Triumph Bancorp, Inc.

2^{nd} Quarter 2020 Earnings

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CORPORATE PARTICIPANTS

Aaron Graft - *Founder, Vice Chairman and CEO*

Bryce Fowler - *EVP, CFO and Treasurer*

Todd Ritterbusch - *Chief Lending Officer*

Luke Wyse - *SVP, Finance and IR*

PRESENTATION

Operator
Good day, and welcome to the Triumph Bancorp, Inc. Second Quarter 2020 Earnings Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation there will be an opportunity to ask questions. Please note this event is being recorded.

I'd now like to turn the conference over to Luke Wyse. Please go ahead.

Luke Wyse
Good morning. Welcome to the Triumph Bancorp conference call to discuss our second quarter 2020 financial results. Before we get started, I'd like to remind you that this presentation 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.

If you're logged into our webcast, please refer to the slide presentation available online, including our Safe Harbor statement on slide 2. For those joining by phone, please note that the Safe Harbor statement and presentation are available on our website at www.triumphbancorp.com. All comments made during today's call are subject to that Safe Harbor statement.

I'm joined this morning by Triumph's Vice Chairman and CEO, Aaron Graft; our Chief Financial Officer, Bryce Fowler; Todd Ritterbusch, our Chief Lending Officer; and Geoff Brenner, our CEO of Triumph Business Capital. After the presentation, we'll be happy to address any questions you may have.

At this time, I'd like to turn the call over to Aaron. Aaron?

Aaron Graft
Thank you, Luke. Good morning, everyone. For the second quarter, we earned net income of $13.4 million or $0.56 per diluted share. Adjusted for the gain on sale of our Triumph Premium Finance assets, diluted earnings per share was $0.25.

Starting with credit and ACL, total credit loss expense was $13.6 million versus $20.3 million in the prior quarter. During the second quarter, we recognized credit loss expense on funded loans of $11 million. Credit loss expense on off balance sheet commitments to lend of $900,000 and $1.7 million of credit loss expense on subordinated notes to collateralized loan obligations in our held to maturity investment portfolio. These are legacy assets associated with our CLO advisory business that we sold in 2017. This portfolio will self-liquidate over the next few years and we do not currently nor do we expect in the future to invest in any additional equity CLO tranches.

Generally speaking, our economic forecast worsened quarter-over-quarter as we're now forecasting unemployment to sit between 9% to 10% over the next four quarters with depressed retail sales over the next three quarters. As a result, the allowance for credit loss or ACL increased to $54.6 million or 1.24% of loans held for investment. Given the focus on this ratio and the short duration of a significant portion of our loan portfolio, we think investors should understand that our ACL ratio is 1.77% of total loans when you exclude PPP loans, factored receivables, and mortgage warehouse balances.

On the loan portfolio, we experienced charge-offs of $1.1 million or 2 basis points of average loans and an increase in specific reserves of $1.7 million. Past due loans decreased by 49 basis points from Q1 to 1.5% of total loans and the ratio of non-performing loans was relatively unchanged.

While these levels are certainly acceptable and not out of line with recent metrics, it should be noted that a significant portion of our loan portfolio is currently in deferral in accordance with guidance from our regulators and the CARES Act. We will discuss these deferrals in more detail later in our remarks.

Turning now to deposits. Deposits were a bright spot for us again in the second quarter and our funding mix continues to improve. Non-interest-bearing deposits grew $275 million and are now up $437 million since we increased our focus on deposit gathering at the end of the second quarter in 2019. Non-interest-bearing deposits as a percentage of total deposits are now 28% of total deposits which is a significant increase from a year ago.

As we noted in our last earnings call, the dislocation in the retail deposit markets that existed in March has normalized and we have retired much of the FHLB funding that we borrowed in the first quarter while also reducing our loan to deposit ratio down from 117% to 108%. As higher cost time deposits continue to mature and re-price, we expect our funding cost to continue to trend lower in the near term.

Turning now to margin. Our loan yields were down from the first quarter 70 basis points while NIM was down 52 basis points. The majority of this change was related to a shift in the mix of our loan portfolio as factoring volume and revenue declined, while mortgage warehouse average balances increased $203 million over Q1 to $716 million.

We also had $219 million in PPP loans carrying a 1% coupon or spread of about 65 basis points at June 30. This compressed overall loan yields 16 basis points and net interest margin approximately 8 basis points. Our PPP fees recognized in interest income totaled $1.4 million and we have $5.8 million of remaining deferred PPP fees at quarter end. As we will detail further in this call, our outlook is for our margin to expand from this low point throughout the remainder of the year.

Finally, a few items this quarter that I'd like to point out. First, we realized $1.3 million in gains on the sale of loans, the majority of which is from our liquid credit loan portfolio and a $1.9 million syndication fee recognized in other non-interest income on a large credit line we structured for a community bank customer. Finally, our service charge fees were below historical levels by approximately $1 million in Q2. We do not expect this to continue in Q3 or beyond as the universal fee waivers we provided to assist our customers ended June 1.

As previously disclosed in the first quarter, we completed the asset sale of our Triumph Premium Finance business to People's Bank on June 30, 2020. The portfolio of loans sold totaled approximately $85 million and we realized the pre-tax net gain on sale of $9.8 million. As part of this transaction, Peoples Bank receives the top notch platform on which to expand the business and Triumph retains a preferred premium finance referral relationship to service our clients.

Now, I'd like to turn the call over to Todd Ritterbusch, our Chief Lending Officer, to talk about our community bank lending and the efforts underway to support our communities and customers in light of the unprecedented impact of COVID-19.

Todd Ritterbusch
Thanks, Aaron. I'd like to start by providing an update on the actions we've taken in support of our clients during the pandemic. Our loan balances on short-term partial or full payment deferral grew to $597 million in the second quarter and subsequently declined to $572 million as of June 30th, as the deferrals have begun to expire.

As of July 14th, our deferred balance stood at $382 million and over the next several weeks, all of our remaining deferrals will expire and clients will need to either resume payments or receive an extension. As of June 30th, we also had $6 million of accrued interest on deferred loans.

Our largest concentrations of remaining deferrals are in our equipment finance business and community bank. Within equipment finance, we initially approved deferrals in anticipation of weakness in transportation. In many cases, our clients performed better than we expected and do not need additional deferrals. So we expect the majority of these deferrals to continue to expire without extension.

In the community bank, our ability to discontinue deferrals depends largely on the pace and timing of the reopening of local economies. To date, more of our community bank clients are rolling off deferrals than expected.

Moving to PPP loans, we are prepared to assist our clients and relationship managers in completing and submitting forgiveness applications to the SBA, subject to the SBA's final instructions and new portal which are forthcoming. We expect forgiveness applications to ramp up quickly in the third quarter. However, the SBA's three-month window for processing applications could mean that our clients won't actually receive the SBA's forgiveness until the fourth quarter or later.

The proceeds of the PPP loans, government stimulus checks, and the stockpiling of cash by our clients contributed to $207 million in checking, savings and money market deposit growth across the community bank footprint in Q2. We have not yet seen clients begin to draw down their liquidity as demand deposits continue to grow through June with those same balances up over $95 million from May.

Our mortgage warehouse continues to be a bright spot in terms of both deposit gathering and loan activity with $69.8 million in deposit growth in the second quarter, while loan volumes and balances remained elevated. We know that the wave of mortgage activity will eventually subside, but we don't yet see an end in sight with July and August volumes expected to remain very high.

For the remainder of the year, our lending priorities will remain to complete PPP loan forgiveness, unwind loan deferrals and manage our credit risk. With that noted, we are actively pursuing marquee new relationships across our lending units. While we aren't forecasting a significant increase in total lending balances for the remainder of the year, we do expect the balance declines driven by PPP loan forgiveness and credit management will be largely offset by new lending, higher spreads and more attractive economics.

I'll now turn the discussion back over to Aaron for a transportation update.

Aaron Graft
Thank you, Todd. Total Q2 2020 Triumph business capital factoring revenue was $21.5 million. The dollar volume of invoice purchased was $1.24 billion during Q2 2020, a 12% decrease compared to 2Q 2019. We purchased 813,000 invoices during Q2 2020, a 7% decrease compared to the same quarter a year ago.

As we discussed in our last call, there has been COVID-19-related uncertainty in freight markets and that volatility negatively impacted our Q2 results. This did not surprise us nor should it surprise those who follow us. We faced challenging economic headwinds through much of Q2, as US quarterly GDP and subsequent freight volumes suffered double-digit percentage declines due to the widespread shelter-in-place orders and the temporary closure of nearly half of all small businesses in the country.

As we projected, these headwinds expressed themselves in a number of challenging Q2 trends compared to Q2 2019, such as average invoice size declining 5.5% and average purchase totals per client declining 8%.

What is interesting, however, is that we saw the early signs of a recovery late in Q2. For example, in the month of June, our factoring business saw total invoice purchased volumes not only return to normal levels but even surpassed June 2019 levels. We also track invoice submission activities by individual clients which indicates when a client suspends its historical invoice factoring activity and presumably their operations, and then when they return.

In April and May, approximately 20% of our Q1 clients stopped submitting invoices altogether, but we saw a solid rebound in June both in terms of the number of clients again submitting invoices but also in the terms of the monthly average invoice amounts. Those return to as high as 90% of our Q1 monthly average in some client segments. This recovery sustained in July and beyond could suggest a freight recovery curve that looks more like a V than an extended U.

In sum, we expect our transportation factoring portfolio will continue to be our most profitable and fastest-growing line of business. As a result of its growth, we expect our margin to expand from Q2 irrespective of the rate environment over the next 12 months.

Now turning to TriumphPay. During the second quarter, TriumphPay processed 767,000 invoices paying 51,000 distinct carriers. Payments processed totaled approximately $667 million, a 26% increase over the prior quarter and a 295% increase from Q2 of 2019. TriumphPay's annual run rate payment volume as of June was $3.1 billion.

We have talked over the last few quarters of our focus on the top 20 brokers in the US. As of today, we have three of those brokers active on the platform. Even more exciting than that is that we have more than five of the remaining top 20 who have submitted applications and are in various stages of contracting or integration. We would expect the majority of those prospects to come onto the platform over the next six to nine months. Once completed, this will bring us closer to our initial goal of serving 50% of the top 20 brokers and will move us much closer to becoming the nexus of billing and payment for the trucking industry.

We still plan to exit this year with a run rate payment volume of $7 billion or more. We expect TriumphPay to reach profitability in the back half of 2021 even with its parabolic growth and the significant investments we are making into the platform to improve the user experience.

Finally, we remain committed to the safety, health, and wellbeing of our team members, customers and communities. Over 90% of our team continues to work from home and do so with excellence. We look forward to better days ahead and we know we as a company and we as a nation will persevere.

With that, we will turn the call over for questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question please press star then two. At this time we will pause momentarily to assemble our roster.

Our first question will come from Matt Olney with Stephens. Please go ahead.

Matt Olney
Hi. Thanks. Good morning, guys.

Aaron Graft
Good morning, Matt. How are you?

Matt Olney
I'm well. I'm well, thank you. I wanted to start with TBC and you gave us a good update in the prepared remarks. I believe you said you purchased around $5 billion of invoices in the second quarter. You mentioned some macro headwinds in the first part of the quarter that sounds like improved towards the back half of the quarter and last few weeks, and we also have some of the acquired loans in that book closing here over the next few weeks and the better invoice pricing that you noted. Is there a goal that we should be mindful of as far as the invoices purchased within TBC that you could achieve over the next quarter or two once these items play out?

Aaron Graft
Yes, Matt, I'll start with this and then Geoff Brenner who leads Triumph Business Capital can add anything. It's hard to set goals within a business like Triumph Business Capital that is so highly correlated to what's happening in real time in the economy.

For example, I don't know that we ran the business any better in June than we did in April and May. It's just truckers had parked their trucks and were sitting at home while there was no freight. Now there is freight and they've come back. The million-dollar question or the trillion-dollar question, if you will, because I think what freight markets do is going to be highly correlated to what the economy does is, will we continue to see this strength in freight? And as we sit here today, it looks pretty good.

The year-over-year comparisons even where we've run as of this very day, we are still running in many cases above 2019. So I wouldn't be able to give you a goal on specific revenue goals, client goals, etc., because there's so much uncertainty in front of us. What we can tell you is we continue to take market share organically and that the freight market as we sit today is pretty good. Now I think where it goes will depend upon political response, COVID-19 vaccination, all of these things.

So I can't really give you a target. All we can give you is the commentary on what we're seeing right now.

Matt Olney
Okay, understood. And then on loan growth, lots of moving parts here that you noted in the prepared remarks with the expectation for overall loan balances once you account for all the puts and takes over the next few quarters? Thanks.

Aaron Graft
Yes, I think our hope would be that our transportation business would grow disproportionately to the rest of the book. And the reason being, Mortgage Warehouse has done great. It's had a great run. It will continue to do that, but we don't see it growing on an absolute basis above where it sits today. That's our comfort level for that business.

CRE, we're getting paid off not because we don't see opportunities or not because we don't want to be in the market, it's just frankly risk premiums have disappeared. Like they were there for a month and now we're seeing construction loans being done at LIBOR plus 260 and big CRE deals being financed at margins we would never touch. So I'm not so concerned about our total loan growth as much as I am of the mix shift, and that's what I think some people struggle to understand when they look at Triumph.

Our margin, probably more than just about any bank in the universe, is highly correlated to the shift of our balance sheet. So if trends like in Q2 where factored receivables fell because people parked their trucks, our NIM compresses. In Q3, it's very likely as our factoring returns to its historical position within our loan book because the margins are so much higher in that line of business than others, that's why we're saying we expect NIM to expand.

So on the whole; I don't know that we'll see material loan growth. I do think we will grow between now and the end of the year and our hope is that that growth shows up largely in transportation because that's our highest margin business we're in.

Matt Olney
Okay. That's helpful, Aaron. And then the last question from me, you gave us a good update on TriumphPay. I think you mentioned last quarter that COVID-19 had caused a slowdown in the integration process modestly for some of your larger clients. Any update as far as the integration progress? How much of a delay has that been and where do we stand now?

Aaron Graft
Well, I think the team to their credit has done a world class job. If there is a silver lining in COVID-19 after everybody got through the original shock and awe, it seems to have heightened the awareness of what the value that TriumphPay can bring to the freight brokerage community and ultimately to the trucking industry as a whole. So as we just laid out in the prepared remarks, you got more than 5 of the remaining of the top 20 who have now are in various forms of integration with us.

As we said, that's a six to nine-month process to onboard that much volume and it will happen sequentially. At this point I wouldn't lay any blame—first of all, I don't think there's any blame to lay. I think that's fantastic. That's beyond our expectations. And as far as the speed of these integrations, COVID may affect it at the margins, but frankly we're talking about really complex integrations with the largest logistics companies in the United States. And so that's going to be a difficult endeavor COVID or no COVID. So I wouldn't say at this point it's really slowed us down. If anything, you're seeing happen what we had hoped, maybe we're so bold as to predict would happen, but we're seeing this start to become ubiquitous in the transportation space and of course it makes the whole process more frictionless for everyone.

So if we get those that we've just mentioned onboarded over the next six to nine months, that will be fantastic and of course as you would expect we continue to build a queue behind that and we continue to onboard Tier 2 brokers all along the way. We don't talk as much about those, but those are currently coming on the system as well.

Matt Olney
Got it. Thank you, guys.

Operator
The next question comes from Brady Gailey with KBW. Please go ahead.

Brady Gailey
Hi. Thanks. Good morning, guys.

Aaron Graft
Good morning.

Brady Gailey
So other fee income was up pretty nicely on a linked-quarter basis, I think it was up about $4 million. So I think I heard that roughly a $2 million syndication fee that's in there that sounds to be somewhat like a one-timer, but I think I heard you mention $1.3 million of loan fees. Was that also in other income? And then was there anything else in there that impacted that in the quarter?

Todd Ritterbusch
So just to clarify, the $1.9 million, you are correct. That was a syndication fee for a very large credit we put together for a community bank customer, a core customer of the bank. We do not expect we're going to be able to do that every quarter; although if presented the opportunity, of course we would.

You're correct on the loan. The $1.3 million gain on sale of loans, that's on a net basis. One of the things if you remember, Brady, we talked about in Q1, there was about a six-week window of time where the market totally dislocated. And in that period of time between liquid credit and AAA CLO securities, we bought about $300 million worth of assets as I recall.

In Q2, as the market has strengthened, we use that as an opportunity to harvest some gains in what we saw from where we purchased in Q1 and we also used it as an opportunity to exit some legacy positions that would have existed before coronavirus and de-risk the portfolio. And so what you see there is the net of that de-risking of the portfolio in that $1.3 million number.

Brady Gailey
Okay, great. On the NIM expansion in the back half of the year, I was going to ask what do you think the magnitude of what that NIM expansion could be, but it really depends on the transportation industry and how fast that rebounds. How are you thinking about how much the NIM could be up in the back half of the year?

Aaron Graft
I don't have a number for you. Your model is just as good as mine. Tell me how big transportation, specifically factoring, is going to be about a percentage of our loan book and I'll tell you where our NIM's going to land. And then the other part, NIM matters and we know it matters for everyone. But our margin is—when I think holistically, look, Mortgage Warehouse pulls down our net interest margin, yet it is a very profitable line of business for us because it's administered so efficiently.

But on the whole, we're not making any projections about where we'll be. We're facing a foe that we've never seen before and so we can't sit here and tell you where NIM's going to be. You know what the yields are we get on our factoring business. We're going to grow that as much as reasonably we're able to do it, but we can't predict—we could have another slowdown. And of course if we do, we're going to feel that factoring in almost real time.

Brady Gailey
Got it, alright. And then lastly just the roughly $6 million of remaining PPP loan fees, it feels like forgiveness is going to happen in 4Q and 1Q. So is the right way to think about the timing on realizing that additional $6 million of fees the same roughly 4Q and 1Q next year?

Todd Ritterbusch
For the most part, yes. We're hoping that the majority of it will come in the fourth quarter. Of course, we're prepared to begin submitting forgiveness applications as soon as the SBA issues the final instructions and opens up the portal. So we might get some of that in the third quarter, but our projections are for most of it to come in the fourth.

Brady Gailey
Okay, great. Thanks, guys.

Operator
The next question comes from Gary Tenner with D.A. Davidson. Please go ahead.

John
Hi, everyone. This is John calling, on for Gary. I just wanted to ask, what was the operating expense load rate at the premium finance business that will be eliminated with the sale of TPS [ph]?

Bryce Fowler
I thought we had disclosed that earlier, but I think that the overall expense level on that as a percent of the portfolio sold was about 2.5% on roughly $100 million on an annual basis.

John
Awesome. And just some early impressions on regarding extension of the initial loan deferral periods as they expire, I know you had talked about a little bit in the prepared remarks but I just want to get more color.

Todd Ritterbusch
Sure. So we disclosed that the loan balances on deferral are coming down. They continue to come down. So if you were to ask for an update as to where we stand today, we're at about $350 million remaining on deferral. We expect those balances to continue to decline as the initial expirations occur through August. And the majority of what we have left, we expect to roll off after the first extension.

So hopefully early fourth quarter we'll be down to a significantly lower balance than we are today. At this point, we don't expect a very large proportion of those loans to require longer-term modifications or to be in such bad shape that we would expect the business to cease operations.

John
Awesome. Thank you.

Operator
Again, if you'd like to ask a question please press star then one.

Our next question comes from Steve Moss with B. Riley FBR. Please go ahead.

Steve Moss
Hi. Good morning.

Aaron Graft
Good morning, Steve.

Steve Moss
I want to start on credit, just in particular what your thoughts are with regard to any updated thoughts on your hospitality and restaurant exposure, and how you're thinking about those loans going forward?

Todd Ritterbusch
Yes. So hospitality is certainly a very big concern for us. I think you probably heard from other banks that this is probably the epicenter of where we're going to feel stress with respect to credit. If you were

to refer to page 7 of our investor presentation, you see there that we currently have exposure of just under 130, that was as of June 30. More than half of that is on deferral and most of what's on deferral will require an additional extension of course, because the occupancy rates remain very, very low.

Fortunately, we have pretty low loan to values on a lot of those properties. And so we aren't yet in a position where we're foreseeing significant specific reserves, but that could change if we began to see those properties deeply discounted and they were to need to liquidate.

Steve Moss
Okay. And just on restaurants as well, just curious, what are you seeing for business activity for those clients and the deferral process as well?

Todd Ritterbusch
Yes. And that portion of our portfolio obviously, it's significantly lower in size. It's also significantly lower with respect to the percentage that are on deferral. So you should be thinking about maybe about a third of those loans being on deferral at this point. And keep in mind that within our restaurant portfolio, we have a significant credit in our liquid credit team that is for a very large, well-managed, great quality credit and quick service chain. So you have significant high-quality exposure within that restaurant. Those restaurants, of course, continue to operate.

As it pertains to the other restaurants in our portfolio, the stuff that's in our community bank, of course the highest concentration of deferrals is in full service and we have a little over $10 million in deferrals in that space and that's of course the space that's been most deeply affected and is trickiest to get back up and running.

Steve Moss
Okay. And then in terms of just as we think about credit cost going forward and perhaps charge-off formation, the reserve ex-PPP in Mortgage Warehouse is quite strong here. Should we think about a lower reserve build on future periods plus charge-offs? I'm curious as to how you're thinking about that.

Todd Ritterbusch
Yes. Our reserve build is largely going to be dependent on what the future economic assumptions are in forecast. That's what's been driving it so far. And so I would expect that to continue to be a major driver.

Bryce Fowler
I agree. This is Bryce. I think the way you phrase is probably the way I'm thinking about it anyway, we think in terms of economic forecast, obviously things can change, but the bulk of that captured. So that's a question of how do these deferrals and potential charge-offs develop over the next few quarters.

Steve Moss
Okay, that's helpful. And then just on the Mortgage Warehouse portfolio, wondering just it's getting into the weeds a little bit, but what was the average balance for the quarter, and perhaps if you have a portfolio yield for that, that would be helpful.

Bryce Fowler
$716 million average balance for this quarter, up about $200 million from the previous quarter.

Steve Moss
Okay. And the yield is probably 3.5%, 4%?

M
[Speaker off-mic].

Steve Moss
Okay, great. And lastly just on expenses, curious as to what your updated expectations are for the third quarter here.

Aaron Graft
We would expect Q3 may marginally increase from Q2. I know normally we give you a specific number. But just again sticking with the theme here of the unknown. For example, in Q2, we controlled a lot of expenses, there was no travel. We intend as long as the world is uncertain to do some of that. There will be some natural expense growth as TPay and other things continue to grow. But I would expect Q3 to be higher than Q2, but not materially.

Steve Moss
Alright. Thank you very much.

Operator
Our next question is a follow-up from Matt Olney with Stephens. Please go ahead.

Matt Olney
Hi, guys. My follow-up was addressed just now, but thank you.

CONCLUSION

Operator
This concludes our question and answer session. I would like to turn the conference back over to Aaron Graft for any closing remarks.

Aaron Graft
Thank you all for joining us this morning. We hope you have a great day and rest of your week. Thank you.

Operator
The conference has now concluded. Thank you attending today's presentation. You may now disconnect.