means many of the smallest independent owner operators are not our borrowers in that portfolio. It's more of a small to medium size fleet product. If you get into large fleet, we're not going to be competitive because as you know, we try to have pricing discipline. So you're talking about the actual trucking companies who produce financials and all the things you would expect, which is why the credit quality has performed well enough that we have regional banks who would like to be our counterparty in that, because it's difficult to produce that many loans as it takes. And they amortize down so quickly, because they're on fully amortizing. They're made on a fully amortized.

Quickly, because they're on fully amortizing. They're made on a fully amortizing basis that there's value in the team, the relationships the team have built, but we've always made sure that we were focusing on the higher end of that universe. And we will continue to do so, and so I think investors are right to have concerns about equipment finance portfolios. I think you're right to have those concerns in any given market. I would be really worried about people who underwrote those loans using algorithms in a black box. I mean, that has been proven not to be successful at scale.

That's not what we do. Our equipment team knows our borrowers, their companies, many of whom have deposit relationships with us now. So we are their bank, and we know them well enough to judge credit well. And I hope that this loan sale that we did, you can imagine that the buyer would've looked through that with a fine tooth comb and to understand the risk. And I hope it demonstrates to you and the market the quality of that equipment finance portfolio.

Matt Olney:

Yeah. That's helpful. And that all makes sense. And just lastly, I want to ask about capital and capital constraints at the company. It seems like you've got plenty of excess capital today. I think your CET1 still over 11%, I'm assuming continued capital build, because there's no dividend. We talk about freeing up capital. You've done some loan sales. I guess, help me appreciate just big picture what the capital constraint is today as you see it.

Aaron Graft:

Well, on an organic basis, Matt, I don't think there is a capital constraint. I mean, as you watched, we hold our balance sheet relatively at its current level and have done so for several quarters. And we've been far more focused on the mix shift of assets underneath to take us into the transportation centric future that we envision for ourselves. So the capital constraint then comes down to the only other two uses of capital, which are on our radar.

Number one would be to buy back shares, and we've executed on that. We're not executing on it right at this moment, but that is a tool that we will not hesitate to use if we see our shares pull back to, as we've said, if you're intrinsically pricing, TriumphPay at zero, we'll buy all of it we can, because we see the long term value proposition. And the second option would be the use of that capital to buy and invest in technology companies that would support our growth in freight audit and pay, much like we did with intelligent audit.

As you would expect, many of those investments, even if the underlying company is profitable, creates a significant intangible, which becomes a use for the capital base we have. So that would be where I would see the constraints to show up, which would be adding additional intangibles to the balance sheet if the opportunity presented itself and then ultimately buying back our own shares because we believe in the long term value of what we're doing. Also would, given where we trade, still create an intangible.

Matt Olney:

Yeah, that's helpful. Thanks guys.

Aaron Graft:

Thank you.

Operator:

All right. I'll now hand things over to Chelsea for any questions from the phone line. Thank you.

Chelsea:

Thank you. At this time, if you would like to ask a question via the telephone, you may do so by pressing star one on your telephone keypad. Once again, that is star one, to ask a question. And we'll pause for a moment to allow questions to queue.

Our first question will come from Adam Hurwich with Ulysses.

Adam Hurwich:

…Term restraint in the balance sheet, medium to longer term. Is there any growth that you'd expect to see on the balance sheet?

Aaron Graft:

No, Adam, I think we're always going to be opportunistic. I would say no or an extremely small chance we would ever consider going over 10 billion in assets. That's not part of our roadmap here. We want to be more nimble than that. And so between now and the end state, and if the end state is we are the ubiquitous payments network for the trucking industry and we allow parties to own the receivables that are generated in that structure through syndications then I think we would say to you over the long term if we are being successful at the play we have called for ourselves, our balance sheet will shrink from here.

Adam Hurwich:

So just to try to understand how you think about it, and I don't need any guidance but just directionally, your GAAP EPS approximates your free capital generation, which means that your optionality going forward vis a vis, whether you buy strategic technologies or return the capital to shareholders, really approximates your earnings and whatever excess capital you generate.

Aaron Graft:

We would agree.

Adam Hurwich:

Fine. Thank you.

Chelsea:

Thank you. Once again, that is star one to ask a question. All right, there are no further questions in the queue via the telephone.

Operator:

Thank you. This includes the Q&A portion.

Aaron Graft:

Thank you all for joining us today. We look forward to speaking with you soon. Have a great day.