Triumph Financial, Inc. Q2 Earnings Call | July 18, 2024

Luke Wyse:

Good morning. It's 9:30 in Dallas, so let's get started. We'd like to open by thanking you for your interest in Triumph Financial and for joining us this morning to discuss our second quarter results. With that, let's get to business. Aaron's letter last evening discussed the quarter's results and the investments we are making in a few projects that we believe will create long-term shareholder value. We are excited about the opportunities we see to lift an industry and create a network that delivers tangible benefits to all participants while improving transparency and creating value for America's truckers.

As you'll see this morning, Todd will not be joining us. Todd is never afraid to get in the trenches and lead during difficult market conditions. However, today he is recovering from Achilles tendon surgery after being reminded that pickleball is not a contact sport. We wish him well and a speedy recovery and expect to welcome him back to the earnings call in Q3.

That quarterly shareholder letter published last evening 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 risk 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 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&A. Aaron?

Aaron P. Graft:

Thanks, Luke, and thank you all for joining us this morning. I have just a few comments before opening it up for questions. The big story this quarter is our progress in building density. Our network engagement stands at just under 47% as we sit here today. With the signing of C.H. Robinson and with Arcvest, a top 20 broker going live during the quarter, we have a site line to achieving critical mass related to our network density. And monetization is what follows density. This is the way it works in network economies.

We have a tremendous amount of momentum right now. Now that's what we see on the horizon. And while our eyes are on the horizon, it is not lost on me that we live in the present. And for the present, our earnings are under pressure for the reasons I wrote about in the letter. There are some things we can control and some that we cannot control.

In choosing our path forward, we have focused mainly on creating long-term value at the expense of improving short-term results. That is why we continue to invest at a time when, I think, most people might slow down or become defensive. Now, taken to an extreme, that view can be cavalier. We do not want to be cavalier. Instead, we want to be intentional and we think an appropriate guardrail to our aspirational growth is fixing our expenses at approximately 97 million per quarter going forward. This

allows some room to make additional technology investments to deliver on our promises to our customers and our prospects, and it forces us to be disciplined about our talent management. This is healthy for us and it will enhance our profitability, both in the short term and the long term.

In closing, the stakes are high. We are building a network that connects many to many, many in a very large market. Those opportunities are hard to find and even harder to execute on when you find them. The rewards for those who win make the effort absolutely worth it. Those are my opening thoughts. Now let's turn the call over for questions.

Speaker 1:

We will now go to Q&A. If you have connected via Zoom and would like to ask a question, please use the raise hand feature at the bottom of your Zoom window. Or if you have dialed in, press star nine. Once called upon, please feel free to unmute and ask your question. Our first question comes from Tim Switzer from KBW. Please go ahead.

Tim Switzer:

Hey, good morning. Hey, good morning. Thanks for taking my question. Certainly wish Todd the best on recovering the Achilles there. The first question I have is, the revenue growth in the T-Pay segment has been kind of chunky historically, and it was above 50% year over year the last three quarters, but it slowed down a bit this quarter. What needs to happen for us to see an acceleration in revenue there? And is it simply an end through session, more brokers or factories on the network, more revenue generating invoices? Can you guys walk us through that?

Melissa Forman:

You just nailed it, it's those three things and so certainly, the transportation recession is creating an issue for short-term earnings. But as you've seen TriumphPay is growing through those headwinds. And so, while we've had payment volume growth and network engagement growth, we've also had expense growth. And one thing I want to point out, is that our expense growth quarter over quarter, while it was just under 6%, our growth year over year, same quarter, was 40%. And you're seeing a lot of that happen on the fee side. So the majority of that is in our fee growth, which is where we think is the most important part of the network that we can control to be able to remove as much market volatility as we can. And so we're seeing that growth happen there, continue to reprice customers as we've talked about in the past. Certainly as we bring on new customers are using our new pricing models. And in that you're seeing those changes happen in the mix of our revenue.

Tim Switzer:

Okay. And my follow up there is, the increases you've seen on generating more revenue from your invoices. It went from a little under 22% to a little over 22% this quarter and you made more progress year over year. What strategies are you guys implementing to, I guess, become more effective at being able to charge and what are some of the challenges you're seeing on doing that?

Melissa Forman:

Yeah, that's a great question. So the difficulty in building this network is the connectivity, right? And that's where we feel like we are building an [inaudible 00:06:17]. And so, it's taking network enabled transactions and connecting them to the factor on the other side so that they can see that value come from the network. And so you've seen us grow the network transactions pretty substantially, quarter

over quarter. This one, it slowed down a little bit at 13% growth, but that's because it gets harder and harder. The bigger you get. The bigger your denominator, the percentage changes.

And so what has to happen though is when I have a transaction that is on a broker side that's network enabled and I'm connecting it to a factor, it's not just saying the factor's enabled and the broker's enabled, it's making sure those two relationships can connect because every factoring management system is different. And so when you start to build density and those connections is when the monetization can start and we're building that now. We're building that foundation. When you think about where we're at from a factors perspective, who's on the network, about 21 to 22% of their portfolio now is being connected through the network. We continue to work on that and ensure that whatever's available on the broker side is usable and consumable on the factor side, and that's where the real value of the network comes into play.

Aaron P. Graft:

You can't answer it any better than Melissa just did, but I think, Tim, the only thing I want to add here is because it's something I've thought about. It's a fair question and I think it's a question of why do things go slow before they go fast? Why wouldn't it be if what we've built here is a better mousetrap, which we all absolutely believe, and I think anyone who uses the product believes, then why doesn't it just take off? Well, I think what you're fighting is the bias against change. Change is hard. Change is hard in your personal life, change is hard for a corporation. And so, I think probably, I know this, when credit cards were introduced to retailers, they didn't go fast at first. "Why are we using plastic? Where is the efficiency? Where am I gaining by taking this, just adding one more form of payment? How does that help me?"

And it's exactly what Melissa said is as we go and you create these connections, it starts to go faster and faster because people experience the value of the change. But what we have to overcome in the density building phase of the network is the bias to not change what's worked for the last 20 years. Adding C.H. Robinson, adding Arcvest, adding this volume, crossing over 50%, continuing on to our long-term goals, that density will overcome the resistance to change because you can just see the economics, you can see in your business how things change. And that's why I think what Melissa and the team are doing is so great, but you just have to keep pushing the ball down the field three to five yards at a time, and then you're going to turn around and look and see, oh man, we have made a lot of progress. But sometimes, in a measured quarter to quarter, it doesn't always feel like that.

Tim Switzer:

Okay, I appreciate it. If I could squeeze in one more, I know this might be an impossible question to answer, but what's that threshold of density that you need to where you really start to see the exponential effect of, I guess it's really network effects here that we're talking about. Do you guys have any idea of when that occurs?

Aaron P. Graft:

Yeah, I mean, that's a great question. What we've said is we expect to cross over 50% by the end of this year. We're at 47% now, that doesn't include any of the Robinson volume. It doesn't include a lot of the volume that, people who are already on. So long-term, what we've said historically, I don't know if I've ever been precise about it, but we can be precise here. I think we'll get to 80% density, and I said, '24 and '25 are our years to continue to build density. Does that mean exactly that on December 31st, 2025, we're at 80%? No, I can't answer that, but I can see the pathway forward. If that's true, somewhere between 50 and 80%, the factoring companies who are the ones who I think benefit the most from the

economies of scale on their side of the transaction start to see more than half of their transactions come through with the opportunity to connect to the network and they can start to adjust their staffing models to recognize the efficiencies.

So there's no magical number, but I think it's somewhere between half and ultimate penetration of 80% because it's impossible to ever say you're going to get that long tail of the last 20%. And that's why I opened the letter saying, '24 and '25 are the density building time and monetization should still grow. We're growing revenue. I'm not asking for permission not to grow revenue. I'm asking investors to understand that being the first mover, that window is open and we need to get to that density threshold between 50 and 80% in order to be able to change this industry and deliver value to our constituents. So that's not a precise answer, that's a band, and that's where we think it is.

Tim Switzer:

Got it. Yeah, appreciate the details there. Really helpful. I'll get back in the queue.

Speaker 1:

Our next question comes from Gary Tenner from D.A. Davidson. Please go ahead.

Gary Tenner:

Thanks. Good morning.

Aaron P. Graft:

Hi, Gary.

Gary Tenner:

Wanted to ask about the conforming volume. It continues to increase as a percentage of total volume in the payments segment. It's maybe slowed from the pace of growth, I think, Melissa, as you pointed out, maybe 13% this quarter. As you think about C.H. Robinson coming live, let's say, second quarter '25 is kind of a full quarter run rate, just for the sake of argument, but what do you think the addition of C.H. Robinson and their volume does in terms of pulling up the conforming penetration rate, if you will, out of the gate?

Melissa Forman:

Yeah. I'll answer that a little bit differently, and I'll do it from the perspective of one factor. Because when you take their total volume and spread that across all the factors, factor in industry, your percentages are going to change because they have to be connected to the network. So C.H. volume to a network-enabled and connected factoring company on average for most factoring portfolios would represent 20 to 25%, sometimes more, of their entire purchase volume. So it's a substantial part of their everyday-

PART 1 OF 4 ENDS [00:13:04]

Melissa Forman:

Higher purchase volume. So it's a substantial part of their everyday business and today they have to manually go do those validations. And so being able to validate and do cash application through the network on an additional 20 to 25% of their portfolio is quite substantial.

Gary Tenner:

Okay. Okay, thank you. And then in terms of factoring as a service, yeah, I don't know that you've talked about this a ton. Can you talk about, Aaron, what exactly looks like and then what it means economically in terms of benefits to TFIN as that gets built out?

Aaron P. Graft:

Yeah. I'm going to let Tim answer operationally because he is the operational expert and then I'll share some thoughts about what I think about financially. So go ahead, Tim.

Tim:

So Gary, I think what's important to think about is that factoring as a service gives our potential customer the ability to utilize our technology, our platform, our expertise in order to create different products and ultimately upgrade their technology. So what we've observed, several things, but one thing specifically we've observed is that the factoring industry as far as FMS providers has not kept up with the pace of technology. And so by doing what we have and invested in instant purchase and other things that we're doing within our focus area, we are raising the bar and creating an opportunity for other factors or anyone that originates factoring transactions to generate and utilize our operation side of it.

So if you can imagine factoring as a service and being able to integrate that with instant purchase on top of that with load pay, it gives us a lot of leverage and a lot of value for that factor to not only fund and make decisions very quickly, but to be able to open the doors and fund on a 24/ 7 basis. And so why is that important? That's important because you have the situation going into a holiday, and we have a specific situation about this is you have a carrier that goes into a holiday, he needs money for whatever repair and maintenance item, and he has paper in his truck that has value to it that can get cash into his bank. And so when you think about factoring as a service, that is the tool that gets the carrier the money they need when they need it. And so there's several components that factoring as a service will add value to a factor.

Aaron P. Graft:

And so on the financial side, I mean, Gary, because everything we do needs to ultimately pay off for our shareholders, right? There are no science projects here, so how do we think about it? Well, if factoring in transportation is a 2 billion revenue industry, which I think is directionally correct, and you look at the profitability or the operating efficiency of factors and then you take out the sales function, because we don't want to sell all factoring, we've been very clear about that. There are other people who need to be out there engaging with these customers, small carriers, mid-size, large carriers who can do that piece with excellence and don't need us. But there is still, once you engage as a factor, once you buy that invoice, whether you've been in the industry 10 years or 10 days, that begins a process. Underwriting, cash collection, cash application, all that validation, verification, all these things that have to happen that are highly repeatable, they're highly repeatable and they can be automated.

We believe, and you can't go find this in some report, but we believe that in this $2 billion revenue industry, factors spend between 500 to 600 million in back office expenses. That's what we think it takes them to do all the things you have to do to ingest the invoice all the way through applying the cash when it's paid. We want factors to be more efficient. We have said that there's $20 of friction on both sides of the transaction. That's not all on the factor side of the transaction. I would think in factoring that friction costs, that whole back office cost, it's a wide range, but it's between five and $10. It's going to be $5 if you're servicing large customers because you're buying schedules of invoices, it'll be closer to

$10 if you're servicing a small carrier because you do more of the work for them and you can't get the economies of scale.

So, connecting with TriumphPay and digitizing all of that is going in and of itself to add efficiency. But if the factoring company is operating on a legacy technology that is incapable of ingesting that data the way we can give it to them that allows them to capture the efficiency, then that value is lost on them. And so, why we're doing this is we're saying to the industry, we have the data feed, we have the pipe from the brokers, and we're saying we're going to have 80% of all truckload brokered transactions in our pipe. You should map to this data so you can make instant decisions. So you can reduce inefficiency. So you don't have to try to struggle with reading illegible documents. Let's make the data pristine and the connection tight. Well, their current technology isn't able to do that. And so if their current technology providers won't do it, and there are some who've done it, but for the most they haven't, then we got to go fix that problem. And if we're going to fix that problem, we expect to be paid to fix that problem. And so we expect to achieve savings in this $5 to 600 million of expense that is being spent doing factoring much the way it's been done in the last 10 years. We're going to change that.

That's what I talk about. This window is open for us to create structured data throughout the life cycle of the transaction because we are connected to the source of truth, which is inside the broker's transportation management software. Pulling that data and giving it to the people who are going to provide financing to the carrier in the format in which it lives, that changes things. And so it's about making the network more resilient, that's one reason you do it. But it's also because if we can go cut 30% of the cost or 40%, I don't know what it'll be at scale, but of that $600 million of spend, then we expect to share in those benefits. That's how SaaS businesses work. You share in the value you create. So, it's a big market to go after, Gary. It's not a science project. It's not just being done to make sure TriumphPay wins, it's being done for that, but it's also being done because it addresses a real economic expense that the industry faces and we can make it better.

Gary Tenner:

Thanks, Aaron. I appreciate that. One last question just related to that, if I could. From a segment perspective, I guess since you're building this out to service other factors or provided as a service to other factors, it almost seems like from a segment perspective, it could be factoring or in the payments business. So just the thoughts around that and as it relates to the expense load associated with the build out there. Can you talk about that a bit?

Aaron P. Graft:

Yeah. A great question and such a good question because something we talked about, I mean this is sort of why the corporate segment exists because we're starting to do things that touch all sides. I'm going to answer your question, which I think the answer is it ends up in payments because it's not us... Factoring as a service providing a service to the people who use the network. So I think that's logically where it fits, but just understand load pay, for example. The expense in developing load pay, some of that expense is showing up in the bank because underneath a load pay account is a checking account. And where do checking accounts live? They live in our banking segment. But the load pay structure and how we're going to market with it and how we're attaching it to the network, well that happens inside of our payment segment.

But if you want load pay to really work, you need to do instant purchasing, which allows us to pay, like they alluded to this earlier, if a carrier gets a proof of delivery signed at 11:00 PM being able to instantly purchase that doesn't really impress anyone unless you can have in their account at 11:01 PM. Well, the technology for that and instant purchase and the artificial intelligence and all the back testing we've

done on billions of transactions, that happened in our factoring segment. And so what we're finding is as we're transitioning community bank to financial technology platform is all three parts of our business add value to what we're creating. So the answer is FaaS lives in payments, but I just need you to understand, and we will try to call it out as best we can, we use the bank for a lot of this. We use factoring and what we do inside of factoring to serve the network. And of course we use payments to host the network. So it's more symbiotic probably than it's ever been historically.

Brad:

Our disclosures around all of this will absolutely evolve as this grows. And when we set up our segments the way that we did, we had three very distinct lines of business and in a lot of cases we were intentionally keeping them separate. And as we have evolved and as we see what is possible for us to build, to serve the industry over the long term, it's all kind of coming back together. So I can't paint you a crystal clear picture of what that will look like because there's still a lot of things that we need to figure out, but you can't expect that to evolve over time.

Aaron P. Graft:

Thanks, Gary. Great. Thanks for the questions.

Speaker 2:

Thanks to all for your questions today. Please limit to two questions only. Our next question will come from Joey Atunas from Raymond James. Please go ahead.

Joey:

Good morning.

Melissa Forman:

Morning.

Aaron P. Graft:

Good morning, Joe.

Joey:

So going back to the revenue component of TPay, on a prior call you mentioned that due to the challenging environment, you elected not to increase pricing for TPay customers in 2024 while also adding that you're not currently charging for all the services offered. I guess, given the increasing density of TPay, how should we think about price increases in 2025 or the benefit from a customer migrating to your new pricing model? I guess said a different way, assuming a static market, how much incremental dollars should we expect TPay to generate from a hypothetical customer after these price increases occur?

Aaron P. Graft:

I mean, it's not a static market. But I mean the density changes and enables monetization. I mean, I can't give it to you in a formula, Joe. I get why you're asking the question. It's a totally appropriate question. How this will go is we will onboard C.H. Robinson and that volume will come and you know what? By the time we're done onboarding C. H. Robinson, whether it's second or third quarter next year, there's going

to be other names. And so when these contracts come up for renewal, we're going to be like, "Hey, when we negotiated this contract with you, in the past 15% of your transactions had the ability to be network transactions, today that number is 60%. You can change your staffing model. This is now. Like cash application looks entirely different for a factor when you do that."

So yes, are we holding pricing because we think that we understand the freight recession? Sure, of course. But this is what I wrote in the letter is businesses that can create economies of scale and then share those benefits back with their constituents, create fans. That is what we're after. We are going to create people who look at what we do and say, "Man, that is so much more efficient than we ever did it in the past. And I can see in my own bottom line that I'm making more money. And so the piece of it that Triumph's taking, I get it."

So the answer is revenue will continue to go up. I think if you annualize our fee revenue quarter to quarter, and this was a lousy quarter, but again, it's a quarter. But still, if you annualize fee revenue growth in TriumphPay.

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Aaron P. Graft:

But still, if you annualize fee revenue growth and try and pay, it was 22% annualized. In a lousy quarter in a soft market, before Robinson's even here. So what we ultimately have to do is we've got to take a $55 million revenue business and we've got to grow it to $100 million. And we've told the market that if you put all this together, that we see a $1 billion opportunity. That's going to take a number of years, but we just have to keep adding revenue. And so if the world were static with the number of brokers we have now, in other words, if you onboarded everything we knew about now, including Robinson, and you're between 50% and 60%, probably closer to 60%, whenever that's done, you would see revenue go up. Because we're adding more value to the factors and the brokers, as it were.

But I promise you there's going to be more volume coming. I guess I shouldn't say promise, but I am committed to and staking, we are betting very much that we're not done at high 50 percentile. We're going beyond that. And every incremental value, every amount of density we add creates more value for the constituents, for which we expect to be paid. And ultimately we think it's $5 a network transaction. And we think we can collect that and the brokers win and the factors win and the carriers win. Win, win, win. That's what we want. That's why we think we're building something that is unique and enduring and not a brittle business and not taking advantage of its participants, but instead enabling everyone to win. And that is what we're focused on.

Joey:

I appreciate it. And just going back to Robinson, can you provide more color on the economics of the deal and how it relates to other customers? Since you announced the deal, has your pipeline changed for both brokers and factors interested in joining the network? And can you give us a refreshed view on how much incremental payment volume is contracted to come online throughout the balance of the year?

Aaron P. Graft:

Yeah. I'll let Melissa do those, but let's just speak about, we would never disclose pricing for any individual customer, whether it's Robinson or our smallest customer. That's just not how we would operate. What I would say is, when Robinson is fully on board, when I tell you that we're going to charge $5 per conforming transaction and part of that's going to be born by the factor and part of it's going to

be born by the broker, Robinson is in my analysis and thinking about that. We're not going to price something with them that doesn't allow us to achieve what we promised the market we would go do. I can't tell you exactly when, and we've got a ton of work to do for them and we're excited to be partnered with them. And as far as that announcement and what it's done to pipeline, Melissa, it's your phone that rings, so I'm going to let you take that one.

Melissa Forman:

Yep. I would say last quarter I told you that I had not been more excited about the status of our pipeline in the history of TriumphPay and I was very excited about where we were going and headed. I would just reiterate that this quarter, I'm even more excited about our pipeline even after these big announcements with CH Robinson and ArcBest. Because it continues to strengthen and grow. We certainly don't usually announce deals ahead of their go live, but we did with CH Robinson because of just the material volume that it contributes to the network and felt like we had to disclose that. But for the rest of those that are in our current integration pipeline, not just in contract signing and late stage sales, we expect near, if all of the volume that we have integrating this year, and if 100% of CH was ramped, we would be close to the 60% market density point that Aaron was talking about earlier.

And so that's a substantial jump from the 47% where we are today to being close to 60% at the end of the year, assuming CH was ramped. So we're excited about it. Again, it's never been stronger. Yes, it does help make the phones ring when you're able to add this kind of density in the market and bring additional value through the network to our constituents.

Aaron P. Graft:

Let me just, one thing. By the end of the year, even if Robinson goes live, we won't have all that volume probably until third quarter of next year. So think of probably third quarter of next year. And do we know, and I'm asking it in real time, but expressing that in terms of dollar volume, what's in the pipeline approximately?

Melissa Forman:

Do I want to say it? I don't know.

Aaron P. Graft:

I don't know.

Melissa Forman:

It's more than $10 million, or $10 billion rather.

Aaron P. Graft:

Yeah.

Joey:

All right. Well, thanks for taking my question.

Speaker 3:

Our next question comes from Jordan Gent from Stevens. Please go ahead.

Jordan Gent:

Hey, good morning. Thanks for taking my question. I just wanted to get a little more color on the network transaction fees. We've been getting teased about the percentage of improvement of network volumes, but I just want to appreciate just how much of TPA revenue comes from the network fees. If you could disclose any of that, that would be great.

Aaron P. Graft:

Do we have that?

Melissa Forman:

Do we have that broken out that way?

Brad:

I don't think we do.

Melissa Forman:

No.

Brad:

I don't think we do.

Aaron P. Graft:

Let us come back to you on that. What you should be able to see right now in our disclosures is the volume of network fees for the quarter. We are not monetizing those at $5 a transaction right now. Hopefully we've been clear about that, that it's well below that number because we're rolling contracts. But I don't know that we have a precise number, and I don't want to just say it off the cuff right now and tell you something wrong, but we can look at adding that disclosure going forward. What you should know is we give you the absolute number of network transaction fees, and we would say that we are not pricing it at $5 right now because on both sides, again, we're in the density building phase, so we're not charging full freight at this time. So that's as much as I can say right now.

Brad:

Yeah. What we do disclose is the amount of the fees that we're collecting from brokers and what we're collecting from factors, and there's network fees embedded in each of that.

Aaron P. Graft:

Yeah.

Jordan Gent:

Okay, perfect. Thanks for answering that. And then maybe just one follow-up on the expense guidance. It was pretty clear in the letter you talked about near term expense, but I just want to maybe dig in more on the long term. There's sales commissions that are going to be burning off over time that should provide some relief. So if you have any commentary on that, that would be great. Thank you.

Brad:

It's hard to look past the next several quarters that we've committed to. We are committing to keeping our expense levels within our current run rate for the foreseeable future. There's a lot that we need to do long-term. What we want to really get across, though, is that we believe that for the foreseeable future, for what's in front of us right now, the roster has been assembled. We've added a lot of really high level talent over the last several months and quarters in anticipation of building what we're doing right now. We've spent some consulting dollars, we've added some people, we've added technology, and we are confident that where we are today is where we can be for at least the next few quarters. We are going to have to be disciplined about what we take on and who we take on for the next few quarters in order to be able to meet that commitment that we're making. But it's something that we're confident that we'll do.

Aaron P. Graft:

And on top of that, just know there are puts and takes in every quarter. This is a little bit the vagary of the system, and we had a material consulting expense in this quarter. We could have delayed that. We could have tried to go that way on our own, but we've watched enough banking as a service relationships blow up that we wanted to dot every I and cross every T, and it didn't matter that it was going to create a drag. I think it's important, and I'm not trying to back away from the question, but I just want to remind you of the north stars here. I think about three things. Think about talking about the network and all that's attached to it, which includes load pay, factoring as a service. All the things we want to do is a billion-dollar revenue opportunity. We're at $55 million right now, so we've got a lot to go do to get that done.

The second thing that gets us there, that's an output, is getting to 80% of truckload density, and we don't stop there. There's LTL, there's other things, a shipper market, there's a ton of things we want to do. But that's a north star of getting to 80%. And then lastly, and it ties to this question, is for our payment segment, which is currently operating at -10%, we've given an interim goal of, we want to be at 25% EBITDA margin. We don't know exactly when that will hit, but obviously to get to 25%, we've got to improve 35%. And long term, this business, this network business needs to deliver above a 50% EBITDA margin. So $1 billion in revenue, 80% density in truckload brokerage, and over the 50% margin, that's a home run. That's what we're going after. You are right in that in the short term, sales commissions do burn off, but those get backfilled.

We need to go do account validations, checking account validations for thousands of new carriers that are going to come on when Robinson goes live. Why? Because we are the trusted party to stand between the criminals, the fraudsters, and the good actors. That's what we do. We handle people's money. And so there are puts and takes. Yes, sales commissions fall off, but we also have to do certain things to deliver on our network promises. But just, I would again invite you to consider those north stars. That's what we think about. And if you deliver those things and you're a bank investor here, if you can deliver that kind of margin and keeping everything else the same, you're talking about an ROA approaching 2%. You've seen what our factoring business does in a normal cycle, obviously the scalability and the efficiency in the payments business, and we run a very efficient bank with a low cost of funds. I don't want that to be lost.

And so you put all that together and that's a high ROE earning institution. But those three things that I talked to you about, the revenue, the density, and the EBITDA margin, that's the goal we're pursuing, and everything we do begins with that in mind.

Jordan Gent:

Thanks for taking my question.

Aaron P. Graft:

You got it.

Speaker 3:

Our next question comes from Hal Goetsch from B. Riley. Please go ahead.

Hal Goetsch:

Hey, good morning, everyone. My question's back to the factoring business, and I know you don't have control over the freight industry, it's uncontrollable. But I want to just get your perspective on the downturn, in that if we look at a two-year stack, it's high 30s down volume. It's like even if I remove price effects of invoice pricing, it's down probably 20. That would be a depression, in my playbook, for volume. And I know a lot of stuff that goes over the road is food and beverage. So that's a big part of what's in my waste bin every week for what comes to my house that gets shipped out and I had to go to a store. So could you just give us a perspective of what is really down? Where are inventories that you can see across the country? Are they leaner than ever before, or are we about as low as wholesale or retail inventories can go? Just give us your thoughts on that. It seems like it's been pretty difficult. I can't imagine having another third year of this. Thanks.

Tim:

Well, I'll take the first swing at that, Hal. The interesting thing about what we see in the marketplace is there's still a fairly large spread between contract rates and spot rates. We are seeing some stabilization of the spot rate market, which is a majority of the small carriers that I think Aaron referred to earlier. And we're starting to see that prop up. We've seen several quarters now. When you look at second quarter-

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Tim:

We've seen several quarters now. I mean when you look at second quarter, it was not great and probably hit our lowest watermark within that quarter. But one thing that we are seeing that we watch very closely is not only the duration of this cycle, but we also look at what's pulling on those margins. We know the carriers, a lot of the small carriers are operating well below their costs, and so that's obviously not sustainable.

We still see that small carrier segment taking most of the bullets. And so one bright spot to kind of zero in on for us is we watch fuel very closely and the correlation with fuel and average invoice amount specifically in that spot market. Why that's important is if average invoice amount is moving in lockstep with fuel, then there's a level of pricing power. We haven't seen that consistently for the last two years.

We're starting to see that now, meaning that if fuel goes up, average invoice amount goes up in lockstep, there's about a week lag. Fuel goes down, we see in average invoices go down. And so fuel is having a really big impact on that. So I look at the duration, it almost matches the duration of the upcycle. And if you look historically at previous cycles, 2013, 2014, '18, '19, those cycles lasted about as long as the upcycle, and I think worth the tail end of that. But we've seen head fakes before. We saw one at the end of the fourth quarter into the first quarter. We're not prepared to say "That's it, we're

done. This is good times, all pastures are green ahead." We're just not quite there. But I think we're seeing enough that it is looking better and fingers are crossed, toes are crossed, but we're not there yet.

Aaron P. Graft:

Okay, thank you.

Speaker 4:

Our next question comes from Frank Chiraldi from Piper Sandler, please go ahead.

Frank Chiraldi:

Good morning. Just wondered, Ari, you mentioned some of the sort of targets thresholds, the hundred million in revenue that we've talked about in the past on the payments network. I'm just wondering if you'd be able to sort of give some guardrails around the timing of that at this point. What's a decent place to put that target? Is it sort of end to 2025 with that 25% EBITDA margin? I'm just curious if you could try to place that a bit for us.

Aaron P. Graft:

Brad Moss is over here ready to tackle me. So is Melissa, I don't think that December 31, 2025, everything would have to go absolutely perfect to be at a hundred million of revenue at that time. And so I don't think if I were underwriting us, I would not put it then. So is it midway through 2026? Is it end of 2026? I'm not exactly sure. It's going to be lumpy, right? I can't predict because this hadn't been done before, or at least I certainly haven't done it before, but I know it's never been done in transportation. I believe, I have the absolute firm conviction that density overcomes every objection. It just does.

And so what's going to happen is you're going to hit an inflection point and we are coming to that inflection point on density. I mean try and pay paid 126,000 carriers last quarter. I don't know that there were that many more active carriers last quarter to have been paid. The inflection point on density is coming. Once that happens, I think the monetization, if you look at any other network business follows pretty rapidly.

Okay, well is that 2025? I don't know. That's a lot of growth between now and the end of 2025. That's why I said we're more focused on density. Is it 2026? I hope so. Look, we know we got to double where our revenue rate now because we got a whole lot more to go do after that. So if it were me, I'd put that into the 2026 numbers or beyond, but our business is not linear enough and I can't predict the state of freight well enough to give you specificity beyond that.

Frank Chiraldi:

Okay, all right. No, fair enough. And then just talking about speaking on monetization, obviously monetizing the factors gets you a significant way to that $5 per network transaction you guys have talked about. And I know or I think that's on a yearly basis that decision is made. So how confident... you got C.H Robinson, which obviously is a huge win. We don't know when this freight recession is going to end. How confident are you, what's your comfort level that 2025 is going to be the year where you can really start fully monetizing the factors and get that whatever it is, $3.50 per? Is that still looking good? Is that maybe pushed back another year just given where we are in the recession? What are your updated thoughts there?

Aaron P. Graft:

So it's hard to predict. The benefit we have is we can look at our own factoring business and we can test volumes in our own business, which happens to be 15% of the market. So you got four of the top five, eight of the top 10, 24 of the top 30 and 59 of the top 100 brokers who are using us. Some for audit, some for payments, some for both. And those who use us for one or the other, I mean there's a lot of gain in that by the way. If someone's just using us for audit and then we bring on payments, there's super opportunities there.

I think in every discussion and negotiation with a factoring company who uses our system, we will show them the volume that was when the contract was signed and we will show you the volume that is and the volume that is scheduled to come and we will have a discussion about what's fair. We want to treat them fairly. We need factoring companies to do well for this network to work. Frankly, the industry needs factoring companies to do well because they serve small truckers and we can't do all of it. We aren't equipped, we don't want to. Nobody can do all of it. You need a robust industry.

So I am very certain that the pricing adjustments will be done to reflect the value delivered. Will it happen in the context of the broader market? Sure, sure. Like we said, we see green shoots. If Trump gets elected and tariffs come and there's now a bunch of freight coming in the West Coast and that helps the market. These are all things we can't predict, but that will all go into the mix.

But it ultimately comes down to how are we doing at taking a factoring company who's spending $10 to do all the back office on an invoice and lowering it to $7? Can we show them the way? And we can show them the way with density and we can help show them the way with factoring as a service, right? For those who want to use it. We're not asking them to take it on faith. We can literally show them the way that it is done. So again, we expect to be paid for that, but we expect to be paid for that only to the effect that we are creating commensurate value for them. We want fans, not just customers, and we take a very long view on those relationships.

Frank Chiraldi:

Gotcha. And it looks like I might be the last question, I'm not sure, but if I could just sneak in one quick one, you brought it up, Aaron, on terms of a potential Trump presidency and higher tariffs. Would that be, do you think in the near term, the number one thing that could boost us out of the freight recession and maybe with less need to reduce capacity by that 15% you guys have talked about, is that the number one mover and shaker of the freight industry that you see looking out to the election?

Aaron P. Graft:

So if it does, it's not a long-term fix, I don't think. At the end of the day it's about tonnage and capacity. I don't know that President Trump or President Biden or whomever is going to be president is going to have quite as much effect on tonnage as they would like to claim in their stump speeches. The economy is a many headed thing. Of course, the more manufacturing that happens in Mexico, that's great for trucking. But even if it's happening in China and showing up on the West Coast, if it shows up in bunches, which we think is happening right now, that's a short-term spike. That's sort of like a hurricane creates a near term spot opportunity.

Long term, I still believe there's too much capacity. And so we are happy to participate in the upside. We're happy for our carriers to get paid $2 and $3 a mile because these people have fixed obligations and they work hard and I want them to win. That doesn't change my long-term thesis, that we'd still have too much capacity for the freight that is to be moved in this country. And so whether it happens quickly or whether it happens slowly, we still need to normalize there.

Frank Chiraldi:

Appreciate it. Thanks for all the color.

Aaron P. Graft:

Sure.

Speaker 4:

And there are no further questions at this time. Thank you.

Aaron P. Graft:

Thank you all for joining us. Hope you have a great rest of your summer and be careful playing pickleball.

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