Triumph Bancorp, Inc.

Second Quarter 2019 Earnings Conference Call and Webcast

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CORPORATE PARTICIPANTS

Aaron Graft, *Vice Chairman and Chief Executive Officer*

Bryce Fowler, *Chief Financial Officer*

Todd Ritterbusch, *Chief Lending Officer*

Luke Wyse, Senior *Vice President of Finance and Investor Relations*

PRESENTATION

Operator
Good day and welcome to the Triumph Bancorp, Inc. Second Quarter 2019 Earnings Conference Call and Webcast. All participants will be in a 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. To ask a question, you may press star, then 1 on a touchtone phone. To withdraw your question, please press star, then 2. Please note this event is being recorded.

I would now like to turn the conference over to Luke Wyse, Senior Vice President of Finance and Investor Relations. Please go ahead.

Luke Wyse
Good morning. Welcome to the Triumph Bancorp conference call to discuss our second quarter 2019 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 statements.

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, and Todd Ritterbusch, our Chief Lending Officer. After the presentation, we'll be happy to address any questions you may have.

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

Aaron Graft
Good morning. For the second quarter, we earned net income to common stockholders of $12.7 million, or 48 cents per diluted share. Q2 was an interesting quarter. Our financial returns were average to below average for us; however, we made significant improvements in our business that we believe will create long-term value for our team and shareholders. If anything, Q2 proved out that our business model is susceptible to revenue volatility due to the short tenor of our assets, particularly our factored receivables purchased from truckers.

Loans held for investment increased $223 million, or 6 percent, in the second quarter. We have added an additional category to our reporting on our loan portfolio starting with this quarter, which we will call national lending. The loans in this category are not new to us. You can see by the composition by loan product for each of these categories in the investor deck on Slide #9 and tables in the earnings release.

Loan growth was diversified as the community bank portfolio grew $54 million, or 3 percent. Most of this growth was C&I lending. The commercial finance portfolio grew $78 million, or 7 percent, despite the soft growth in transportation factoring. Equivalent lending performance and growth remained strong, and we saw nice growth in asset-based lending.

National lending includes mortgage warehouse lending, premium finance, and liquid credit. For mortgage warehouse, we had a $62 million increase in average balances this quarter, or 26 percent over the prior quarter. The liquid credit portfolio consists of widely syndicated leverage loans. This is a niche line of business we have participated in opportunistically in the past, and we intend to do so in the future. We have a small team dedicated to this activity, and we expect this portfolio to grow from its current size and to vary over time depending on opportunities in the syndicated loan market and in other parts of our business.

Total deposits increased by $345 million, or 10 percent, in the second quarter. Most of this increase was related to the Dallas branch slated for a fourth quarter opening as well as higher-rate CDs offered outside our retail footprint on a national basis and broker deposits. Our loan-to-deposit ratio at quarter end decreased to 105 percent. This ratio is inflated approximately 10 percent by our use of Federal Home Loan Bank advances to fund our mortgage warehouse line of business. We continue to develop our retail deposit-gathering efforts and expect to roll out new product offerings to our branch network in late third or early fourth quarter. Our treasury management capabilities are actively being marketed and are beginning to bear fruit.

Second quarter net interest income was up $2 million from Q1. Loan yield declined 4 basis points to 7.95 percent, largely due to the softness experienced in transportation factoring. The cost of total deposits increased 15 basis points, to 1.14 percent, largely due to the relatively high marginal cost of the deposit growth this quarter. Net interest margin declined 16 basis points, to 5.99 percent. We accreted $1.3 million of loan discount in Q2.

Our asset quality remains solid. NPAs to total assets ticked up 2 basis points, to 86 basis points. Past-due loans to total loans decreased by 43 basis points. Net charge-offs to average loans were 5 basis points.

Second quarter expenses at $50.7 million were better than the $51.5 million estimate of Q2 we provided in our last earnings call. We estimate that non-interest expense will increase to $52.8 million for the third quarter of 2019. We now expect full-year expenses of $204 million, or 2 percent above our projection at the first of the year.

Next, let’s talk about transportation or specifically over-the-road trucking, which generates a significant portion of our revenue. In Q2 the spot market rate per mile continued to be down from late 2018 levels, and we did not experience the typical seasonal rebound mid-second quarter in spot rates. We believe there are several short-term factors pushing the spot market rates lower, with the primary factor being the supply-and-demand imbalance we saw in 2018 starting to correct itself. We believe manufacturers and retailers pulled forward freight demands ahead of both the threatened and implemented tariffs, which created the record spot market demand in 2018.

Those levels of demand brought lots of new capacity into the market, evidenced by historical new and used truck sales, but these levels were not sustainable. To that end, Triumph’s view is that the current softness in the spot market in the first half of 2019, is definitely not secular and probably not even cyclical but, instead, tied to a supply-and-demand imbalance created by the trade issues from 2018. 2019 feels like 2016 for us, which was not a bad year.

Trucking will continue to be cyclical, but we like the secular trends driving over-the-road trucking in the U.S. We believe the U.S. will continue to prosper so consumers will be buying and companies will be moving more goods 20 years from now, which will drive evermore demand for trucking. Regardless of what the trucking market does in any given quarter, we are committed to this business for the long term.

In Q2, total factoring revenue of Triumph business capital increased about $1 million quarter over quarter, or 4 percent, to a total of $26 million. This increase in revenue was driven by a 6 percent increase in purchases, to $1.4 billion during Q2. The number of invoices purchased increased 84,000 from Q1. We purchased 874,000 invoices in Q2. Growth this quarter was slower compared to Q2 a year ago when we were in the midst of a record year for transportation. The average transportation invoice size decreased $49, to $1,492, or 3 percent.

To illustrate the impact of invoice size, all else being equal and holding the average invoice size flat, on 807,000 transportation invoices purchased, this $49 decline in invoice price reduced total factoring revenue approximately $700,000 for the quarter and reduced total factored receivables at quarter end by approximately $15 million.

At the end of the second quarter and into the third quarter so far, we have seen spot rates stabilize and settle into a more traditional rate per mile, similar to the years before the end of 2017 and 2018 and a more traditional seasonal pattern based on trailer type. Our transportation factoring portfolio turns about 11 times per year, creating revenue volatility from quarter to quarter, but its launch experience continues to be very acceptable, and it remains our most profitable business line.

We are hopeful the markets for the business for the remainder of the year can improve. We can't control either invoice sizes or utilization, but we can control the client growth, and despite a slower market and less volume than is typical in Q2, we saw active clients increase by 73 clients, to a total of 6,455 during the second quarter.

I continue to be very excited about our progress with TriumphPay in terms of integrating new clients, marketing to new prospective clients, and enhancements to the system. We now have 146 clients, up from 130 clients last quarter. During the second quarter, TriumphPay processed 150,000 invoices paying 28,000 distinct carriers. Payments processed totaled approximately $169 million, a 20 percent increase over the prior quarter and a 169 percent increase from Q2 2018. We have a pipeline of freight brokers in the queue to join the system, including some of the largest third-party logistics companies in the country. I expect the growth to continue to be dramatic.

We are trying to make it clear to investors that we are doing something unique here, and if you just look at the breadcrumb trail we've laid out over the last few quarters, you should see how it is unfolding. TriumphPay will be profitable for us in 2020 and I believe make a significant impact on 2021 full-year performance. Investors should not overlook the fact that TriumphPay also generates slope for us in addition to interest income and fee revenue.

With that as background, let me speak to what we are seeing in the general market. During the quarter, we repurchased approximately 591,000 shares in the treasury stock at an average price of $29.42, for a total of $17.4 million. This completed the original $25 million repurchase program authorized by our Board. Yesterday we announced the authorization of a second $25 million repurchase program. We will continue to repurchase our shares throughout the year if, in our view, the stock remains undervalued.

We also continue to evaluate the implementation of a dividend. For several years, we have carried excess capital to stay primed for M&A opportunities. We will still evaluate those opportunities to the extent we believe they can enhance our deposit franchise, but they are fewer and farther between. We have no interest in growing for growth sake. When I look at our business model, we have the ability to generate the same or potentially better returns on capital at $5 [billion] to $7 billion in assets than we would at $12 [billion] to $15 billion. In other words, we can achieve our 1.8 percent goal or better consistently, without an increase in the size of our balance sheet, by focusing on the lines of business and products where we are uniquely positioned with our scale-of-industry knowledge. For us, that means transportation or, more specifically, over-the-road trucking. This balance sheet discipline will cause our assets to shift organically, which will lead to higher returns, because our fastest growing businesses are also our highest margin businesses. When those businesses achieve certain concentration levels within the bank, we have the ability to turn the additional growth into fee income through participation channels we are building. Overall, we're not opposed to growing our balance sheet but only if we can grow by acquiring high-quality deposits at the right price.

With that, I'll turn the call back over to the Operator for any questions.

QUESTIONS AND ANSWERS

Operator
Thank you. We will now begin the question-and-answer session. To ask a question, you may press star, then 1 on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed or you would like to withdraw your question, please press star, then 2. At this time we will pause momentarily to assemble our roster.

Our first question today comes from Brady Gailey with KBW. Please go ahead.

Brady Gailey
Hey, good morning, guys.

Aaron Graft
Good morning, Brady.

Brady Gailey
So we have another quarter of the average invoice size moving down here? I think it's kind of been this way for at least the last like three or four quarters. Aaron, I heard your comments as you were opening the call. It feels like you're thinking that 2Q's level could be a bottom, and as we move to the back half of this year, you could see average invoice sizes go up. And then what's your take on kind of how that plays into your loan growth expectations? I think last quarter we were talking about kind of a $500 [million] to $700 million amount of loan growth this year. Is that still the right way to think about loan growth in 2019?

Aaron Graft
Sure. So there's a chart, if you look, Brady, in the slide deck that we put in for this quarter, that I think is interesting, that shows the high correlation between the spot market and new truck orders. And you can see on the far right-hand side of that chart, the most recent data. You can see the spot rate creeping up. Now, whether that trend line will continue is difficult to predict. You've got a lot of different things going on, freight, the mixed shift that happens quarterly within freight; for example, refrigerated freight really peaks towards July and then starts to taper off. Other types of freight pick up. What it looks like right now, it appears the spot market is

strengthening as we work through this excess capacity. It is not going back to 2018 levels, at least in short order. Now, again, that market moves fast, and we're wed to that market, but overall, unless something happens, I would expect the overall spot freight market, at least reflected by the invoices we purchase, to be marginally better in the third quarter than it was in the second quarter.

With respect to total loan growth, and I hope this came clear in what we're saying, we absolutely have the opportunity to grow loans $500 [million] to $700 million for full year. I don't know whether we will, Brady. We really are focused on growing the things that are the most profitable, and our loan pipeline is full. We're just not sure if we're going to open the spigot as much as we talked about. When we're looking at a high cost of incremental funds, I think we're far more interested in approving and growing loans that exceed our internal rate hurdles than just total loan growth. So this was a good quarter for total growth, but we're paying a lot more attention to shifting the balance sheet than we are to growing the balance sheet.

Brady Gailey
All right. And then a follow-up. So if you look at the growth you experienced in 2Q, you also look at the buy-back activity you had, your key C&E ratio went from about 10.4 percent last quarter down to 9.8 percent this quarter. It feels like, with your current [unintelligible] trading, how it's trading M&A, is less likely for you guys. As you look to the buy-back as a way to deploy capital and with the stock being even cheaper today than it was when you repurchased the stock in the first half of the year, it feels like you'll be pretty aggressive on the buy-back here. How low do you think you would be comfortable seeing the TCE ratio decline?

Aaron Graft
Well, we don't just look at that ratio. Our total capital to total risk-rated assets at 11½ percent, I think we disclosed to you in the past, is something we've looked at. We certainly have room to complete the $25 million buy-back plan that was recently announced. We're not going to be cavalier about that, and, look, the ideal thing for us would be a large branch deal. We've worked on some; they haven't come to fruition, because if you think about it, of our deposits, $1.6 billion of those deposits are what we would call high-cost deposits. If you could roll those $1.6 billion in deposits into 40-basis point deposits, where sort of our community bank retail network is priced, you would drop at least $30 million in net income to the bottom line, without growing the balance sheet at all, just churning the deposit portfolio.

So a branch deal that would move us in that direction is still interesting. That being said, whether or not we get a branch deal done with the position we have in Triumph Business Capital and what we keep telling you is going to happen in TriumphPay, I at least am interested in continuing to repurchase shares when we can buy them at less than 10 times forward earnings, because we believe that in relatively short order, in a couple of years, we will be rewarded on that. So, yes, you should expect us to be active in repurchasing shares. It is unlikely that there is full bank M&A that will make sense. We continue to look at it. Any M&A for us is almost exclusively going to be focused on improving our deposit network.

Brady Gailey
Got it. Thanks.

Operator
Our next question comes from Matt Olney with Stephens. Please go ahead.

Matt Olney

Hey, thank you. Good morning, guys.

Aaron Graft
Good morning, Matt.

Matt Olney
Aaron, you mentioned the possibility of participating in some loans out and generating some fee income. Can you give us some more color around that? Is there a timeline of when this would become more realistic and would move the needle?

Aaron Graft
Sure. Well, those references were specifically with respect to exposure to transportation, okay? So there's two things that would lead us to do any sort of participation. One would be exposure to a single name. One of the top two or three third-party logistics companies could exceed our legal lending limit for exposure to one borrower, in which case, we've already laid the groundwork to participate additional exposure for that name or those names with other institutions.

The second way would be where total transportation exposure for us meets - we always have to think about how much of our revenue are we comfortable having coming from transportation? Right now it's around 35 percent. So I suspect, Matt, that in the next 12 months, there will be individual names that we will start to do participations out to other institutions. We've even looked at capital market structures, and we have some, creative ideas how we can do this, yet retain the fee that we think we earned from building this platform. So I think you'll see some — internally, at least, we'll see some individual participations out and some fee income starting surely next year, and then as TriumphPay becomes what we think it will become, then that will become a significantly growing exercise, because the volumes that we're talking about moving through the system will be far more than a $5 [billion] or $7 billion bank balance sheet or, frankly, a $12 billion bank balance sheet can handle. So I think you'll see that just continue to progress, and in 2021, I think it could be material.

Matt Olney
Okay, good. That's helpful. And then on the credit front, it looks like you guys had another strong quarter of credit trends, but one of your peers highlighted some credit issues around ag, so can you just kind of remind us of what your ag exposure is and what type of ag exposure it is, and are you seeing any incremental pressure there?

Todd Ritterbusch
Hi, Matt, this is Todd Ritterbusch. Yeah, so our ag exposure, if you combine both our traditional agricultural lending and farmland, is, just south of $300 million. So we don't have the same concentration that you've seen with some of our competitors, and it's important to note that some of the recent news is focused specifically on cattle lending, where we don't have a high concentration. We're more concentrated in corn farming, and within cattle lending, the problems have been more in dairy than in beef, and we have virtually no dairy. So some of that news isn't really all that relevant to us. Nonetheless, we watch the agricultural portfolio very, very closely, and so while it represents less than 10 percent of our loans, it's more like a quarter of our specific reserves, and we have made sure that we continue to monitor those relationships as they continue through time, very carefully.

One other important point here is that these agricultural loans are largely sourced out of our community markets where we have long relationships with the individual farmers, so it's a very granular portfolio and built on long-term relationships and success, so even though there has been some stress in that space, we're not abandoning those farmers, and we're working with them to work through those situations one on one.

Matt Olney
Okay. That's helpful, Todd. Thank you. I will hop back in the queue.

Operator
Our next question comes from Brad Milsaps with Sandler O'Neill. Please go ahead.

Brad Milsaps
Hey, good morning, guys.

Aaron Graft
Good morning, Brad.

Brad Milsaps
Aaron or Bryce, just curious if you could just talk about the NIM a bit in light of the potential for the Fed reducing rates, and also you guys have had pretty high deposit betas on the way up, given your need for funding. Just kind of curious against that backdrop, how quickly you think you'll be able to lower deposit costs if the Fed does make a move.

Bryce Fowler
Sure, Brad. This is Bryce. I think overall there, we continue to be priced fairly low across our retail branch network. I don't see room, really, to reduce those rates overall quickly, at least. I think the impact to us will be just the overall impact is having more on our more national type price deposit base, CD portfolios, and the money market accounts we have out there. There are some money markets of probably a couple hundred million or so that we've priced down pretty quickly with the Fed move. We've already seen a back-off in incremental deposit rates and the CD market on a national basis very significantly, and I think we're probably at least 75 basis points below where we were on one-year money for that just a couple of months ago, and I would expect that with this move, that would continue to go down, so marginal cost there has already dropped significantly for us.

Aaron Graf
And, Brad, one other thing that I would point out that is different from us than I presume any other bank in your coverage universe is what happens in Triumph Business Capital has a tremendous effect on our net interest margin. And so for us, NIM — certainly deposits and costs of deposits matter, but if transportation factoring is going up, our NIM is naturally going to expand just due to the margins we earn on those assets.

Brad Milsaps
Right. Right, absolutely. And just to follow up on the transportation discussion, Aaron, I guess the pace of new clients, it's still positive, but it has slowed in terms of additions. I know the market is massive, but do you think you need to make or are additional people needed to further accelerate client acquisition, or is it just maybe a soft spot in the market as you spoke to earlier with maybe people just not moving around as much? Just kind of curious on the pace of new client additions.

Aaron Graft

Yeah, so I would not read too much into what happened this quarter. I think we have the team, the technology, it continues to get better. The jump in independent owner/operators who come into this industry and then versus going back to working for a fleet, happens very, very quickly. And so, like I said, I think the chart that you see in the slide deck, I mean, it is amazing how quickly this market responds and then it corrects, so what you saw in this quarter is there were, less entrants into the market. Now, there's still a significant amount of new entrants into the market relative to historical levels, but it wasn't like it was in 2018 when people were hearing stories of how much money their friends were making in trucking. In trucking, if you live by the spot market alone, it is a feast-or-famine way to live, and we hope our truckers do some contract hauling, et cetera, but I would not read into the fact that there was just 73 new clients this quarter.

The pipeline is strong. There is no need for us to add a bunch of things other than time. As you all know, you've heard from me in the past, we've added net new clients almost every month going on six or seven straight years, and so it may not happen always as fast as we like, but every month we continue to take ground from the rest of the industry, and I think we'll continue to do so.

Brad Milsaps
Great. And just one follow-up for Bryce on expenses. If I kind of annualize your fourth quarter '18 expenses versus your guide for 2019, it implies about 8½ percent growth. As you get into '20, I mean, is that kind of the rate of investment we'll continue to see, or do you think you can back off of that kind of expense growth rate as you make some of these investments and they start to bear fruit?

Bruce Fowler
Sure, Brad. I think that we really haven't guided out of into 2020, but I think you're thinking correctly there. I would expect with the things we have going here, expense growth next year on a percent basis will be a little lower than that.

Brad Milsaps
All right. Great. Thank you, guys.

Operator
Our next question comes from Jared Shaw with Wells Fargo Securities. Please go ahead.

Jared Shaw
Hi, guys. Good morning.

Aaron Graft
Good morning, Jared.

Jared Shaw
Following up on Brad's margin question, though, if we're seeing overall easing on that incremental dollar of deposit cost and the potential for the average ticket to go higher on the factoring side, we should be generally expecting to see margin moving up from here. Is that probably the best way to look at it, especially as you're looking at focusing more on the higher profitable part of the business?

Aaron Graft

Yeah, things don’t change in a quarter, but, yes, if both of those things are true, then that will remain true. I expect you’re going to see seasonality continue in trucking like as we’ve talked about, we think this past quarter was — or even what happened in the last year was distorted by a few things. So trucking will start to slow again in Q4, but I don't think, Jared, you will see us go out and grow deposits the way we did this quarter at that level, at that high of a cost, any time in the near future, because, as I said, we’re far more interested, given where the market is, where we are in the cycle, and just really just an assessment of what we want to be as a company, we’re far more interested in quality growth than overall growth. And we think we can do a lot of that growth and specifically talking about growing earnings — inside the balance sheet that currently exists.

So I don’t foresee us putting on high-cost incremental CDs approaching 3 percent again any time in the near future. With that being the case, if rates are falling and transportation factoring continues to grow as a percentage of total assets, which it will over time, then, yes, NIM should expand.

Jared Shaw
Okay. So if we’re looking at this - generally a smaller balance sheet focusing on the more profitable side of the business, does that just get us to that 180 ROA goal faster, or does that ultimately cause that 180 goal to be a higher goal?

Aaron Graft
I think that causes —

Jared Shaw
[Inaudible]

Aaron Graft
Sure. I would say we will go beyond that 180 goal eventually, because if you’d look at these business lines, once we achieve maturation or the full absorption of what TriumphPay and Triumph Business Capital are doing, plus they’re generating fee income, yeah, I think the opportunity and expectation would be to eventually go above that. Right now I’m more interested on getting to that number, which just requires solid execution for the next few quarters, and so our long-term plans don’t just stop at 180. That’s just been a signpost for the investment community of where our progress was, but we don’t intend to stop there.

Jaren Shaw
Okay. And then on TriumphPay in the past, you had talked about wanting to work towards bringing on some of those larger carriers. Could you give an update on how that is progressing and some of the pick-ups and new carriers you have this quarter, any at the high end of the business range there?

Aaron Graft
Yeah, there are still the bellwether clients that we’re pursuing. I don't have anything to announce about those specifically. I will say that we believe we will have four of the top 20 within the next few quarters on the system. And as those come on, of course, we’ll be talking about those individually, and at some point, once you’ve added brokers of that size, we expect many more to follow, and the pipeline is very full. At this point, we’ve got integrations going out for the remainder of the year. The team is doing an excellent job, and they’ll be continuing to add. I mean, 20 percent quarter-over-quarter growth and 160 percent year-over-year growth is pretty impressive, and I expect that we’ll continue to grow from here.

Jared Shaw
Okay. Great. Thanks. And then just, finally for me, with the pressure on the spot rate market, are you seeing smaller competitors just sort of folding up and going out of business? Is that where you're getting that market share from, or is it that you're picking up incremental market share and adding as part of that relationship to those new customers?

Aaron Graft
Yeah, we haven't seen any of our transportation factoring competitors fold up, by any means. I think there are always new entrants coming into the transportation market, and we get a significant portion of those due to our market position. And then we're always trying to compete for good clients that our competitors have, and they're trying to compete for our good clients, so it's not been any, that I know of, transportation factoring competitors have left the market. It's just us taking a piece of the market that's there to get.

Jared Shaw
Great. Thanks.

Operator
Again, if you have a question, please press star, then 1. Our next question comes from Gary Tenner with D.A. Davison. Please go ahead.

Gary Tenner
[No response]

Operator
Again, if you have a question, please press star, then 1.

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

CONCLUSION

Aaron Graft
Thank you for joining us today. We hope you have a great rest of your week.

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