Triumph Financial, Inc. Q1 Earnings Call | April 18, 2024

Luke Wyse:

Good morning. It's 9:30 in Dallas. So let's get started. We know you likely have numerous demands vying for your attention during this busy time with a quarter, so we'd like to open by thanking you for your interest in Triumph Financial and for joining us this morning to discuss our first quarter results. With that, let's get to business.

Aaron's letter last evening covered a lot, both about the quarter's results and the opportunities we see to create future shareholder value through prudent and timely investments today. Reiterating as closing, we are impacted by the soft freight market but excited about the long-term momentum we see. As referenced last evening, we published our quarterly shareholder letter. That letter and our quarterly results will form the basis of our call today. However, before we get started, I would like to remind you that this conversation may include forward-looking statements. Those statements are subject to risk and uncertainties that could cause actual and anticipated results to differ. The company undertakes no obligation to publicly revise any of these forward-looking statements. 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 good morning, everyone. Thank you for joining us. Since I wrote such a long letter, I feel like I owe it to you to give a short opening. So I just have a few things to point out for you.

First, our earnings were weaker than they've been historically, and they're going to remain under pressure as long as this freight recession continues. Second, there was credit noise in the quarter, but not all of that noise was a bad thing. Now, credit may be a headwind for us for the time being, but we are proactively managing through it. And finally, TriumphPay took more ground this quarter. We welcomed well-known names to the network. We increased volumes on an absolute basis in spite of the weakest quarter in truckload freight in my memory. And finally, I think some investors will hopefully find value in the transaction and value map we included in this letter. It dimensions the market size and the revenue opportunity and it puts into writing what I have believed for several years. We have a lot of growth in front of us. So at this point, let's turn the call over for questions.

Facilitator:

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, please press *9. Once called upon, please feel free to unmute and ask your question. Please limit to one question and one follow-up. Our first question will come from Joe Yanchunis of Raymond James.

Joe Yanchunis:

Hi, there. Are you able to hear me?

Melissa Forman:

Yep.

Facilitator:

Yes.

Aaron P. Graft:

Good morning.

Joe Yanchunis:

Good morning. So in your shareholder letter you referenced that the pipeline for T-Pay was full and you say your confidence in T-Pay touching 50% of brokered freight by year end. Given that backdrop, can you provide some color on how much incremental payment volume is currently contracted to come online over the balance of the year?

Melissa Forman:

Yeah. Joe, what I would tell you is that we are looking at the pipeline in terms of both payment volume and audit volume, the non-payment volume. And that's because that's what creates the network transaction and that's what's most important to drive revenue. So to give you the look into what we think we'll see in 2024 is we have a pipeline of 5 to $10 billion of additional volume that we'll be adding. And that's a combination of audit volume and payment volume, but all of which will be attributed to the network.

Joe Yanchunis:

I appreciate that. And sticking with T-Pay, congrats on winning the Apex business. That seems like a big deal for the network. So all else equal, if all contracted broker and factoring volume were on the network today, what would be the level of conforming transactions for the network and what would be the financial implications of that?

Aaron P. Graft:

So great question. If every factor and every broker were on the network, then the math problem you're solving for there would be taking the 110 billion of brokered freight that exists that we called out in the letter and then take 65% of that, because statistically or on average, that's the amount of freight that is transacted generally from a broker and then purchased via factor. Okay. If you remember, just a couple of years ago we did the first ever conforming transaction, and over the course of an entire year, and we've since come to call it a network transaction, we got to $1 billion, took us 12 months. You might've noticed in this single quarter, in the weakest quarter that I ever remember in freight we did $1 billion this quarter, and that was 40% growth over prior quarters.

But if you just use the math of 65% of 110 billion, you get to roughly 70 billion, and if you want to divide that by four, you get to 16, 17 billion a quarter would be the total addressable opportunity. There would additionally be some opportunity beyond that if you added shippers into the equation, but I think it's best to talk about brokered freight. So you're talking about $17 billion of volume and you would divide that by 1,700. That's roughly where the average invoice is now. And then you would think about how would we monetize each individual network transaction if we had near 100% adoption. Well, the answer is the pricing would go up because the constituents who use the network would be able to entirely re-engineer their back offices. The amount of instant purchasing, the amount of auto cash application, the implications would be huge. So that's the opportunity. As it currently exists, that's the total market. We're at $1 billion a quarter right now. And so that tells you that there's a lot of growth opportunity in front of us.

Facilitator:

Our next-

Joe Yanchunis:

Okay. I was actually more referring to what is currently contracted to come online. So if you just assume Apex business is fully up and running and all the other, that 5 to 10 billion of additional volume is currently live on the system. Sorry. I wasn't talking about the entire addressable market, just-

Aaron P. Graft:

I'm sorry. I missed. I think to do that math live real-time for you right now, it would be... We can make some assumptions.

Joe Yanchunis:

Sorry. That's all right.

Aaron P. Graft:

You're going to see it grow. I mean, because all of the brokers that are coming on to the platform pay all of the factors and we just added a top five factor. Apex is a material player in the industry. So I can't give you quarter over quarter growth. So I'll just stick with my answer of I've given you what the whole market is and that we keep adding people to it. And again, that revenue doesn't show up this year. That revenue shows up next year and beyond. So that's as much color really, Joe, as I can give you at this time.

Joe Yanchunis:

All right. Thank you much. I appreciate it. I'll hop back with you.

Facilitator:

Our next question will be from Thomas Wendler of Stephens.

Thomas Wendler:

Hey. Good morning, everyone.

Aaron P. Graft:

Good morning.

Thomas Wendler:

Just given the industry headwinds, is supply chain financing something we could see clients lean on? Just looking for some color around what we should be expecting for growth there if industry pressures continue.

Aaron P. Graft:

There's no question that everybody is feeling the stress. Arguably, the only people who are not feeling the stress, and I don't even know that they would agree with this statement, would be shippers. They're seeing contract rates fall and they're pushing to make their freight costs as low as possible. Now, these are smart people who think long-term and I think they also think about not just, "What can we negotiate in the moment?" but, "What can we get for the long-term?" But there's still going to be some of that near-termism. They're pushing to save money. And so that's got to fall somewhere. And so freight brokers are feeling it. Carriers are feeling it. Factors are feeling it.

Triumph is feeling it. And as we think about in a world in where money is no longer free, there is time value of money, of people who would like for us to provide liquidity. And we tried to lay out for you in the letter all the different ways, all the different options that we can use our balance sheet to help add liquidity into this transactional flow. I can't tell you exactly how much it will grow. I can't tell you whether it'll be doing extended standard pays for shippers or more factoring or supply chain finance for freight brokers. I mean, each of those are independent, individualized discussions. But I would say that we get a lot of inbound requests for us to step in to that value chain that we illustrated to you in this letter and for us to inject liquidity into it. So I think it's an opportunity. Absolutely.

Thomas Wendler:

Thank you. And then as you said in your comments, not all the provisioning this quarter was bad. We saw some pretty strong growth in C&D. Can you give me some color around new production and then how are you thinking about growth in construction moving forward?

Todd Ritterbusch:

Yeah. The growth that you saw in C&D was related to one relationship that we have. It's a long-term relationship. It's a great relationship. They came to us with an opportunity that offered terrific risk-adjusted returns, and so we jumped at that opportunity. More broadly when we think about construction and development, we're going to be selective. It's going to be those sorts of opportunities that are with existing clients and will probably be much smaller than what you saw in the first quarter.

Thomas Wendler:

All right. Thank you for answering my question.

Facilitator:

Our next question will be from Tim Switzer of KBW.

Tim Switzer:

Hey. Good morning. Thank you for taking my question.

Aaron P. Graft:

Morning, Tim.

Tim Switzer:

The press release... Hey. Thank you. The press release is great, Aaron, where you're outlining the path to over potentially $1 billion in revenue for Triumph over the long-term. And we try to think about the long-term earnings implication of that. Historically, you guys have talked about a 50% EBITDA margin for

T-Pay. What's the overall margin we could maybe assume on that billion dollars over the long-term and what's like the ROE, ROA profile there?

Aaron P. Graft:

Yeah. So that's a tremendous question. I'm sure there's people at the table wanting to tackle me right now, but let's just... Look, we know that and we can demonstrate to you in the industry that

Aaron P. Graft:

Networks generally achieve EBITDA margins that are higher than most other business lines. That's true in transportation, although there is no financial network that exists in transportation other than the one we're building.

I would say I would go back to what I've said historically is we think that this ultimately settles in somewhere between 50% and 70% EBITDA margin. Now, here's the big question embedded in that, and it ties to the revenue discussion. We laid out for you the ways in which we can touch a single load of freight at the shipper level, at the broker level, at the factory level, at the carrier level, and at the vendor level, which is when the carrier goes in and spends that margin that they were paid to cover their next load. A day will come when we touch that value chain in so many different places that we're going to say not all of that belongs on our balance sheet. We're not going to grow our balance sheet to the sky. We are using our balance sheet right now as a strategic advantage because no other FinTech trying to compete with us can go do what we can do to open the doors we can open. But a day will come when the syndication of that risk into the broader capital markets, which I think would want exposure to that paper, that day will come. And when you do that and you look at how capital efficient the remainder of the business is and the fees that are generated for it and the float that we generate, then you're going to skew to the higher end of that EBITDA margin fairway that we've laid out for you.

But this journey won't be done next quarter, next year, even in two years. I mean, we're doing something that's not been done before. The great news is there's not a lot of incumbents that we have to displace from here to where we are going, but it is a tremendous amount of work to get there. And we believe that a billion dollar revenue opportunity is realistic. I get it. That's 20 times where we are right now, but we can see where we are embedded in the transaction. We see the inbound interest in what we do, and we understand for analysts and investors that we must do that in order to grow the valuation. We must do that where our EBITDA margin looks more like a SaaS business and a more capital efficient, less balance sheet intensive business. And so that's in the out years.

So I hope that answers the question, at least gives you a fairway of what we think it looks like as we start to approach maturity, how we think we get there and what we think we look like. Those are my best thoughts at current.

Tim Switzer:

Okay, great. Yeah, I appreciate that. And I understand the difficulty of talking about some of these longer term projects and what it looks like ultimately, but you also mentioned about half of that billion dollars of future revenue is from revenue streams you haven't necessarily tapped yet. I know some of these are expanding to the shipper market, some data related products. Could you talk about maybe the potential timelines of when we could get more color on these, when you can maybe start to roll some of these newer ones out, and which new products would you be most excited about?

Aaron P. Graft:

Yes, great question. And so obviously starting last quarter we gave you one, that's load pay, which is not a fuel card, right? I don't know why I feel the need to say that now, but I do want to say it. It's a virtual wallet that allows our customers and the fuel cards they use to exchange value with each other regardless of the time of day, regardless of whether it's a holiday.

You reference data. Look, data in the transportation space is in and of itself at least a billion dollar market and probably greater, depends on the things you count. When you talk about from load boards to rain late data products, all these things. And there are many players in that space, and there are many smart companies in that space.

We think we have our own value proposition to bring to data. Why? Because we've paid more truckers than anyone in the world. And when you pay truckers, you know certain things about truckers that other people can't see, don't see, won't see.

And so as we go forward, I think you'll hear us talk about in 2025 some of the things we want to do to add value to the industry to help protect our customers from fraud, to help them create more efficient processes, to help them find carriers. We have some ideas, but that is a 2025 initiative and beyond because we got enough to say grace over right now.

Beyond that, you referenced the shipper market. We make payments for roughly 50 shippers and we have some very large shippers, some Fortune 1000 shippers who are part of that. I refer you back to the value chain we laid out. The data that is needed by the factor to buy the invoice from the carrier is the same data that the factor will need to submit to the broker in order to get paid. And that same data needs to be submitted by the broker to the shipper to get paid. We are the ones who hold that data. We have it in a structured format.

So part of this journey that is in that revenue that's more opaque at this time is to take that structured data to the shipper market, where every one of these loads, every single load starts there. No broker makes anything. All of the loads start in the shipper market, and we're talking about 300 billion plus of procured transportation is what US companies need to go get. So between shipper and data and some of the other things we're thinking about, you'll start to hear us talk about that in 2025. We'll start to give you more specificity as we go, and I think it will make it more clear what that road map is and why I can say to you with a great deal of conviction that I believe our opportunity to turn TriumphPay into something that generates a billion dollars plus in revenue at very high margins is indeed a very real thing.

Facilitator:

Our next question comes from Hal Getch of B. Riley.

Hal Getch:

Hey, thank you. I've got two questions. One, on the factory business, the business is down quite substantially, over probably 40% double-digit negative comps down for two years, and a big part of that is just invoice price. That's probably dominated, is invoice prices are down from $2,500 to $1,800, and that would suggest hey, the volume's down, the overall volume's down low double-digit, but you said this is the worst you've ever seen. Is it the worst and the longest you've seen now? Because this appears to be near a low. I wanted to get your thoughts on that trajectory. Thanks.

Tiim Valdez:

Yeah, Hal, I've never seen anything like this. Been in this business now over 25 years, and when you look at the length of this slowdown, it is historic. I mean, Aaron mentions it in the letter, I've never seen anything like this.

Now we have seen a normalization of those rates, so we track very closely a couple of things. One thing that's really important to us is we track how fuel impacts our carriers and what that means on their average invoice amount. So if you look at fuel prices increasing week over week on a DOE average and invoices not reacting, usually there's about a weak lag. But if the invoice doesn't react within a fairly short period of time, we know there's no pricing power for that particular carrier and that constituent.

What we've noticed in the first quarter is that our small carrier segment has stabilized and the average invoice amount for the small carrier can't go any lower, to Aaron's point in the letter. It can't go any lower because we're already at breakeven or below in some cases.

Where we saw the weakness more in the first quarter is the contract rate and the margin between contract and spot rates contracting a little bit. And so ultimately those have to normalize as well before we start to see something change.

Hal Getch:

Okay. One follow up question on the deposit franchise. Do you think we've seen the peak in deposit cost increases, that we've seen the bulk of the surge? And can you also just comment on how you use the broker deposits from time to time? It seems to fluctuate a little bit. Thanks.

Todd Ritterbusch:

Sure. I'll answer the deposit question. So I don't think that we've seen the peak in deposit costs. As long as you see rates available in the marketplace on promotions above 5%, and we're carrying a cost deposits that is much, much lower than that, there will be upward pressure on our deposit costs. We do anticipate that when rates do begin to come down, we'll be able to capitalize on that and bring our rates down in line to a large extent, but for the time being, we do expect rates to continue to creep higher in our core deposit franchise. Brad, do you want to address the other question?

Brad Voss:

Sure, Hal, you did notice that our broker deposit levels have fluctuated quite a bit over time, and I think that will continue to happen. We view broker deposits as part of a portfolio of non-core funding options that we use, and we really use the one that is the most economically advantageous at any time. If you look at our overall wholesale funding portfolio, the cost of that over the last couple of quarters is actually just a touch below where we can sell money overnight to the Fed, and we actively manage those costs and that composition. So as you see that composition change among federal home loan bank advances and brokered funding, it changes because the economics associated with those are moving back and forth.

Hal Getch:

Thank you.

Facilitator:

Our next question comes from Frank Sheraldi with Piper Sandler.

Frank Sheraldi:

Good morning. Just wanted to go back to something Melissa said about pickup and volume. Just want to make sure I heard correctly. I think you said five to 10 billion in volume pickup, and was that over 12 months? And did you say that was all network volume? Just trying to clarify those numbers.

Melissa Forman:

Yeah, Frank, thank you for clarifying that question. So the five to 10 billion would be based on an annualized rate, so that's the contracts and the implementations, integrations we have in our queue. Some may roll over into first quarter of '25 as those implementations start taking place, but that is the total annualized volume that you'd see. So you would not expect to pick that up total volume in 2024. Does that make sense?

Frank Sheraldi:

Sure. Okay. So that's annualized volume, but is that all network or is that across the total?

Melissa Forman:

The majority. Yeah, so the majority of that would be network volume. There are ways in which we can add volume to the network that is all sides of the transaction right from the pre-purchase all the way down to the cash application. So some of that volume will live on one side of the network transaction, some will be on both.

Frank Sheraldi:

Okay.

Frank Sheraldi:

And then, just to follow up to that, when we're thinking about 2025, in terms of revenues, I know, correct me if I'm wrong, but I think that the factoring fee, or factor fees, the fees of factors are paying has been pretty stable. And I think that's because you haven't really, for the most part, been charging network fees to these factors.

And so, do you think starting, I think the idea is to start, perhaps in 4Q '24, depending on where your penetration is on network transactions. It seems like the penetration is going to be pretty strong. So is that still a good timeline to think about? Or does it depend on how healthy the freight economy is at that point? And just remind us, if you could, the potential pick up there right off the bat, in terms of revenues.

Melissa Forman:

Yeah, that's a great question. And so if you remember, when we priced out the network, we had about 150,000-167,000 transactions quarterly when that pricing was set. That represented about 3% of our total payment volume at the time.

When you look at where we've landed this quarter, and what we've achieved this quarter, we are up to over 600,000 in network transactions, representing, as Aaron mentioned, a billion dollars in those payments, and 16% of our payment volume.

So substantial growth in that timeframe. The pricing that was set for our factoring clients was set based on that Q4 of '22 volume, right? With the market where it is, we've made a decision as a business to give grace to those payment term increases, in Q4 of last year. And we're going to keep watching the market and keep making sure, keep adding the value as we're doing, giving factors the ability to leverage that data and make the changes that they need, especially in the market where it is right now, where they're feeling so compressed, where there's margin compression. But we'll continue to monitor it. And when the timing is right, we'll be able to see that pricing increase, and it will include all of the network volume that we will have at that time. Aaron would add something?

Aaron P. Graft:

No. Hey, I think that is just such a great answer. I just want you to hear what, I want to reiterate something Melissa says, and I see her with her team and out in the market. When we get on these earnings calls, we talk about, "Well, how can you monetize it? What is the dollar transaction value?"

And that's an appropriate question. It's something that we owe to investors. I want you to know how we think about it as we run our business. We start with how much value is this to you, our factoring customer? Because if we put the monetization ahead of the value creation, that's not a way to build a long-term partnership. And the greatest partnerships, the greatest networks are more concerned about adding more value to their constituents than how quickly they take it out.

And so I love the fact that Melissa has a long-term view, and that we as an enterprise have a long-term view. And what's going to drive this is, if you end up making 60-70% of a factor's payments are available to them as network transactions, that changes their staffing model. It changes their operational processes. It changes how they do cash application. It reduces several dollars, if not $10 in friction per invoice, for which it is entirely appropriate for us to be paid.

But right now we are talking about the value creation, which is primarily driven by creating density in the network, pushing more transactions. Our technology continues to get better. We still hold to those long-term economics we told you, that we think a conforming transaction or a network transaction generates somewhere around $5 in total revenue.

And we think it eliminates $20 of friction between the payer and the payee, generally the broker and the factor. But that value prop goes up as density goes up. And that's why most networks never make it, is because they get ahead of themselves on trying to monetize things instead of focusing on density. And so I don't mean to be long- winded in this, but I want our investors to understand, I am way more concerned about the density of the network and the value we are delivering to our constituents than exactly what we price it at in 2025.

I think it goes up, I don't know if we get to our long-term ultimate goals then. It will depend upon, can I look our customers in the face, can Melissa look our customers in the face and say, we delivered way more value than we're charging. And if that's true, we will charge it.

Melissa Forman:

Yeah, and if I could just add, Aaron, I think what is most important for us, again, growing that network density, making sure that the payments network in general is valuable to all of our constituents. But in this market right now, my primary job is to make sure that my clients, Tim, as a factoring customer, all of my other factoring clients, my broker clients, my shipper clients, that I'm giving them the data they need and the efficiencies they need to help their trucking companies, their clients, thrive.

And that is what is heavy on our hearts, that we take and make a priority every day, is how do I help this industry thrive, not just how do I make my quarter numbers look good?

Frank Sheraldi:

Great. Thank you.

Facilitator:

As a reminder, if you 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. Our next question will be from Gary Tenner from DA Davidson.

Gary Tenner:

Thanks. Good morning.

Aaron P. Graft:

Morning, Gary.

Gary Tenner:

Aaron, I wanted to ask the revenue chart that you've got on page four of the shareholder letter by the customer cohort, if we were to look at that based on payment volume, or transaction volume versus revenue dollars, how might that look different over the last couple of years, as your customer's ramp and then stabilize?

Aaron P. Graft:

So I want to make sure I understand the question. So there's a ramp associated, obviously the revenue from new customers, it doesn't all come on at one time. So revenue dollars is, you're not getting an accurate picture for 2023 and 2024 cohort, of what the entire opportunity set is relative to revenue dollars.

But if we think about where those revenue dollars come from, the discussions and the work that Melissa and the team are doing, you're creating revenue dollars, number one, with just the contractual arrangement, what we get paid to handle audit and payment. Number two, we make money off of the float, the timing difference between when we draft payment and when payment's actually made.

And then, finally we make money by injecting liquidity into transactions using our balance sheet. So what that chart is designed to show, and I hope this is answering the question, is if you look into the pre-2019 cohort, where we were thinking about Triumph Pay, really as a balance sheet only solution, is that the volatility in the revenue was correlated to the size of the invoice, very much like our factoring business.

If you fast- forward into these more recent year cohort, we still have some volatility tied to the size of the invoice. Seasonality is still a real thing in Triumph Pay. But that volatility is muted by the fact that we're doing these contractual year-long arrangements to facilitate a certain expected number of transactions at a certain price. And so you start to see that volatility dampen, which is what we think a network should do. I think that answers the question, but if I need to get more specific, I will do my best. Gary, just let me know.

Gary Tenner:

No, that helps, Aaron. I appreciate it. And then sort of an unrelated question, just from a capital perspective, finished the quarter still pretty close to 12% on CET1. I think down maybe 10 basis points versus year-end. Any updated thoughts, especially with the stock having come in a little bit, in terms of deployment of capital?

I know you've talked about trying to keep some in reserve, if there's an acquisition opportunity that comes about that could help propel the business? But just update how you're thinking about it.

Aaron P. Graft:

Sure. And I think in broadly, I'm going to take your question as an invitation to answer just how we think long-term. So if you look at the business and our businesses, the community bank can't stand alone. Right? The community bank is mature, got the team, the balance sheet, all that's in place, and it can grow. We haven't historically been growing it because we didn't think the risk opportunity made sense. And we have a tremendous deposit franchise. I think something a lot of people miss.

If you look at the factoring business, that is a mature business. It's a business that we have intentionally restricted growth on because we wanted to honor the commitment that we don't want to be the largest factoring company in America. That's not our goal. We want to see the factoring industry update and stay relevant in the 21st century, and we want to help that.

But our factoring business, this is the worst quarter I remember, and it was still a pre-tax, two and a half percent or better ROA. So that business can stand alone. Triumph Pay is not at a place to stand alone. It's not going to be at a place to stand alone in 2024 in 2025. And I don't even think delivering a few percentage points of EBITDA on margin to the positive means that it can stand alone, because it requires investments.

And so we've got two options, right? How do you access the capital required to go make the investments for Triumph Pay to go win at the scale that we are telling you we believe we can win? Well, one option is to fund it much the way that a venture capital backed or PE backed firm would fund it, and allow it to run with a lot of losses, and hope that you scale it up over time, and then you hit an infliction point in the curve three to five years from now.

And you can do that. But I think that would dilute our investors, the people who've been with us since the beginning and made the long-term bet, that we could just take retained earnings and build this without creating that kind of dilution. We believe that the value of Triumph Pay belongs to our current investors.

So we choose to take our near-term profitability, which we could make this place a lot more profitable if we cared how much in any given quarter in any given year. But we choose to take that profitability and we choose to invest it into something that we think has a multiple attached to it, from a growth perspective and evaluation perspective, that helps us all win. So when I think about 190 million in excess capital, I think about it through that grid. What helps Triumph Pay win the most? Is it buying back our shares? It might be.

Aaron P. Graft:

I don't know that you'll see us in the market right now, but over the long term do I think our shares are going to appreciate? Absolutely. What I think about right now is I want to be prepared to ride out the rest of this recession. I don't care if it's three months, six months, nine months, 12 months, I want to ride it out in a position to be able to act when no one else can act. That's number one. And number two, I believe that the longer this goes and the more market penetration we create, the more opportunities we will have to do some accretive M&A to the network, and I want to be prepared for that. So I don't think about it of managing our capital ratio to a certain specific percentage in any given quarter, I think about it as what helps us get to this long-term goal of where we're going.

And if that makes us look, I don't know if sloppy is the right word, but over capitalized in a given season. Or if that makes us look not optimized for earnings in a given season, I'm okay with that. And I think anyone who invests here should be okay with that because our eyes are on the long-term prize and that is getting TriumphPay to something far more than just barely EBITDA margin positive, but something that's truly transformative. So hopefully, directionally answers your question, but I want investors to know how we think and that is how we think.

Frank Sheraldi:

Thank you, Aaron.

Facilitator:

Our next question will be from Frank Schiraldi, from Piper Sandler.

Frank Sheraldi:

Yeah, just as a follow-up on the freight recession and just thinking through that, you need to see some capacity come out of the system to level set and create a recovery here. Just based on what you're seeing in your book in terms of the capacity you're seeing leave the system, what is the best guess in terms of where we need to get to, how much capacity needs to leave the system, and what you're seeing as a trend line. Where does that match up in your mind? Do you think it's more of a 2025 event? Is there a lot more work to do there? Just anything on that front.

Aaron P. Graft:

And Tim could give you anecdotes in the factoring business and Melissa could talk to you about what she sees in TriumphPay. I think speaking in generalities, we need 15% or more capacity to leave the system. Now, not all capacity is created equal, that's where you've got to be careful with these statistics. 96% of these authorities out there are very, very small and they may not leave the system, they may just park the truck and go drive for Uber for a season because they make more money doing that. This unwinding does not happen nearly as quickly as people think, and you might ... in '08, maybe you saw that because the whole world was melting down. What's happening is the rest of the world is just trucking along just fine. It's the truckers who are feeling the pain right now and nobody's paying attention to that very much except those of us who live it every day.

My friends at the freight brokers who've already reported, they're feeling it, right? And we know it. We live it, we see it. I think you need some capacity to leave the system to hope that it's just going to be tonnage driven, that more freight's going to come through, I think is folly. We don't see that happening. And so we're not economists. We give you the predictions we give you in the shareholder letter, not that they inform how we make every decision. We only give you those because you understand the grid through which we think, and I struggle to see how you're going to see a material improvement in freight in 2024. And I desperately hope I'm wrong, but either way, we're going to keep doing what we've been doing.

Frank Sheraldi:

And then as something as significant and terrible as the collapse of the Francis Scott Bridge in Baltimore and closing of that port, I mean, what sort of impact does that have on the freight recession? Does that create more ... it certainly creates more stress, I would think, in the near term. Does that create more capacity coming out of the system? Does that accelerate that? But just your thoughts on how that impacts the freight recession and how it impacts yourselves.

Aaron P. Graft:

It does not have a meaningful impact on the freight recession. They're going to reroute that freight to other ports. You've got to reposition the trucks to go to those other ports, but that-

Melissa:

It's a temporary blip.

Aaron P. Graft:

... yeah, it's a regional temporary distortion. We see that in hurricane season, that freight gets out of whack in certain regions. I don't know that there is any solution to cure the market, low freight prices, other than low freight prices. Capital, and this is the beauty of capitalism, finds its way to where risk-adjusted returns are appropriate. It just needs some more time to understand that additional allocation of capacity into this market will not get rewarded and that capital will find its way to go somewhere else. That's the only solution. One short, I mean, any regional blips or storm seasons. That's why I said we're seeing some things trend in April up, but we don't think that's statistically significant. We just need capacity to leave the system and that is happening. We just all wish it would happen faster.

Frank Sheraldi:

Okay. And if there's no other question, just wanted to see if I could slip in one more on credit, just in terms of the noise in the quarter. And to your point, some of the provisioning was due to the growth in construction, but in terms of where you guys are seeing the most or have the most concerns, is it the equipment finance book or given the size of that, is it elsewhere? Is it the commercial real estate book? Just your thoughts on potential stress points in the portfolio and trends from here on the credit front.

Todd Ritterbusch:

Yeah, I'll take that one. So I would say generally transportation is the focus, but within transportation, equipment finance is definitely the focus. So when you think about what's going to happen in equipment finance going forward, first I would say don't use the first quarter loss as a proxy for what's going to happen every quarter. That was an anomalous situation that probably won't repeat itself. As we look forward, we think the losses are contained and they're for a couple of reasons.

First of all, even 24 months into this recession, most of our clients are continuing to pay as agreed. For that small minority that's not paying as agreed, we've got good collateral positions that we're shoring up further as we're offering payment relief in its various forms. So that contains it. But I think the most important thing is the team that we have in place. So we've talked before about how they've served the industry through the cycles and handled those cycles. I can tell you, working with them every day, they are doing a terrific job on a customer-by-customer basis. They have great relationships, they have great outlets for equipment and that gives me a great confidence. It's a real competitive advantage for us.

Frank Sheraldi:

Okay. And on the commercial real estate side, I mean I know you guys have very low LTV, so I'm sure that makes you feel pretty good about potential loss there, but just seeing some of that stress we're seeing industry-wide, is it reasonable to think we'll see some deterioration in terms of criticized classifieds, maybe non-performers, while not seeing maybe ultimate loss? Is that reasonable?

Todd Ritterbusch:

I'd say it's possible. It's not necessarily our forecast in commercial real estate, so you nailed it. We've historically drawn a lot of comfort from our loan-to-value positions, but more recently we focused on price discovery. So as we begin to look at these properties and see what they're valued at today, not what we thought they were valued at a year or two or three years ago, we're increasingly comfortable and reaffirmed that we're fine with those. The modifications we've made have been for the purpose of making sure that those properties continue to cash flow and their owners have a reason to stay in those properties and that's what's happened. That's why those modifications haven't required further modification. And you also noted that we didn't put more modifications on this quarter. We don't expect a lot more. If we have to put on a few more, it will just be for the purpose of adjusting the rate primarily to something that's sustainable for those properties over the longer term. And for that reason, they wouldn't necessarily become non-performing assets.

Frank Sheraldi:

Okay, great. I appreciate all the comments. Thanks.

Aaron P. Graft:

For sure.

Facilitator:

There are no further questions at this time. Thank you.

Aaron P. Graft:

Well, thank you all for joining us. Hope you enjoy the rest of your week and we look forward to speaking to you again soon. Thank you.