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PRESENTATION

Operator

Greetings and welcome to the Marlin Business Services Corporation Third Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Lasse Glassen, with ADDO Investor Relation. Thank you. You may begin.

Lasse Glassen - *ADDO Investor Relations - MD*

Good morning and thank you for joining us today for Marlin Business Services Corp.'s 2018 Third Quarter Results Conference Call. On the call today is Jeff Hilzinger, President and Chief Executive Officer, along with Lou Maslowe, Senior Vice President and Chief Risk 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 discussion of the risks that could impact the company's future operating results and financial conditions.

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

Jeffrey A. Hilzinger - *Marlin Business Services Corp. - President & CEO*

Thank you, Lasse. Good morning, and thank you, everyone, for joining us to discuss our 2018 third quarter results. I will begin with an overview of our third quarter highlights as well as the progress update on our Marlin 2.0 strategy to successfully transform our company from a micro-ticket equipment lessor into a broader provider of credit products and services to small businesses. Lou Maslowe, our Chief Risk Officer, will comment on credit quality. After Lou's remarks, I will provide additional detail on our third quarter financial results along with our business outlook.

The third quarter was another productive period for Marlin highlighted by solid growth in origination volume, continued stable credit quality, strong earnings performance, the successful completion of an asset-backed securitization transaction, and an important strategic acquisition to augment our organic growth initiatives. Excluding referral volume, total origination volume was $173.1 million for the quarter compared with a $147.4 million last year, resulting in a year-over-year increase of 17.4%.

As I'll speak to in a few moments, this increase included strong growth from both our Equipment Finance and working capital loan products, and from our direct origination channel. In addition, as part of Marlin's capital markets activities, we referred or sold $43.5 million of leases and loans that were better suited for our capital markets partners balance sheets. Due to these origination in capital markets activities, our net investment in leases and loans expanded to $970.4 million, up 9% from a year ago, and our total managed assets grew to approximately $1.1 billion, an increase of 18% from last year.

Our ability to achieve this robust growth while maintaining our disciplined underwriting standards and stable portfolio performance is evidence of how core risk management is to Marlin's culture. Looking at our third quarter profitability, we reported GAAP earnings of $0.47 per diluted share compared with $0.26 per diluted share for the third quarter last year. On a non-GAAP basis, we reported earnings of $6.4 million or $0.51 per diluted share compared with non-GAAP earnings of $3.9 million or $0.31 per diluted share a year ago. A reconciliation of non-GAAP to GAAP net income is available in the press release we published yesterday afternoon.

During the quarter, we also announced the change to Marlin's senior leadership team with the departure of Taylor Kamp as Chief Financial Officer. During his 3-year tenure with the company, Taylor made solid contributions and we wish him all the best in his future endeavors. As Marlin moves forward, we have engaged executive search from Korn Ferry in a nationwide search for Taylor's successor. We believe that Marlin's CFO position is a highly desirable opportunity as evidenced by the very strong slate of candidates we are seeing. While we are certainly working with a sense of urgency to fill the position, we are committed to finding the most qualified and experienced person for this very important role at Marlin. At this point, we expect the new CFO to be announced and hopefully in place before year-end.

I'd now like to switch gears and provide an update on our business transformation initiative that we refer to as Marlin 2.0. Through Marlin 2.0, we expect to drive growth and improved returns on equity by; first, strategically expanding our target market; second, better leveraging the company's capital base and fixed cost through origination and portfolio growth; third, improving our operating efficiency by better leveraging fixed cost through scale and through operational improvements to reduce unit processing costs; and fourth, proactively managing the company's risk profile to be consistent with our risk appetite.

I'd like to share with you the progress we've made on each of these areas since our last call. First, regarding our strategic market expansion activities under the 2.0 strategy, rather than positioning the company as solely an equipment lessor, we are focused on providing multiple products and financing solutions to meet the credit needs of our small business customers. Along with this, we have also broadened our go-to-market strategy by not only continuing to originate through our equipment vendor partners, but also directly with our end user customers.

As a complement to our traditional Equipment Finance business, we continue to be very pleased with the performance of our working capital loan product. Third quarter working capital loan origination volume increased by 42% year-over-year to $19.6 million, delivering a working capital loan portfolio balance of $32.5 million at quarter end, representing 28% year-over-year growth. An important driver of this growth is the early success of our recently launched data-driven strategic marketing initiative that is providing our direct sales force with increasingly qualified leads for customers with a high propensity to require a working capital loan.

Also because the working capital loan portfolio has continued to perform better than expected, we were able to implement several adjustments to our credit model to better optimize our risk-adjusted returns for this product. These adjustments which Lou will elaborate on in his comments contributed to an increase in our approval rate from 51% to 57% during the quarter. We also remain pleased with our efforts to provide financing solutions directly to our end user customers. Here we are successfully leveraging relationships built over the past 2 decades including approximately 80,000 active small business customers along with more than 2,500 new contracts that we originate each month.

The objective under our direct strategy is to identify additional financing opportunities with these existing customers by offering multiple products and to create ongoing relationships with these customers by meeting a broader set of their financing needs. During the quarter, direct origination volume increased to $35.5 million compared with $23.4 million last year, resulting in a year-over-year increase of 51%. This was the third quarter in a row where our direct origination volume grew more than 50% year-over-year. While our overall origination growth picked up nicely this past quarter, we experienced slower than anticipated growth in the first half of the year due primarily to slowing growth in our indirect Equipment Finance business.

As was discussed on the last quarter's call, this was partially due to open sales positions resulting from repositioning measures taken earlier this year to optimize the productivity and effectiveness of our sales force. However, we have made notable progress in expanding our sales team as evidenced by Equipment Finance origination volume during the quarter that increased by 15% over last year, and we are on track to have a fully staffed sales organization by the end of the fourth quarter.

And finally, consistent with our stated strategy of augmenting organic growth with strategic corporate development activities, late in the quarter we announced the acquisition of Fleet Financing Resources or FFR. FFR, a broker platform that originated approximately $75 million in 2017, is a well-established originator focused on financing commercial transportation equipment with an emphasis currently on livery equipment such as motor coaches, buses, shuttle buses and other equipment used in the movement of people. Exact terms of the transaction were not disclosed, but included an initial payment with an earn out based on the achievement of certain future performance targets.

We expect the transaction to be accretive to Marlin's earnings per share in 2018 and to generate strong returns on invested capital over time by accelerating growth and further leveraging Marlin's fixed infrastructure cost. As a backdrop to the FFR acquisition, last year we made the conscious decision to pivot to a new strategy in our transportation vertical by focusing on financing equipment used by small businesses as opposed to equipment used primarily by transportation companies. The acquisition of FFR represents an important milestone in this pivot as the platform brings significant domain expertise, not only in livery, but across the entire vocational transportation equipment spectrum, while also substantially accelerating the growth of our existing commercial transportation Equipment Finance business.

In addition, while FFR originates both directly and indirectly, approximately 70% of the platform's 2017 origination volume was direct to end user customers, which is consistent with our focus on expanding Marlin's direct origination capabilities. Overall, FFR is highly complementary to our current commercial transportation equipment strategy and more broadly to our Marlin 2.0 strategic initiatives. Going forward, FFR will be known as our commercial vehicle group and will continue to be led by Dave Reynolds, FFR's co-founder and former President and CEO. Integration activities are substantially complete and we look forward to providing updates on the expansion of our commercial vehicle finance business on future calls.

We also made good headway during the quarter on our second key priority, which focuses on leveraging Marlin's capital and fixed cost through growth. Thanks to strong origination volume and solid portfolio growth during the quarter, we were able to reduce Marlin's equity-to-assets ratio to 17.2% from 17.3% at the end of last year. Our assets syndication program also remains very active and continues to diversify Marlin's funding sources. Overall, we view these asset sales as an efficient way to optimize our portfolio by better managing its overall size and composition in terms of returns, credit risk, and exposure to particular industries, geographies, and asset classes.

During the third quarter, investor demand for Marlin's product was very strong resulting in the sale of $40 million in assets that generated an immediate net pretax gain on sale of approximately $2.2 million. In addition, we continue to service the assets sold which allows us to maintain an ongoing relationship with these customers in support of our direct strategy. In total, we are now servicing approximately $129 million in assets for our capital markets partners.

And finally, as previously announced, during the quarter, we successfully completed an asset-backed securitization transaction, issuing approximately $202 million in term notes to various institutional investors. The 2 primary strategic objectives of this financing were to further diversify our funding sources and to release capital for growth through a higher advance rate against the securitized assets than what is achievable through our wholly-owned depository Marlin Business Bank. Ultimately, we believe this and future ABS securitizations will lead to higher returns on equity by allowing us to continue to grow and scale within our existing capital base.

Moving on to our third area of focus. We made additional strides in the quarter to better leverage the company's fixed costs through growth and to improve operational efficiencies through ongoing process improvements. After adjusting for temporary acquisition related costs and the reclassification of servicing asset amortization that was implemented this quarter, our non-GAAP operating efficiency ratio for the quarter improved to 54.5% from 56.1% last year and our non-GAAP noninterest expense as a percentage of average managed finance receivables for the quarter improved to 6.1% from 6.7% last year.

Overall, I'm quite pleased with both the measurable progress we have made in streamlining and automating our business processes. We expect our core efficiency ratio to continue to improve in the future as we further leverage our fixed cost and portfolio growth and operate more efficiently through our various process renewal initiatives.

Our fourth and final key area of focus is proactively managing the company's risk profile to be in line with our risk appetite. Our efforts here are delivering stable portfolio results as illustrated by delinquency and charge-offs within an acceptable range. That said, we continue to fine-tune our enterprise-wide risk management program that defines the aggregate level and types of risk Marlin is willing to assume to achieve our strategic and financial objectives.

As an example of our efforts on this front, during the quarter, we continued to refine our risk analytics by completing work on the stratification of our origination activity in the 4 designated categories of credit quality irrespective of business type, equipment type, or the originating platform. This is important work in support of our risk-based pricing initiative and we believe this new risk stratification will also provide meaningful insight to investors regarding changes in our credit quality and pricing over time, and represents an example of the company's increasingly sophisticated use of its data. Lou will provide additional details on this activity along with the portfolio's performance in his remarks. In summary, we enjoyed a strong third quarter with momentum continuing to build and we are poised for a strong finish to 2018.

With that, I'd like to now turn the call over to Lou Maslowe, our Chief Risk Officer, to discuss the performance of our portfolio in more detail. Lou?

Louis E. Maslowe - *Marlin Business Services Corp. - Chief Risk Officer & Senior VP*

Thank you, Jeff, and good morning, everyone. We are pleased with Marlin's third quarter portfolio performance, which remains stable and in line with our expectations. Equipment Finance receivables over 30 days delinquent were 1.02%, up 5 basis points from the second quarter and down 13 basis points year-over-year. Equipment Finance receivables over 60 days delinquent were 0.57%, up 1 basis point from the second quarter and down 6 basis points from the third quarter of last year.

The biggest contributor to the year-over-year improvement in delinquency was the transportation portfolio which improved by 79 and 65 basis points for 30 and 60-plus day delinquency respectively. Aggregate net charge-offs increased slightly in the third quarter to 1.90% of average finance receivables on an annualized basis, as compared with 1.84% in the prior quarter and 1.73% in the third quarter of 2017.

Equipment Finance charge-offs increased by 11 basis points quarter-over-quarter and 12 basis points year-over-year. The quarter-over-quarter increase was primarily attributed to higher charge-offs in our broker channel which has performed extremely well over the past couple of years. We continue to closely monitor the performance of all of our broker partner's portfolios.

Although Equipment Finance charge-offs are still within the range we've experienced since the first quarter of 2013, we have seen an increase over the past 5 quarters. While we expect an increase in the amount of charge-offs given the growth in our portfolio, we have also seen a gradual increase in charge-offs as a percentage of average finance receivables. As we have explained in the past, we view the increase in part due to a return to more normal levels.

We have also recently seen an increase in fraudulent activity. In the third quarter, we had losses totaling $310,000 related to suspected fraudulent activity. As a percentage of total charge-offs, such losses represented 5.6% as compared to an average of 2.4% over the past several years. Although it is difficult to benchmark due to the lack of public data, discussions with our industry peers confirm that fraud activity is increasing.

In response to the increase in fraudulent activity, we developed a detailed action plan that includes enhancements to procedures, increased surveillance staff, and the implementation of new tools to combat the increase in attempted frauds. For example, we recently created a fraud model that will be implemented into our credit scoring process in November.

Charge-offs for our working capital loan product in the third quarter improved to 4.42% of average finance receivables on an annualized basis from 6.0% in the second quarter. As I previously mentioned, we target an annual charge-off rate of 6.0% for this product. We were pleased with this quarter's results which validates our expanded underwriting approach.

As mentioned earlier by Jeff, we made some adjustments to our underwriting during the quarter. Specifically, we made some adjustments to our working capital credit model that will increase the overall score for certain applicants, qualifying them for longer terms and hence larger loan amounts. We also implemented a change to reduce the number of applications that are approved for less than the requested loan amount.

While the changes are having the desired effect of increasing our approval and booking rates, we expect that the portfolio will continue to perform at or better than target. The allowance for credit losses was 1.65% of average finance receivables, which was up 3 basis points in the second quarter due to an increase in the Equipment Finance allowance from 1.53% to 1.55%.

The uptick as a percentage of finance receivables was primarily driven by slightly higher delinquency and a small reduction in recoveries during the quarter. The loss reserve remaining for Hurricanes Harvey and Irma was $307,000 as compared to the original allowance of $500,000. We remain confident that the hurricane loss allowance will be sufficient to address remaining losses in the portfolio from these natural disasters, of which there is a remaining net investment of approximately $2.0 million.

Our analysis indicates the potential portfolio impact of Hurricanes Lawrence and Michael this past quarter will be limited and therefore does not necessitate a special reserve. As Jeff briefly touched upon, one of the ways we are using data analytics is to better optimize our pricing strategy to a risk-based framework. We recently completed an initiative to define credit quality grades A through D for Equipment Finance originations which will provide greater insight into changing portfolio quality mix and its impact on yield from quarter-to-quarter.

The letter grades correlate to a stratification based on expected lifetime loss. Based on applications submitted in the third quarter, the weighted average yield of book contracts was 16 basis points higher than the third quarter of 2017, while the A grade as a percentage of the total applications book increased by 600 basis points, demonstrating that we are having some success in passing through increases in base interest rates.

Pricing changes by risk grade were as follows: A grades decreased by 1 basis point; B grades increased by 42 basis points; C grades increased by 61 basis points; and D grades increased by 56 basis points. These results demonstrate that there is less price sensitivity in the lower risk grades which will help inform future pricing decisions. While we have utilized risk-based pricing on larger transactions in the past, it has historically been on a case-by-case basis. We are now taking a programmatic approach which improves our ability to more appropriately align yields with each strata's associated risk.

We anticipate that the credit environment will remain favorable into 2019. The small business optimism index from the National Federation of Independent Businesses continued to reflect very positive sentiment among small business owners, as September's result was the third highest index reading in the survey's 45-year history. Similarly the Thomson Reuters/PayNet Small Business Lending Index, which measures the volume of new commercial loans and leases to small businesses, was at a near record high in August of 2018.

Finally, I'd like to comment about FFR's credit underwriting methodology. We found during our due diligence that the FFR team has a great depth of knowledge and experience financing transportation equipment. With an average transaction size of approximately 200,000, FFR evaluates its transactions based on credit history, cash flow and collateral coverage. FFR has a successful track record of financing a range of credit profiles. FFR has a more collateral intensive underwriting process than Marlin's traditional Equipment Finance business which is an important new competency that we can leverage going forward. Overall, we found that the company has a strong credit culture that will fit well within Marlin.

In closing, we remain satisfied with our portfolio performance which continues to demonstrate stable results. We're also excited about the advancements in our risk-based pricing strategy which we believe will further advance ROE over time.

With that, I'll turn the call back over to Jeff for a more detailed discussion of our third quarter or financial performance. Jeff?

Jeffrey A. Hilzinger - *Marlin Business Services Corp. - President & CEO*

Thank you, Lou. For the quarter, yield on total originations was 12.77%, up 53 basis points from the prior quarter and up 59 basis points from the third quarter of 2017. Third quarter yield on direct originations was 22.39%, up 380 basis points from the prior quarter due primarily to product mix and the company's ability to pass through base rate increases in this channel. The yield on indirect originations for the quarter was 10.29%, down 25 basis points from the second quarter due primarily to changes in our origination mix for platforms that have generally lower yields.

As Lou mentioned earlier, as we work to implement and refine our new risk-based pricing strategy, we expect to see a shift in yields in the coming quarters as we work to better align credit quality with pricing across all of our origination platforms. As we have messaged before, yield is not a proxy for ROE, but this new programmatic risk-based pricing approach will allow us to more precisely price the risk we are underwriting and ultimately drive long-term ROE expansion for Marlin.

For the quarter, net interest margin or NIM was 9.94%, down 37 basis points from the prior quarter and down 79 basis points from the third quarter of 2017. Given the improvement in overall yield on newer originations during the quarter, the decrease in NIM on a quarter-over-quarter basis was due exclusively to higher interest expense which increased to 2.07%, up 48 basis points from the previous quarter and up 68 basis points from the third quarter of 2017.

These increases were driven almost exclusively by a higher interest expense from the securitization transaction that closed early this quarter. It's important to remember though that the company received a substantially deeper advance rate against the securitized assets than what was being achieved through our depository. So when taken together, the impact of the increased interest expense is more than offset by the increased leverage with the net effect being significantly accretive to ROE over time as the company fully leverages the $25 million of capital that was released from the securitization.

Third quarter noninterest expenses were $15.7 million compared with $16 million in the prior quarter and $15.7 million in the third quarter last year. The decrease compared to the prior quarter was primarily due to a $1 million decrease in general and administrative expenses due primarily to the reclassification of servicing asset amortization from general and administrative expense to noninterest income. This was partially offset by expenses related to the CFO departure as well as increases in legal fees from the ABS transaction and FFR acquisition, the timing of certain insurance related expenses and higher acquisition related commission expense due to better-than-expected performance from HKF.

The year-over-year increase in noninterest expense is primarily due to the CFO departure, higher insurance related expenses, higher HKF commissions as well as increases in IT investment and increased sales commissions due to higher overall origination volume offset by the aforementioned reclassification. Noninterest income was $4.4 million for the third quarter compared with $4.6 million in the prior quarter and $3.6 million in the prior year period. The decrease in noninterest income compared to the prior quarter was primarily due to $1.3 million increase in gains on sale from the company's capital markets activities offset by a decrease of $1.4 million in servicing fee income primarily due to reclassifying prior servicing asset amortization from general and administrative expense and noninterest income.

The year-over-year increase in noninterest income is primarily due to increases in gains on sale and insurance-related income, partially offset by a decrease for the aforementioned reclassification and a small decrease in referral income. And finally, our Board of Directors declared a regular quarterly dividend of $0.14 per share payable on November 23, 2018 to shareholders of record as of November 12, 2018.

Now turning to our business outlook for 2018. Total origination volume, including referral volume, is expected to finish approximately 15% to 20% above 2017 levels. Portfolio performance is expected to remain in line with the results observed over the last 12 months. Net interest margin as a percentage of AFR is expected to be between 9.75% and 10%. ROE is expected to continue to improve in 2018 as the company continues to improve operating scale. And lastly, EPS on an adjusted basis is expected to be between $2 and $2.10 per share.

That concludes our prepared remarks, and with that, let's open up the call for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Brian Hogan with William Blair.

Brian Dean Hogan - *William Blair & Company L.L.C., Research Division - Associate*

I want to hit on the originations real quick and then it ties into FFR. So year-to-date, your originations are up 12%. And just with your guidance 15% to 20% and I know FFR, you said they did $75 million of originations and so are you including the FFR originations in your guidance there? I guess what's organic growth expected versus the addition of FFR.

Jeffrey A. Hilzinger - *Marlin Business Services Corp. - President & CEO*

Yes. The 15% to 20% guidance, Brian, does include referral volume. I mean we defined it as including referral volume before we acquired FFR. So I think given the -- we were at 9% growth in the first quarter, 11% in the second quarter, 17.5%, 17.4% in the third quarter and I think the organic growth is going to be in that 15% to 20% range, and then certainly FFR is going to be additive to that. And FFR's volume is, it's seasonal. So $75 million doesn't come in evenly over the 4 quarters primarily because there is -- most of these are what they call track leases which means that they are tax leases from a lessor's perspective. So the value of tax benefits improves as you move through the year. And so this segment -- all segments that have tax leases like this have a tendency to be backend weighted in the year.

Brian Dean Hogan - *William Blair & Company L.L.C., Research Division - Associate*

So like the $75 million, would you say like a third of it is in the fourth quarter? I mean what -- can you give me some sense?

Jeffrey A. Hilzinger - *Marlin Business Services Corp. - President & CEO*

Yes, I think it's going to be -- it still will be somewhere between sort of 30% and 40%.

Brian Dean Hogan - *William Blair & Company L.L.C., Research Division - Associate*

The gain on sale in the period, $2.2 million, you said is the yield like 5.4%. Is that a yield that you would expect going forward? I mean you sold a good chunk, obviously, due to the timing of the term loan there. But -- and what do you expect for to sell going forward?

Jeffrey A. Hilzinger - *Marlin Business Services Corp. - President & CEO*

Yes. We're on -- for 2018, we're sort of on a $30 million a quarter pace. We sold $20 million in the second quarter because we didn't think the conditions were as good as they were going to be in the third quarter, and that turned out to be true. So that's why we sold $40 million instead of $30 million in the third quarter. But that $30 million pace is I think a reasonable one to assume in the fourth quarter, but conditions continue to be excellent for the intermediation of these assets. So it may be a little more than that as we sort of move through the quarter, but I think the sort of a $30 million per quarter rate is good to assume.

Brian Dean Hogan - *William Blair & Company L.L.C., Research Division - Associate*

And the yield?

Jeffrey A. Hilzinger - *Marlin Business Services Corp. - President & CEO*

Yes. I think the gain is going to be continue to be around sort of 5%, 5.5%.

Brian Dean Hogan - *William Blair & Company L.L.C., Research Division - Associate*

The personnel ramp in the quarter, I mean you added 19 personnel. And I just -- what's that do for your originations? And I'm just going to try to tie that into the efficiency ratio. Obviously, we had buildup productivity time, and so that I guess what is your cadence of the productivity and efficiency ratio improvement with the ramp in the personnel?

Jeffrey A. Hilzinger - *Marlin Business Services Corp. - President & CEO*

Yes, so we think efficiency ratio will be flat quarter-to-quarter and flat from third quarter to fourth quarter and that that's taking into account the addition of this headcount, and you're right, there is a natural ramp to a plateau, to a seasoned plateau. And so that takes into account the fact that we've got a number of folks that are in that ramp phase both the third quarter and fourth quarter.

Brian Dean Hogan - *William Blair & Company L.L.C., Research Division - Associate*

And broadly the economy, you're not in the media peak earnings, what have you -- and from the data that I have seen, I don't really see and you indicated the alpha index in the small business indices and what have you. What are you seeing from your small businesses that you work with?

Jeffrey A. Hilzinger - *Marlin Business Services Corp. - President & CEO*

Yes. I mean it's -- I hear you on that. It's hard to reconcile sort of what we read in the media versus what we are experiencing here every day. I think our experience is more consistent with the data that Lou presided than it is what we sort of hear in the general media. Having said that, there are a lot of macro forces at play, whether it's trade issues or mid-term elections or pricing, I mean there is a lot of macro forces at play. And so I think notwithstanding the fact that we don't really see anything in our portfolio that would indicate that there is a portfolio or that there is a recession looming, I think from management standpoint our working assumption is that there'll be some sort of a correction in 2020. So how long, how deep, obviously nobody's crystal ball is clear on that. But for planning purposes, that's the working assumption that we're making.

Brian Dean Hogan - *William Blair & Company L.L.C., Research Division - Associate*

And then on credit quality, delinquencies in the working capital loan, obviously it's the period imbalance in there. And I understand that relatively short periods of -- but the DQ's were up pretty substantially on a rate basis. Can you articulate what's going on there? It was just a blip or...

Louis E. Maslowe - *Marlin Business Services Corp. - Chief Risk Officer & Senior VP*

Sure. Yes, it's -- I would say it's just a blip. As we've talked about before, it can be a bit chunky because there aren't that many accounts. And if you have some larger accounts go delinquent, it will have that type of impact on the delinquency rate. In the case at the end of September, we had three particular accounts that were above 30 that drove the higher delinquency. But they're still on the books because they are still paying. One was in the hurricane zone, so they had some issues because of that. One of the borrowers was in the hospital, so there were some delayed payment. So that's really those 3 accounts for the higher delinquency.

Brian Dean Hogan - *William Blair & Company L.L.C., Research Division - Associate*

And then on the fraud, how confident are you that you have the -- you put the right actions in place in your underwritings so that it's going to remain controlled?

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Louis E. Maslowe - *Marlin Business Services Corp. - Chief Risk Officer & Senior VP*

That's a good question. I mean the first thing I'd like to say is fraud is not a new risk for our business. It's one that we have always dealt with. What we have seen recently is an uptick in the number of fraud attempts, many of which we catch, some of which we don't. And the goal isn't to drive fraud to 0 in terms of actual results because if we did that, we'd have to shut down the business. But because of the rising number of fraud attempts, it did warrant additional action. So we've taken a number of steps to deal with it. I mentioned the fraud model. We're also looking at tools that better identify, for example, fraudulent e-mails or IP addresses, making sure that the payee bank accounts are legitimate. So there is a number of tools out there and additional technology that we're in the process of taking advantage of. But to answer your question over time, I'm very confident that we'll keep the risk of fraud at a manageable level. Yes.

Jeffrey A. Hilzinger - *Marlin Business Services Corp. - President & CEO*

I think we're -- yes, Brian, it's an interesting time in terms of fraud section or fraud surveillance because I think with the rise of the platforms that are providing these working capital loans in most cases exclusively, they're marketing directly to a $20 million, $30 million basis small businesses. And so the fraud that they experience, we've heard and seen numbers where charge-offs -- half of the platform charge-offs are due to fraud. And so there has been a -- there's really been a focus especially on those platforms part in trying to bring technological solutions to bear to be able to improve the detection of fraud without necessarily slowing down or making the process more cumbersome for customers. And we think that those tools will work perfectly for us as well. So I think Lou described a lot of the conventional things that we're doing that I think we're doing much better. But I think over the long run, the way you reconcile creating better surveillance without upsetting or causing a deterioration in the customer experience is by employing these increasingly impressive fraud detection models or technological solutions that are there and continuing to emerge.

Louis E. Maslowe - *Marlin Business Services Corp. - Chief Risk Officer & Senior VP*

And just to emphasize a point I made in my comments earlier that it's really industry-wide that's experiencing this. In fact, I have a meeting next month with a number of lenders to talk specifically about fraud. It's to kind of share best practices together because it is something that everyone has been experiencing.

Operator

(Operator Instructions) Our next question comes from the line of Bill Dezellem with Tieton Capital Management.

William J. Dezellem - *Tieton Capital Management, LLC - President, CIO and Chief Compliance Officer*

Group of questions. First of all, relative to the increase yields on the direct originations, you had mentioned I believe within your opening remarks that that's a function of mix. Would you talk further about that shift please?

Jeffrey A. Hilzinger - *Marlin Business Services Corp. - President & CEO*

It's a couple of things. So in the -- the direct channel consists of both of Equipment Finance and our working capital loan product. The working capital loan product is -- it is to the extent that it's increasing in terms of its percentage or how that origination volume is big as comprised, obviously the direct channel yield is going to rise as well. And in fact, that's what we saw in the quarter. We had funding stream or the working capital loan product was a greater percentage of origination volume in that quarter than it had in the previous quarters. And then -- so that's the mix effect. But we've also been deliberately passing through price increases and to reflect the increase in base interest rates. And we've been passing through at least the last quarter -- 3 quarters about 100 basis points per quarter. And we've been able to -- we've been able to have them stick. So you have -- you have overall -- you have overall pricing rising due to price increases in the working capital loan product and, yes, the working capital loan product in this quarter anyway reflecting a greater percentage of the total direct volume.

William J. Dezellem - *Tieton Capital Management, LLC - President, CIO and Chief Compliance Officer*

And then on your finance sources, are you calling some of those back?

Jeffrey A. Hilzinger - *Marlin Business Services Corp. - President & CEO*

I don't follow you.

William J. Dezellem - *Tieton Capital Management, LLC - President, CIO and Chief Compliance Officer*

Well, the number of finance sources decreased and that made us wonder if you are identifying those that are less productive for you and no longer working with them and that's the best way to do that, sort of calling from that perspective.

Jeffrey A. Hilzinger - *Marlin Business Services Corp. - President & CEO*

Yes, yes, yes. That's -- yes, now I understand your question. We -- yes, over the last 6 months or so, we -- another one of the initiatives that Lou has been working on has been increasing our overall vendor or partner surveillance activities. And the conventional way to do that to survey our partners is typically around their -- the portfolio -- the performance of the portfolio that they've originated. We've actually -- we're actually taking it one step further which is sort of looking at the return on equity that's being generated by the portfolios that are being generated by those partners as opposed to just the portfolio performance. So obviously portfolio performance is an important part of that calculus, but we have gone through and we have made decisions to raise pricing or to change our strategy within certain partner relationships. In some cases, we have exited some of the partner relationships because we didn't see a task force having those relationships ultimately becoming accretive from an ROE standpoint. So it's -- I think when you're originating through intermediaries like the indirect side of our businesses, having an active surveillance process and understanding partner profitability is really a pretty basic rigor.

William J. Dezellem - *Tieton Capital Management, LLC - President, CIO and Chief Compliance Officer*

And did I understand you correctly that there is an increased emphasis on that in the last few months? And if so, is this something that could be meaningful enough that it will show up in overall results -- benefiting the overall results over the next several quarters?

Jeffrey A. Hilzinger - *Marlin Business Services Corp. - President & CEO*

I don't know about the next several quarters, but it certainly will show up over time. It is really an extension of the underlying partner profitability or channel profitability work we did which is basically creating return on equity models at the branch level within the company and understanding sort of which origination platforms are generating flows that are accretive to the enterprise ROE or accretive to our ROE goals and which ones aren't. So it's only natural to take that analysis and push it down to the next level which is the partners that are within those indirect branches. And so I think what you heard me describe was simply a natural effort of taking that -- those analytics and moving them to another level below. And of course the next level below that is you're actually doing -- you're calculating ROE at the transaction level which is very typical for middle ticket or a large ticket Equipment Finance businesses, but it is in my experience relatively unusual in small ticket or micro ticket because it needs to be a completely automated process. And we're-- we'd like to take it to that level because obviously that helps us make more informed decisions about what assets we want to -- if we originate, we want to keep on our balance sheet and which ones we want to aggregate and intermediate or which ones we just want to refer and never have on our balance sheet at all. So it's important. The transaction level --ROE's are an important way to sort of inform analytically, make us more sophisticated in terms of our choice about what we keep and what we sell.

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William J. Dezellem - *Tieton Capital Management, LLC - President, CIO and Chief Compliance Officer*

And finally, FFR, when would you anticipate that they will be fully integrated?

Jeffrey A. Hilzinger - *Marlin Business Services Corp. - President & CEO*

So I -- it depends on what you mean by integration. I would say that they're pretty much fully integrated at this point in terms of allowing them to be able to do what they've done historically within the context of the Marlin system. So they're connected from an accounting standpoint. They're connected into credit. They're connected into the sales function. They're connected into the capital markets function. Where I don't think where the integration has yet to begin is the synergistic opportunities between the platform. And so that would be just broadly described as taking their underwriting and asset expertise and leveraging that across other parts of Marlin's existing business or certainly within Marlin's commercial vehicle finance business which is what we've been referring to as Transportation 2.0 given the pivot that we went through a year ago. And then I think the IP that could be transferred from Marlin to FFR is really around our expertise in being able to originate through dealers. It's sort of our vendor orientation on the Equipment Finance side of the business. So they do about 70% --- FFR does about 70% of their business direct, which we think is terrific and we love that. But we think that there is an opportunity to sort of put in place for them the same sort of flywheel relationship between increasing the number of dealers or indirect partners that they do business with as a way to feed new customers into their system which can then allow them to be able to do more direct business. So I would say that those conversations are still nascent. And the reason for that is that that we just want to make sure that the chemistry is good here, that the integration is comfortable. The platform went through a pretty significant due diligence process with us, which I think really caused them to sort of take their eye off the ball a little bit in terms of their marketing. So they are back, full bore on that. So I think we want to get them sort of comfortable and to the point where the existing business is the best it can be and then we'll engage in a process of looking at these more synergistic opportunities.

Operator

Thank you. There are no further questions at this time. I would like to turn the call back over to management for any closing remarks.

Jeffrey A. Hilzinger - *Marlin Business Services Corp. - President & CEO*

Thank you for your support and for joining us on today's call. Thanks to the success of our strategic initiatives and solid operational execution, momentum continues to build and we anticipate a strong finish to the year. We look forward to speaking with you again when we report our 2018 fourth quarter full year results in early February. Thank you again.

Operator

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.
