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MRLN - Q2 2016 Marlin Business Services Corp Earnings Call

EVENT DATE/TIME: JULY 29, 2016 / 01:00PM GMT

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to Marlin Business Services Corporation's Second Quarter 2016 Earnings Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session with instructions following at that time. (Operator Instructions) As a reminder, this conference is being recorded. And now, I'll turn the conference over to your host, Lasse Glassen. Please begin.

Lasse Glassen - ***Marlin Business Services Corp. - Addo Investor Relations***

Good morning and thank you for joining us today for Marlin Business Services Corp's 2016 Second Quarter Earnings Conference Call. On the call today is Jeff Hilzinger, President and Chief Executive Officer; Ed Siciliano, Executive Vice President and Chief Operating Officer; and Taylor Kamp, Senior Vice President and Chief Financial Officer.

Before beginning today's call, let me remind you that some of the statements made today will be forward-looking and are made under the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those projected or implied due to a variety of factors. We refer you to Marlin's recent filings with the SEC for a more detailed discussions of the risks that could impact the Company's future operating results and financial condition.

With that, it's now my pleasure to turn the call over to Marlin's President and CEO, Jeff Hilzinger. Jeff?

Jeff Hilzinger - ***Marlin Business Services Corp. - President & CEO***

Thank you, Lasse. Good morning and thanks everyone for joining us to discuss our 2016 second quarter results. It is a privilege to speak to you today on my first earnings conference call as President and Chief Executive Officer of Marlin Business Services. At a high level, Marlin is uniquely positioned in a large and highly fragmented market and I look forward to building on the fundamental strengths of our Company to take Marlin to the next level of growth and profitability.

Our management team is energized, excited and working with a sense of urgency to capitalize on the significant opportunities we see as a provider of credit products and services to small and mid-size businesses nationwide. With the recent changes in Marlin's leadership, we're taking a fresh look at how we operate and we're looking to empower our employees to better serve our customers. I believe the actions we are taking today will help significantly expand our market share and drive profitable growth in the quarters and years ahead.

I'll begin my more specific remarks by offering a few comments on the recent leadership transition at Marlin. I'll then provide an overview of our financial results from this past quarter and describe our primary areas of focus as we work to harness Marlin's tremendous potential. Ed Siciliano, our Chief Operating Officer will then provide comments on our second quarter operational performance and Taylor Kamp, our Chief Financial Officer will then discuss additional details about our financial results.

I've been on the job for nearly two months and bring a fresh perspective to Marlin, coupled with many years of relevant experience. I've spent my entire 35-year career in the commercial finance industry, including the last four years as president of EverBank Commercial Finance, a business that my team and I grew to a $4 billion diversified commercial finance platform.

Before that I co-founded US Express Leasing, small ticket vendor finance start-up. It merged with Tygris Commercial Finance Group, and ultimately merged with EverBank to form the basis of what is now EverBank Commercial Finance.

Prior to this, I spent more than 20 years at Heller Financial in a variety of leadership positions. In each of my roles, I developed a deep appreciation for the middle market and the importance that access to credit has on small and mid-size businesses' ability to grow. I look forward to working with the Marlin team as we deepen our commitment to helping small and mid-size businesses grow, while also taking advantage of a dynamic and rapidly changing commercial finance marketplace.

In addition to myself, we recently announced several new additions to the Marlin leadership team and some promotions. Earlier this month, Ed Siciliano was promoted to Chief Operating Officer. As many of you are aware, Ed has been Marlin's Chief Sales Officer since 2007 and served as Interim Chief Executive Officer from October 2015 until June 2016. As evidenced by the second quarter and year-to-date results, Ed did a terrific job during his tenure as interim CEO and on behalf of everyone at Marlin, I want to thank him for his stewardship.

In addition, earlier this month, we announced the hiring of David Herring as the Vice President of Sales for the Transportation and Finance Group. Going forward, this will be a key business channel for Marlin and in his position, Dave is responsible for the development of partnerships with heavy-duty truck dealerships. He is extremely well suited for this role. Prior to joining Marlin, Dave served as a Senior Vice President for GE Capital, Transportation and Finance.

And finally, we continue to work diligently to fill the open position of Chief Credit Officer. Given the importance of this position, we are moving ahead with urgency, but at the same time, mindful, that this is a critical role and we need to make sure we find the right person. We have identified several excellent candidates and hope to have the position filled soon. Suffice it to say, we have a talented world-class team with tremendous industry experience in place now. As we move forward, we plan to leverage new ideas and perspectives while preserving what has helped make Marlin a leading national financing platform for small and mid-size businesses throughout the United States.

With that, I'll now turn to a brief summary of our second quarter financial results that included accelerating origination volume, excellent credit quality and solid net income growth. Total origination volume increased 30% year-over-year to $121 million; and starting with the fourth quarter of 2015, we have now achieved new records for origination volume in each of the last three quarters. We continue to benefit from last year's strategic investments in expanding our sales force, coupled with contributions from Funding Stream, our working capital loan product and the transportation and franchise channel initiatives.

Importantly, we are achieving this growth while maintaining our disciplined underwriting standards and strong overall credit quality, which remains a top priority at Marlin. Second quarter net income of $4.5 million or $0.36 per share, increased 22% compared to the prior quarter, and 8% year-over-year driven by gains in revenue from growth in earning assets, an increasing focus on expense management and excellent credit performance. Without a doubt, these results indicate that Ed, Taylor and the entire team did a terrific job during the quarter and I applaud the entire Marlin team's execution.

Since assuming the CEO title at Marlin, I've spent a lot of time speaking with and learning from a diverse set of Marlin's key constituencies. These have included customers, employees, regulators, industry analysts and current and prospective shareholders. From these conversations, it is clear to me that our business has many strengths that have been the foundation for Marlin's success over the last 20 years. Some of these strengths include a nearly 20-year operating track record including two decades of strong credit performance and credit history with our customers.

From this, we have developed a proprietary underwriting and risk management process that has been tested through multiple credit cycles. Credit underwriting and portfolio servicing are clearly two of Marlin's most significant core competencies. As a bank holding company, Marlin has access to low cost deposits that provides our origination platforms with competitive and stable funding across credit cycles.

Marlin Business Bank is a unique and differentiating strength that would be difficult for any of Marlin's non-depository competitors to replicate. We have unique origination platforms that have proven value propositions and have been successful in effectively penetrating a highly fragmented and highly competitive marketplace. We also have a deep understanding of our small business customers requirements and provide them with products they value and excellent service.

During our history, we've originated approximately $4.5 billion of leases and loans with over 300,000 small and mid-size businesses through over 25,000 equipment manufacturers and dealers. And finally, we have a highly diversified portfolio with borrowers in all 50 states across scores of industry segments and across more than 100 different equipment categories.

Our portfolio, in fact, is large enough and diversified enough to effectively act as an index for the US small business economy. Given our long track record and more importantly our strong performance over the past several quarters, it's clear to me that the fundamental strengths of our business have created a sound business model that is unique and difficult to replicate.

We have done a very good job with respect to credit underwriting and risk management, which have been the cornerstones of our success and will continue to be key pillars of our operating philosophy going forward. Having said that, I do believe that Marlin has just scratched the surface of a tremendous opportunity to drive significant gains in market share and achieve sustainable profitable growth.

To address this opportunity, our leadership team is currently focused on three key areas of immediate emphasis. First, a strategic revisioning of the Company; second, better leveraging the Company's capital base and fixed costs through origination and portfolio growth; and third, improved operating efficiencies through scale and operational improvements. Let me take a moment to discuss each of these in more detail.

First, with respect to the Company's strategic repositioning, Marlin has historically operated primarily as a micro-ticket equipment lessor. I believe that this narrow approach under leverages the Marlin platform and does not take full advantage of the Company's strengths. While this mindset may be slowly changing, particularly with the early traction we're seeing with our Funding Stream working capital loan product. I believe that the continued expansion of Marlin into a broader provider of credit products and services to small and mid-size businesses will be an important and central component of this new vision; a process that we're referring to as the transformation from Marlin 1.0 to Marlin 2.0.

I think the opportunities for Marlin are particularly attractive today given the shifting commercial finance landscape with two of the most significant trends being the increasing regulatory pressure on big banks with the distraction from their customers that it is causing and the emerging disruptive force from Fintechs. I believe that both of these trends are significant and enduring, and that Marlin is uniquely positioned to benefit from both of them.

Given all of this, Marlin's senior leadership team is highly focused on this revisioning initiative because it's only from a firm strategic foundation that the other two major initiatives can be successful. Second, with respect to better leveraging the Company's capital and fixed costs, Marlin is currently too small for both its capital base and its infrastructure. Marlin's subscale state relative to its structural cost is a significant contributor to its high operating efficiency ratio. Given this, it's very important that the Company continue to accelerate its growth in order to better leverage both its infrastructure and its capital base across a larger portfolio. This is the primary driver behind the investments that have been made in building the funding stream, transportation and franchise origination platforms. As a result of the investments Marlin made in these platforms last year, the Company was able to experience record origination volumes during the second quarter. We are also in the process of evaluating our capital plan to make sure that we are optimizing the use of our capital as we grow.

And finally, Marlin's historical leasing business has been operating for close to 20 years with an evolving set of operating processes that would benefit from being evaluated and renewed. This process renewal initiative will substantially improve Marlin's productivity with a corresponding improvement in the Company's operating efficiency and its return on equity. Given that the value proposition for any small-ticket business is speed, consistency and convenience, improving the speed and consistency of Marlin's operating system will reduce Marlin's unit processing costs and allow us to better meet its customer's requirements.

This is a unique dynamic in small-ticket businesses where reducing processing costs will actually enhance the value proposition. This virtuous self-reinforcing cycle can have a powerful impact on both the financial performance and competitiveness of a high volume processing business like Marlin's; that is why we place such a high priority on this initiative.

In summary, Marlin is a great Company and I'm excited to be leading the team and the organization into the next phase of growth. I'm confident that based on the team we have in place and the initiatives and efforts underway, we will emerge a stronger more vibrant growth Company. I look forward to executing on our strategy, enhancing our financial and operational performance and driving superior value for all of our stakeholders in the quarters and years ahead.

Now, I'd like to turn the call over to Ed Siciliano, our COO to discuss our second quarter operational performance in more detail. Ed?

Ed Siciliano - ***Marlin Business Services Corp. - EVP & COO***

Thank you, Jeff and good morning everyone. My comments today will focus on our second quarter origination activities and overall credit quality. I am very pleased to report total origination volume in the second quarter was $121.5 million, breaking the previous record established last quarter by more than 12% and up 30% compared to the second quarter last year. Our standalone equipment finance originations independent of Funding Stream also reached a historic high of $113.6 million about 8% higher than the previous record.

With a record production in the quarter, Marlin achieved a noteworthy historical milestone. During the quarter, all time cumulative origination volume exceeded $4.5 billion. In addition our net investment in leases and loans grew to $731 million, up 4.1% from the prior quarter and up 14% from the second quarter last year. The origination volume growth on both the year-over-year and sequential quarter basis was driven by a number of factors including higher application levels, increased dealer contribution and growing momentum in our franchise and transportation business.

Importantly, our origination momentum was not the result of any changes to our underwriting standards. Excluding transportation and franchise, which are still establishing themselves in their markets, our credit approval rate of 65% in the quarter was on par with 62% in the prior quarter, and 64% in the second quarter last year. Overall Marlin's disciplined underwriting continues to manifest itself in excellent credit quality and portfolio performance. For the quarter, 30 plus and 60 plus day delinquencies were 71 basis points and 43 basis points, down slightly from the prior quarter and essentially flat to the same period last year.

Net charge-offs during the quarter were $2.4 million as compared to $2.3 million in the prior quarter and $2.9 million in the second quarter last year. We are also beginning to see early benefits from our working capital loan product Funding Stream, which we launched about a year ago. I am pleased to report that momentum for Funding Stream continued to build in the second quarter; total Funding Stream origination volume increased to $7.9 million, up 25% from the prior quarter and nearly 15 times higher than the second quarter last year when the product was first launched.

While still in its early days, Funding Stream continues to gain traction. Loans through this product represented 6.5% of total originations in the second quarter, up from 5.8% of total originations in the first quarter and up from less than 1% of total originations in the second quarter last year. With Funding Stream, we continue to see strong application levels and better than expected credit results further demonstrating the value of cross-selling to our existing customer base and the efficiency and scale of a well-designed web-based technology platform.

Importantly, yields on this product are nearly three times higher than our average yields on equipment finance transactions. So growth in Funding Stream has helped to offset reduced equipment finance yield due to a run-off of older, higher yielding equipment leases and a slight mix shift to larger leases with higher credit quality. In fact, overall net interest and fee margin of 11.5% was down just 8 basis points from the prior quarter. During the quarter, we completed a sale of equipment leases previously held on balance sheet totaling $2.3 million.

This was our initial foray into secondary capital markets transactions and we are continuing to refine our go-forward strategy in this arena. This transaction generated a modest immediate gain on sale of $72,000 that was recorded in the second quarter; however, we retain servicing rights on these leases that were sold and we'll recognize servicing fees over the life of leases. Completing the sale of these assets enables us to test the mechanics of a small portfolio sale and overall we are quite pleased with the outcome.

Looking ahead, asset sales will be centered around assets that Marlin originates, that may reside more efficiently on other investors' balance sheets or that Marlin elects to sell because of other economic or risk factors. In closing, we at Marlin, are looking forward to achieving many new milestones in the quarters and years ahead. I am very excited to help execute and manage the growth strategy Jeff outlined in his remarks, while maintaining Marlin's commitment to excellent customer service, sensible credit underwriting practices and prudent expense management. We look forward to presenting future results and demonstrate the unique potential of Marlin's small business lending platform.

With that, I'll turn the call over to our CFO, Taylor Kamp for a more detailed discussion of our second quarter financial results. Taylor?

Taylor Kamp *- Marlin Business Services Corp. - SVP & CFO*

Thank you, Ed and Jeff and good morning. Marlin had another exceptionally strong quarter as we continue to build momentum in our business. In the second quarter, we generated net income of $4.5 million, an EPS of $0.36 per diluted share. As previously noted, total origination volume was $121.5 million, up 12% from the prior quarter and 30% from a year ago.

This was the third consecutive quarter of record originations. Our net investment in leases and loans grew approximately 4.1% from last quarter and 14% year-over-year to $730.8 million. Return on equity for the quarter increased significantly to 11.66%, up 192 basis points from the prior quarter and up 219 basis points from a year ago.

We expect ROE to continue to increase as the business grows and we better leverage fixed costs through increasing scale even before the positive impact of revisioning and process improvement activities take hold. For the quarter, net interest margin or NIM was 11.50%, 8 basis points lower than the prior quarter. We expect to see NIM levels in the equipment finance business continue to move slightly down as older higher rate business rolls off and the origination mix shifts slightly to flows with larger average transaction sizes with higher credit quality.

However, it is important to point out that with the increasing contribution of our Funding Stream loan product, we continue to see improvement in average total new business yield and some offsets to the decline in NIM. In fact, the yield on new originations for equipment finance and Funding Stream increased to 11.8% in the second quarter, up 9 basis points from the prior quarter and up 66 basis points from a year ago. Please note, we have introduced some enhancements to our supplemental financial reporting to better align it with our strategic objectives and better represent key origination channels.

To that end, we have reclassified certain historical financial information previously reported in our loan category to equipment finance and isolated our Funding Stream loan product. This reclassification will impact a historical and future reporting for volume, new business yields, delinquency, net investment, charge-offs and loss allowance.

You should also expect to see additional enhancements in future periods. Cost of funds increased from last quarter 5 basis points to 1.05%. Fee income decreased 1 basis point from last quarter, but it was down 13 basis points from a year ago. This decrease from last year was due mostly to lower late charges resulting from lower portfolio delinquency. As that emphasized, the portfolio continued to perform well in the second quarter.

Total charge-offs increased slightly to 1.38% of average finance receivables, as compared to 1.35% last quarter, but were down significantly from 1.84% last year. For the quarter, the loss allowance for credit loss reserves was 1.30% of total finance receivables and 265.8% coverage of 60-day delinquencies. While we are only one month into the third quarter, we are seeing a continuation of the strong credit performance. Additional information on static pool losses and delinquencies is available on our Investor Relations website.

Second quarter 2016 operating expense was $12.5 million as compared to $11.6 million a year ago. The increase in expense from last year was primarily due to an increase in average headcount of about 14 employees and the ramp up of our new product channels. Variable expense was also up from last year due to higher application levels and higher loan and lease originations. Despite marginally higher expenses, increased levels of earning assets from the growth in our equipment finance and Funding Stream portfolios more than offset higher year-over-year expenses. As a result, our efficiency ratio improved to 55.6% in the second quarter from 58.2% and 56.2% last quarter and a year-ago respectively.

Our capital position remains strong with an equity to assets ratio of 18.49%, 54 basis points below last quarter and 458 basis points below last year. The large decrease from a year ago, reflects the impact of our $2 per share special dividend declared in September of 2015. I am pleased to report that our Board of Directors declared a regular quarterly dividend of $0.14 per share payable on August 18, 2016, to shareholders of record as of August 8, 2016.

We continue to be committed to prudently balancing our growth strategy while still providing value to shareholders. We will weigh capital investment alternatives and adjust our capital trajectory as needed with the best interests of our shareholders in mind.

Now, turning to our business outlook for the full year ending December 31, 2016, full year origination volume including both equipment finance and Funding Stream is expected to finish in the range of $460 million to $480 million. At the low end of the range, this would represent an almost 21% increase over 2015, and an almost 20% increase over 2006, which was our next best year of volume.

Credit quality is expected to remain strong with the continuation of recent positive trends. Net interest margin is expected to move slightly lower and sideways for the remainder of 2016 with the continued roll off of higher yielding legacy equipment finance assets and a slight shift in equipment finance originations to flows with larger average transaction sizes and higher credit quality. This will be partially offset by well-managed growth in the higher yielding funding stream product.

And lastly, full year ROE is expected to continue to increase as the business grows and better leverages its fixed costs through increasing scale. In closing, Marlin's second quarter performance especially in the areas of volume production and credit quality, serves as strong evidence that Marlin remains on very sound financial footing. After a great start in 2016, we carry significant momentum into the second half of the year.

And with that, I will turn the call over to the operator for Q&A.

QUESTION AND ANSWER

Operator

(Operator Instructions). Chris York, JMP Securities.

Chris York - ***JMP Securities - Analyst***

So, first, I wanted to lead by extending my congratulations to Jeff on your appointment as CEO and then Ed on his promotion to COO. And then, secondly, I wanted to begin with talking little bit about lease and loan guidance, could you elaborate a little bit more on the implied second half 2016 production guidance, because on first look for me it seems a little conservative on a couple levels.

Ed Siciliano - ***Marlin Business Services Corp. - EVP & COO***

Yes, I'll start Chris. This is Ed. Yes, as you know, that was our first origination guidance in ever I think, maybe 18, 19 years, so we wanted it to be feasible. If we execute on our plan, we will be at the higher range of that guidance. And as it relates to loan, I think we'll be in the range of $35 million to $ 40 million.

We are seeing a little bit of a rational behavior in the alternative lending space, which we're just not going to participate in, and by that I mean, we're seeing some of our competitors buying a little deeper, mispricing loans and maybe lending a little more than the customer's cash flow would support. So, loan might be a little bit lower, but overall, we're optimistic and if we execute, we will be at the higher end of that range.

Jeff Hilzinger - Marlin Business Services Corp. - President & CEO

Yes. I think there is -- Chris, I think there is -- you've to look at the two business segments separately; Funding Stream and equipment finance. So, I think in equipment finance case, there's a lot of momentum there really being driven primarily by transportation and franchise, although the legacy channels are also performing well. And then with respect to Funding Stream, I think that there is a very good spot for Funding Stream in Marlin -- the product that clearly is in demand by small businesses.

I think Marlin is in a really unique position to be able to take advantage of it because of its credit history and its credit data, its experience underwriting small businesses and the fact that we're originating primarily on our installed customer base.

Having said that, it's still an unproven asset class in terms of its performance over a cycle. So, we want to be cautious and I think we view the growth in that product as being one that needs to be steady over time.

Chris York - ***JMP Securities - Analyst***

That seems prudent and makes sense to me. Switching gears or elaborating a little bit on the competitive environment, specifically what are you seeing from captives, from banks in terms of their approach to the market and supply, and then maybe alternatively, the demand for capital equipment and the legacy Marlin product and then maybe some of the new channels that you just spoke about with franchise and transportation?

Jeff Hilzinger - ***Marlin Business Services Corp. - President & CEO***

Yes. This is Jeff, Chris. I would say, some people have described the current state of the commercial finance market as being in turmoil and certainly I think if you look at the impact of GE's decision to divest itself of capital, a lot of people would agree with that. I think from our perspective from Marlin's purge, I would say that it's more about competitors especially banks being distracted.

The big banks in particular are, you know, they've been forced to become increasingly inwardly focused as they deal with this increasing regulatory burden and I still think there's a long way to go on that. And so, ultimately there, you got to believe that those institutions are going to figure it out and they'll ultimately come back and improve their focus on their customers, but I think there is going to be a period of time here where I think Marlin has got an opportunity to really take advantage of its ability to be really centrally focused on its customers now.

Ed Siciliano - ***Marlin Business Services Corp. - EVP & COO***

I would add, as banks are pulling back, we're moving slightly up ticket, so the timing is very, very good. Our average ticket booked Chris in the second quarter was $18,000, I think that's a high watermark for us as well. And then as it relates to franchise and transportation, very, very pleased we got into those channels both performing as expected. I would share with you that in the second quarter, if you combine those two channels, they contributed 12% of overall applications in the quarter, which was about $37 million, so they're starting to become material to our business.

We had a large win in the transportation space which we put out in the press release that was Rush Enterprises, which is the largest transportation dealer -- commercial transportation dealer in the United States, so we're hoping for good things, a new relationship. So, very much on track, and then finally, Jeff talked about the banks, on the independent side, there seems to be less independent competitors. They have been bought up or merged, so the timing of investing in the business last year is really paying off because the market opportunity is greater this year and it's evidenced by the results.

Jeff Hilzinger - ***Marlin Business Services Corp. - President & CEO***

I just want to make one last comment Chris on your point about captives. So, I think regardless of the market environment you're in, it's never good for independent platform like Marlin to compete against the captives. They're advantaged by definition and so the worse deal that we can look at is one that's been turned down by a captive, because if anybody is going to do, it's going to be the captive. So, I think the better approach with captives is to cooperate with them and to partner with them, and I think Marlin can do that because most captives don't have a very good small ticket processing capability and they are typically looking for partners to help them do that. And I think working in a cooperative way with captives is a lot safer and I think it allows Marlin to exploit its core competencies better than trying to compete head-to-head with captives.

Chris York - ***JMP Securities - Analyst***

Got it. That makes a lot of sense. And then just kind of going down my list here, a couple more and then I'll hop into queue, how should we think about capital and tying that in with your desire for growth, considering as context the Company has historically repurchased stock and then occasionally paid out excess capital in one-time dividend and then you guys have the recurring dividend?

Jeff Hilzinger - ***Marlin Business Services Corp. - President & CEO***

Yes. So, it's still obviously very early days, Chris. I've been here for about eight weeks now and we've done enough work to know that the business -- know that the business is growing, the management team has got a growth mandate on the Board, the revisioning process is going to help us identify exactly what form that is going to take, and so I think we have a runway to leverage the excess capital that's in the business today with it being exclusively funded by the bank, but I'm not sure it being exclusively funded by the bank is the most efficient ultimate way that we want to fund Marlin.

So, I think as part of the capital plan, you're going to see us working on wholesale funding option. As a holding company, we're going to be building out a sell side capital markets capability, which Ed talked a little bit about sort of the first transaction that we kind of tried in the second quarter. I think that gives us a blend of options of diversity of funding sources. I think the bank will always be central and critical to Marlin for reasons that are pretty obvious.

Having said that, I think that the portfolio performance justifies an effective advance rate in the bank that's greater than 85% and we're going to work down that path, but we don't have control over that. So, we're going to simultaneously work on some mechanisms that allow us to get the overall net leverage on the enterprise up. And so, I think as we go through the revisioning and [understand] the capital plan, obviously dividend policy and share buybacks and all that sort of stuff is going to be part of that. So, I really -- I think it's premature at this point for us to talk specifically about what that might look like, but know that it's a central part of the things that we are working on today.

Chris York - ***JMP Securities - Analyst***

Got it. And then maybe kind of as a follow-up. So, how does your view for growth tying in with capital here affect your views for your long-term ROEs? I think historically Marlin has said that the long-term goal is 13% to 15%. Now, if you obtain more balance sheet leverage, can we go above that?

Jeff Hilzinger - ***Marlin Business Services Corp. - President & CEO***

Yes. So, I think, by definition, Marlin 2.0 will have a higher ROE than Marlin 1.0 is, though with the guidance that the management is given in Marlin 1.0. How much more and what the timing is to sort of have that flow through the financials, I'm not really in a position to say at this point. But with what I've experienced so far here and with the conversations that we've had about what Marlin 2.0 could be and I think what -- even within that, what the equipment finance business can be in the near term, I think we're all pretty confident that we're going to be able to create improving operating efficiency and improving ROEs in the near future.

Chris York - ***JMP Securities - Analyst***

Understood. One last one and then I'll hop back in the queue. So, as you look at the maturity of your lease book and then the yields of those leases, could you provide us with a rough maybe approximation with when you think that the margin would trough?

Taylor Kamp - ***Marlin Business Services Corp. - SVP & CFO***

Yes. I think -- this is Taylor, hi. We would expect the margin to trough toward the end of this year. In general, that includes the Funding Stream product. And start to increase that sans any government interest rate increase, but we would expect that to increase as Funding Stream becomes a bigger part of the mix. I would expect -- if you separate the two, I would expect the NIM on the equipment finance segment of the business to continue down for a little longer.

Jeff Hilzinger - ***Marlin Business Services Corp. - President & CEO***

I think -- this is Jeff again, Chris, I think there is an important concept I think implicit in your question which is, I think historically at Marlin, NIM has been viewed as a proxy for ROE, and I don't agree with that. NIM is certainly a very important component of ROE, but other things like the IRR that's in the lease, if it has residuals, the tenure of the lease, transaction size, credit profile, processing intensity and then the leverage that is sort of justified depending on the credit profile and the lease, all are -- it can have a big impact on ROE. So, NIM is important, but NIM is not our primary focus. Our primary focus is ROE.

So, I think I've seen flows in the past that have lower NIM than what Marlin has, but because they're homogeneous and their large transaction size with good credit profile, the ROE actually is higher than what the -- than the ROE that Marlin is generating today. So, anyway -- so, we're, obviously NIM is always very important and is a very big driver, but it's not a proxy for ROE in my view and that ROE is really what we're going to be focused like a laser beam on here.

Operator

Brian Hogan, William Blair.

Brian Hogan - ***William Blair - Analyst***

Question on the efficiency ratio. Do you have a longer term target in mind as you obviously scale up and work through your productivity enhancements and do you have a peer comparison, (inaudible) so what's your goals there? And then along with that, are you still doing, I assume that's still in there, but it's still kind of [hiding], but the investment spend, I guess if you would just separate the investment spend versus the ongoing operating spend, what would the efficiency ratio be today?

Jeff Hilzinger - ***Marlin Business Services Corp. - President & CEO***

I can take the first question and then maybe Taylor can take a stab at the second one. I have a target operating efficiency ratio in mind, I'm just not prepared to share it at this point. So, it's going to be better -- substantially better I think than what it is today, and I think it's a combination of scale, leveraging, fixed cost and then making the variable cost lower through process renewal.

And that, that's going to happen over a couple of year period, as we grow and as process renewal, the benefits from process renewal begin to roll through the financials. You will see that basically by the platform being able to process a lot more unit volume with the same headcount or the same cost that it has today. So, our hope is that, as processing efficiency is released from process renewal that growth will absorb the release capacity and that that will result in lower unit processing costs over time, and that will drive improved operating efficiency which is a very big driver of return on equity in a business like this.

Taylor Kamp - ***Marlin Business Services Corp. - SVP & CFO***

Yes, and I would add on investment spend, we have been pretty consistent in the message there recently that the investment in our new initiatives around Funding Stream, transportation finance and franchise would -- we would continue to invest through the first half of this year and then, really that winds down and comes to a halt. And so, we're really pretty much done with that legacy investment spend. As far as going forward, I think Jeff touched on it, is that we expect to, as we go from Marlin 1.0 to [1.2], that the improvement in productivity will offset any incremental spend and so we wouldn't expect sort of the same concept of investment spend dragging down the efficiency ratio.

Jeff Hilzinger - ***Marlin Business Services Corp. - President & CEO***

I think that we need to be careful here that investment spending is not a project. For a business like this to grow, it needs to constantly be investing back in the business in terms of automation, in terms of new platforms, in terms of expanding existing platforms. So, that's going to -- that has to continue. I think the question is, how do we pay for it, so that when you net it all together, we have improving operating efficiency and improving ROE, while all that activity is going on, and that's going to absolutely happen. We're just in the process of working through exactly how that's going to look through this revisioning process.

Brian Hogan - ***William Blair - Analyst***

And then moving onto your asset sales as an indication, [2.7%] in the quarter and Ed, you mentioned $72,000 gain on sale, where does that show up is one question. But then two, you said, you mentioned (inaudible) going forward, roughly, how much is that and where is that going to show up? And then along with it, the level of asset sales going forward, is it going to be incredibly lumpy or is it -- do you have a plan on roughly so much per quarter, comments on that, please?

Jeff Hilzinger *- Marlin Business Services Corp. - President & CEO*

Yes. So, let me start with the second question first, Brian, and then we can talk about the accounting vocation and stuff, where Taylor can in just a minute. So, I think that sell side capital markets is an important capability for any kind of commercial finance platform, because I think the biggest strategic benefit is, is that ultimately, it allows you to separate the development of your origination franchise from your franchise funding capacity. So, I think, Marlin is an origination engine and it can originate more than what logically should reside on its balance sheet for the life of the financial instrument. So, I think that's a liberating idea for a platform like this, because it means that you can originate things that you have limited your funding capacity or sort of what your own economics limit you to.

I think the other thing that it does is, it validates the liquidity of the portfolio, it validates the economic profile in that liquidity, validates your docs, validates your credit, it validates your pricing, and so to answer your question specifically, I think you are going to see that this is going to be a quarterly rhythm, and it's going to become a normal part of what Marlin does for the reasons that I just described.

Having said that, we don't want to create a gain on sale business model here; we want to be a balance sheet lender and we want to use the bag that we've got -- we ultimately will have this diversified set of, I think pretty efficient funding sources to be able to grow the portfolio and to be a portfolio lender. So, typically most equipment finance platforms are syndicating on a regular basis and the goal typically is somewhere between 10% and 20% -- no more than 10% or 20% of net income is coming from gain on sale activities.

And I think we'll probably be at the lower end of that at least initially, as we continue to sort of -- the process last quarter was sort of clunky, which is what you would expect when you've never done it before. So, we've got -- we're learning, the business is learning as we go through that process and ultimately, I think it will become pretty efficient in a way it executes and it will become pretty clear in our selection criteria about what it is we're syndicating and why we're syndicating it.

Ed Siciliano *- Marlin Business Services Corp. - EVP & COO*

And Brian, this is Ed. The only thing I would add is that from a customer perspective, our applications were up 31%. We're accepting larger tickets and some other credits, different types of credits. In essence, we've expanded the value prop to our customers, which is being received really well. So, as long as we can seamlessly place those transactions that we would have otherwise rejected or not put on balance sheet, it's really enhancing the customer experience and if we can get some fee income by doing that, it's a win-win-win.

Jeff Hilzinger *- Marlin Business Services Corp. - President & CEO*

And I would say, I forgot to say that before, but we retained servicing, Brian, on the last sale and I think we would retain servicing on everything that we would do going forward because one of the reasons that Marlin's customers do business with Marlin is because they expect Marlin to service the assets. So, I think that all -- everything will be sold -- what we sell, will be sold on a servicing retained basis, which is kind of a good lead into maybe the accounting between the servicing asset and the gain on sale.

Taylor Kamp - ***Marlin Business Services Corp. - SVP & CFO***

So, on the sale, the servicing cost was baked into the price that we received from the buyer and so the excess cash premium, if you will, is broken into a couple of pieces. So, the piece that Ed referenced of $72,000 that shows up in other income, so other other income. There is a piece that's been allocated to the servicing asset which will be accreted into income over time, it will be accreted into income over the same -- in the same line. And so, to give you a flavor of what the total cash premium was, let's say it was about 4.5% of the amount sold. That makes sense?

Brian Hogan - ***William Blair - Analyst***

Yes, thank you. And then, I guess reps and warranties on those stuff that you syndicate, I mean what are you on the [look] forward or coming back, can you explain that?

Taylor Kamp - Marlin Business Services Corp. - SVP & CFO

So, the reps and warranties on that are pretty standard. We aren't giving any credit -- there is no credit enhancement or credit backstopping on that. It's really for sort of embedded fraud and misrepresentation and things like that. So, it's pretty standard stuff, document enforceability, so it's -- certainly we transfer the risk of the account to the buyer.

Brian Hogan - ***William Blair - Analyst***

And what are your thoughts on the economy overall? I mean, in your prepared remarks, you mentioned, you had an indication that the overall small business economy and then to go along with that, what is the quality of your application [grow], I mean you can get a lot of applications [to see] a lot of bad (inaudible).

Jeff Hilzinger - ***Marlin Business Services Corp. - President & CEO***

So, I think, our sense of at least to small business economy is that the environment is benign. It's been benign for a while and we are not seeing -- we are not seeing any early warning signs. I mean, within a micro-ticket or small ticket portfolio, retail is sort of the first thing that you see are distressed and within retail restaurants are probably, they're probably the canary in the coal mine and when you look at the performance here, when we see retail or restaurant transactions that are having problems, they seem to be specific to that business.

They don't seem to be being caused as a result of macro forces that are at play on the portfolio. So, that's the reason that we're giving the guidance that we expect the portfolio to continue to perform in the second half as it has in the first-half. I think I will let Ed speak a little bit about the second question, but I would just say, if you take out transportation and franchise, which have low approval rates today because they're new in their markets and they're being tested by market in terms of what Marlin's credit box is and Marlin is trying to figure out exactly what its credit box needs to be in those two segments as well. So, there is a lot of learning going on there.

We had a 65% approval rate in the second quarter which is, that's pretty good. I mean it's good for Marlin relative to its historical approval rates and that's a good approval rate for really any kind of micro-ticket or small ticket. I mean, outstanding approval rates which mean, you've optimized all your flows and your sort of the number one referral source would be in the low 70s. So, we are at the mid-60s is, I think, to me that we're positioned well within our referral sources. We are getting good looks and that we are not seeing any deterioration in the sort of the credit quality that is coming through the door at this point.

Ed Siciliano - ***Marlin Business Services Corp. - EVP & COO***

The only thing I can add is, I think we are in that period of kind of slack tied with small businesses. We don't have a headwind, we don't have a tailwind, but we are still gaining and that's because we are taking market share. We've expanded our box, we've expanded our platform, our channels, so we're growing that way. Potentially, once we get past this crazy election cycle, we'll get bit of a tailwind, but right now, it's kind of neutral.

Jeff Hilzinger - Marlin Business Services Corp. - President & CEO

We just have to see what happens with interest rates. So, we're -- if they're going to rise at some point, I don't know whether it will even fall or it will be sometime after that, but we're preparing ourselves for that eventuality as well, and then the only other thing I would say in certain segments, you are going to see this as the segments expand and something like transportation, I mean a good approval rate in it for a transportation flow is (inaudible). So, I think we need to be careful that we don't apply 65% or 70% as the standard to all flows in small micro-ticket, because it's not true.

There are certain -- franchise should be up in the 60% to 70% range. It's more like the core business at Marlin, but transportation and there are other segments where the size of the potential flows is so great that as much as you tell people, I don't want to do that kind of business, they show to you anyway. So, you end up having approval rates that are in the -- I think in transportation, if we [recorded] 50% or 55%, we would be highly happy with that.

Brian Hogan - ***William Blair - Analyst***

And then one last one. In your prepared remarks, you mentioned that if you execute you'd be towards the top end of your origination targets. What are the risks for your origination targets? I mean you've -- I mean, $460 million to $480 million is kind of, what has to happen to get to -- at the bottom end of the range?

Ed Siciliano - ***Marlin Business Services Corp. - EVP & COO***

The only risk that I see Brian, is that, we just had a conversation about credit quality through the door, if that were to diminish, we would trust our credit models and we simply wouldn't put that business on the books. If the economy changes in any fashion, as we go into the November election cycle, that could have an impact, but otherwise I will tell you, even in through July here, we're running at applications through the door at a level that would support the high end of that range.

Operator

Chris York, JMP Securities.

Chris York - ***JMP Securities - Analyst***

Yes. Just a couple more from me. Thanks guys. Jeff, you talked about how you're taking a fresh look at how you empower employees. Could you elaborate on that comment and has or will the compensation model change for your sales force?

Jeff Hilzinger - ***Marlin Business Services Corp. - President & CEO***

Yes. I mean, I think part of the process renewal initiative, Chris, is that it's generally pushing down authorities into the business. You do it in a very measured way, you do it in a framework so that it's well controlled, but one of the things that really slows a process like that a company like Marlin uses is, is when things need to get escalated all the time.

So, I think as part of that, I think the empowerment comment really was from an expectation that there will be a continuation of moving authorities down into the business and using automation and frameworks as a way to create a well-controlled process, but one that's occurring within the business. And I can't remember what's your -- what was your second question?

Chris York - ***JMP Securities - Analyst***

Compensation model.

Jeff Hilzinger - ***Marlin Business Services Corp. - President & CEO***

Yes. I mean, we're always evaluating the compensation models across the entire business. I think from a sales force standpoint, I'm a believer in aligning sales force comp with company profitability, not just volume and not just -- we make money -- as we said, there are ROEs inherent in different kinds of flows, and those ROEs are contingent upon the flows, looking in a certain way and being processed in a certain way, and so I think having the sales force be compensated in a way that incents them to create or originate flows that are the Marlin's best advantaged to process is a good thing.

And so, having said that I think the Marlin sales force is doing a great job right now, and so that's on -- that's in my list to reevaluate and it will probably happen as part of the business planning process that we'll begin probably sometime in September or early October.

Chris York *- JMP Securities - Analyst*

Thanks for the additional color. Last one from me, maybe taking a step back and thinking big picture. We're talking about the opportunity from banks, which has been here for quite some time, but Jeff, given your previous seat at a bank, I think investors may value hearing about your primary experience as to the regulations that are affecting banks, and maybe the extension of equipment finance, and therefore the opportunity at Marlin. So, maybe could you talk a little bit or highlight an example of what you experienced, what attracted you to Marlin and then the opportunity to take share from banks?

Jeff Hilzinger *- Marlin Business Services Corp. - President & CEO*

Yes. So, the bulk of my career was not regulated at all, because I worked for commercial finance companies or start-ups that were -- none of them were funded -- were part of banks or funded by banks. So, my first experience in a regulatory environment was at EverBank. And my experience there was when EverBank went from being regulated by the OTS to being regulated by the OCC.

My experience there was that it had a pretty significant impact on the way that I spend my time and the way my team spend their time, and there was a palpable influence or effect on the way that we spent our time and the priorities that we had in running the business. And whether those priorities are better or worse, I don't know. I guess time will tell, but they definitely take us away from -- it took us away from a customer focus or at least a customer focus we had before.

So, I think Marlin is different, Marlin is a lot smaller. It's in a completely different regulatory framework. I think it has its own risk with respect to sort of creeping consumer regulation into small business lending and we're watching that carefully. But Marlin has a -- I met with some of our regulators. It has a very good reputation with the regulators. I think the regulators have confidence that the bank is being operated in a safe and sound manner or at least that's what they told me, and when you look the results of the audits and you look at the way that they interact with us, it's a very positive thing.

So, obviously, I think if you're bank funded, it comes with a lot of really great positives, but it can come with a lot of hidden costs and my experience so far has been that the costs at Marlin to be bank funded are a lot less than what the costs are, and I'm defining costs broadly here, are lot less than the costs that certainly big banks are feeling today. And somebody told me a couple of months ago that they thought that only half of Dodd-Frank had been implemented, so that was a pretty scary thought for me as well. So, that's kind of -- at least 60 days in, Chris that's kind of where my head is at.

Operator

Thank you. This ends the Q&A portion of today's conference. I would like to turn the call over to management for any closing remarks.

Jeff Hilzinger *- Marlin Business Services Corp. - President & CEO*

Thank you everybody for your support and for joining us on today's call. We look forward to speaking with you again when we report our 2016 third quarter results in the fall. Have a good quarter. Thanks.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may now disconnect. Have a wonderful day.