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MRLN - Q3 2015 Marlin Business Services Corp Earnings Call

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CORPORATE PARTICIPANTS

Ed Siciliano *Marlin Business Services Corp. - Interim CEO, EVP, and Chief Sales Officer*

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

CONFERENCE CALL PARTICIPANTS

Brian Hogan *William Blair & Company - Analyst*

Chris York *JMP Securities - Analyst*

Brian Hollenden *Sidoti & Company - Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Marlin Business Services Corp., third quarter 2015 earnings conference call. (Operator Instructions)

As a reminder, this conference is being recorded and is being webcast simultaneously on the Investor Relations section of Marlin's website, at www.marlinfinance.com. The recording of the call will be archived on the website for approximately 45 days.

I would like to remind you that this conference call may contain statements that are forward-looking within the meaning of the applicable federal securities laws and are based on Marlin Business Services Corp.'s current expectations and assumptions, which are subject to a number of risks and uncertainties that could cause actual results to differ materially from those anticipated.

Factors that could cause actual results to differ from those anticipated are detailed in the Company's Securities and Exchange Commission's filings. Listeners are cautioned not to place undue reliance on these forward-looking statements. Such forward-looking statements speak only as of the date of which they are made, and the Company does not undertake any obligation to update any forward-looking statements to reflect events or circumstances after the date of this call.

Speaking to you today will be Ed Siciliano, Chief Sales Officer and Interim Chief Executive Officer. Also on the call is Taylor Kamp, Chief Financial Officer. The Company will begin the call with prepared comments and follow up with a question-and-answer session.

It is now my pleasure to introduce your host, Mr. Ed Siciliano of Marlin Business Services Corp. Thank you, Ed. You may begin.

Ed Siciliano - ***Marlin Business Services Corp. - Interim CEO, EVP, and Chief Sales Officer***

Thank you, Michelle.

Good morning, everyone, and welcome to today's call. Let me begin with a few comments about our general business and the momentum that we have been building in 2015.

To start, application volume has been very strong and is being driven by a larger sales force, larger tickets, and new products. This robust application flow converted into over $100 million in total new originations in the third quarter, a 22% increase compared to last year.

Quarter-ending investment in lease and loans also increased, ending at $659 million, up approximately 7% from a year ago.

Yields on new originations declined 10 basis points as a result of a few factors, including channel mix which leaned toward major account channels in the quarter. Major account channels tend to have higher average tickets and lower pricing, along with higher credit quality. We view the price/credit quality tradeoff as a good one for our business.

The yield decline was largely offset by the yields generated on our capital loan product, which I'll discuss shortly.

We continued to execute on our hiring plan, and we are on track to reach a sales force of approximately 135 reps by year-end. Our hiring for the remainder of 2015 will be focused on our newer initiatives, like capital loan, franchise, and transportation.

With respect to transportation, we have formed a team of experienced commercial truck and specialty vehicle professionals focused on serving small business customers. We saw an opportunity in an underserved market which matched our ticket, pricing, and credit risk appetites.

In the quarter, we booked $2.3 million in capital loans at a 36% yield. We are encouraged by the high demand from our existing customers for our funding stream product, which allows businesses to conveniently and expeditiously fund and accelerate their growth.

The infrastructure buildout for the product is largely behind us now, with very strong credit underwriting in place. At this point, we are well positioned to increase funding stream originations, but we'll continue to do so at a disciplined pace.

Credit quality remains strong, with 30-plus day delinquencies of 75 basis points and charge-offs at 1.23%. Taylor will discuss our credit performance in greater detail in just a moment.

It was a good quarter, and we are excited about our business prospects heading into Q4 and beyond. Our core channels are growing. Loan and other new initiatives are contributing. And we will continue to add offerings that leverage our infrastructure and proven credit and operational expertise to generate attractive risk-adjusted returns.

Lastly, and on a personal note, on behalf of the entire Marlin family I'd like to extend our sincere gratitude to Dan Dyer, who recently retired as CEO and Director, for his leadership and countless contributions over 18 years. Thank you, Dan.

With that, I will turn the call over to Taylor. Taylor?

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

Thank you Ed, and good morning.

As many of you are aware, I've been with Marlin now for about 12 weeks. And I can say without any reservation that I'm extremely excited to be here. Marlin's fundamentals and management are strong, and its unique platform provides an attractive opportunity for growth as we fulfill the financial needs of small businesses.

I would first like to cover some of the more traditional headline metrics for the quarter and year to date, but I also want to discuss how Marlin will from time to time supplement these data with other information about the Company's performance.

We had very solid operating results in the third quarter, with net income of $4.8 million and EPS of $0.38 per diluted share.

Total origination volume came in at $101.9 million for the quarter, up 22% from a year ago.

Our net investment in leases and loans grew 6.6% year over year, to $659.2 million, and our ROE was 10.95%, down from 11.5% a year ago. Note that the 10.95% does not yet fully reflect the positive impact of recent capital planning activities.

Our business continues to generate an attractive net interest and fee margin. For the quarter, NIM was 11.96%, a bit lower than the second quarter of 2015.

Cost of funds increased slightly, to 89 basis points, while fee income improved in the quarter both in absolute dollars and in percentage. It is important to note, and as presented in our supplemental information, our Funding Stream product is helping to improve our overall NIM.

As Ed indicated, credit quality remains strong. Thirty-plus day delinquencies were 75 basis points, versus 70 basis points in the second quarter. Charge-offs declined to 1.23% of average finance receivables, versus 1.84% last quarter. On a year-to-date basis, our coincident charge-offs were 1.59% of average finance receivables and in line with expected charge-off levels.

The allowance for credit losses remain robust, at 1.31% of average total finance receivables and 269.6% coverage of 60-plus day receivables.

Additional information on static pool losses and delinquencies is available on our Investor Relations website.

Third quarter 2015 expenses were $11.4 million, versus $11.6 million in the second quarter, even as we continued to make investments in new initiatives in the third quarter.

Yesterday, we declared a regular dividend of 14 cents per share. As you are aware, we also declared a special dividend of $2.00 per share on September 14.

In addition and in keeping with our stock buyback plan announced in 2014, the Company repurchased approximately 196,000 shares of stock in the third quarter, bringing the total year-to-date Q3 repurchases to approximately 407,000 shares at a total cost of about $7 million.

Our capital position remains strong, with an equity-to-assets ratio of 19%. The special dividend and continued execution on our stock repurchase strategy further demonstrate Marlin's commitment to prudent capital management. As previously communicated, we do not expect these capital planning activities to negatively impact our regular dividend practice or impede our growth plans.

In my introductory remarks, I noted our intention now, and in the future, to introduce enhancements to the data we publish by providing additional information on certain initiatives and other discrete events. To that end, this quarter we segregated certain financial and performance data about our Funding Stream loan product in the supplemental information in this quarter's earnings release.

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

QUESTION AND ANSWER

Operator

(Operator Instructions) Brian Hogan, William Blair.

Brian Hogan - ***William Blair & Company - Analyst***

Just kind of an initial question is, Dan leaving seemed a little sudden and a surprise, and (inaudible) retiring, being on board for almost a year, I guess, [post this]. But why now? And what are you looking for in the new CEO?

Ed Siciliano - ***Marlin Business Services Corp. - Interim CEO, EVP, and Chief Sales Officer***

In regards to Dan's retirement, Brian, public company boards and management are always working on succession planning, as you know. Marlin is no different. Dan and the Board agreed that this was the right time. There's probably no perfect time, but they thought this was the right time.

You're probably aware that Dan has agreed to be a consultant to the Company for the next year, which provides us a lot of comfort as we transition through the period.

Again, as mentioned earlier, we're extremely grateful to Dan for his 18 years of service and dedication. Having said that, we're very confident with the team in place. We have a deep talent bench of both tenured and new leadership here at Marlin. So, we're going to be executing on the new growth plans.

I don't have much of a comment in terms of what we're looking for. Somebody that's going to really augment the talent that we already have in house, in terms of the new CEO what we're looking for.

Brian Hogan - ***William Blair & Company - Analyst***

Okay. Moving to originations, you said there was kind of a channel mix change more to the national, which obviously brings down the yield a little bit -- and I'm sure it moves around by quarter -- but what is your outlook, going forward, by channel?

Ed Siciliano - ***Marlin Business Services Corp. - Interim CEO, EVP, and Chief Sales Officer***

Yes, that's fine. So, in the third quarter, early in the third quarter, we had a particularly large engineering software company run a kind of a leasing special, and we did a lot of business with them early in the summer. Very, very high quality business, lower yields.

We were opportunistic. We took that business. It was good for us. And that drove yields on lease originations down a bit through the quarter.

Looking forward, I think yields have generally stabilized by channel, but channel mix will probably be similar in the fourth quarter to what it was in the third quarter, a little more for our major account channels.

In the fourth quarter, we do see a little more competitive pressure. As funding sources are trying to finish up their year strong and put volume on, it will get a little more competitive on pricing. But again, we're going to be opportunistic.

If we have a chance to drive [good price quality] in the fourth quarter, we're going to do that, the same as we did in the fourth quarter.

So, the guidance I would give is I would imagine yields on our leasing business will be very consistent Q3 to Q4.

Brian Hogan - ***William Blair & Company - Analyst***

And the demand? You mentioned competition will be a little stepped up in the fourth quarter, but is demand there as the economy seems to be a little bit, you could say, uncertain, at least from our point of view. And for one, I'd love your perspective on the economy from your small business perspective.

Ed Siciliano - ***Marlin Business Services Corp. - Interim CEO, EVP, and Chief Sales Officer***

Yes, sure, Brian. Demand is actually very strong, has been all year. And that's continued, I will share, even into the fourth quarter.

So, the input, the lead indicator to our business is applications in the door. And in the month of October, we actually had our strongest application flow through the door in the past 12 months.

So, that's an indicator to us of a couple of things. Our new channels -- franchise, transportation, loaner -- are accelerating, but also generally demand is very strong. And we hope that continues through the fourth quarter. We would expect that it would.

Applications in the door aren't everything, and you've got to have good application quality through the door. And you've got to prove it, and then of course it has to book. But again, the lead indicator is the raw number of apps through the door, which has been very strong.

Brian Hogan - ***William Blair & Company - Analyst***

Sure. And the capital loan originations obviously in ramp-up mode. What do you think -- how fast is it going to ramp? And at what levels do you think are you comfortable with originating per quarter?

Ed Siciliano - ***Marlin Business Services Corp. - Interim CEO, EVP, and Chief Sales Officer***

It's a good question. So, our current run rate is positive. We're optimistic that it's going to continue on a good trajectory through Q4 and into 2016.

As mentioned in my earlier comments, demand from our customers has been very, very strong. But what you can expect is measured growth, solid credit underwriting, and an increased contribution to the bottom line.

We're working on 2016 forecasting now in terms of what we're going to spend on the marketing side to accelerate that product. But it's going to be accretive to earnings sooner than later based on what we're seeing, based on what our customers are in need of.

Brian Hogan - ***William Blair & Company - Analyst***

And the credit outlook for the personal loan and, obviously, DFLs as well? But the 1.65% charge-off rate for the personal loan product, it's obviously very early but considering the yield of 36%, that's pretty good.

Ed Siciliano - ***Marlin Business Services Corp. - Interim CEO, EVP, and Chief Sales Officer***

Yes, it is. We're taking it slow. We're calibrating credit models. We feel like we've got that locked down at this point. So, it's time to turn on the business a little bit. You can expect that to increase a bit as the product matures, but within the guidelines that we set for ourselves.

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

Hi Brian, it's Taylor. I would say that in the early days here of that working capital product, a single charge-off can be chunkier or lumpy. And so, that's really what drove that. We just wouldn't expect that kind of metric going forward as the portfolio gets larger.

Brian Hogan - ***William Blair & Company - Analyst***

What is a typical run rate charge-off rate you're looking for or modeling to, I guess?

Ed Siciliano - ***Marlin Business Services Corp. - Interim CEO, EVP, and Chief Sales Officer***

Yes, 6% to 7%.

Brian Hogan - ***William Blair & Company - Analyst***

All right, thanks. The expenses for the capital lease, I think you said they're mostly behind you. And so, for the expense ratio, efficiency ratio, going forward, do you expect kind of a step down into the low 50%s from here?

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

Well, as we move forward with that product, obviously the revenue line is relatively higher than the lease product. And so, I'm not sure we have a benchmark yet for what the efficiency ratio would be in that product. But you would expect that to be significantly lower than the lease product, just because the denominator will have a much bigger impact.

Brian Hogan - ***William Blair & Company - Analyst***

Right. All right. And then, the insurance product that you announced. What's the initial feedback from that? How [do you go to] the market on that? What's the ramp on that?

Ed Siciliano - ***Marlin Business Services Corp. - Interim CEO, EVP, and Chief Sales Officer***

So, the program with the Hartford is an ancillary offering we're providing to our customers in order for Marlin to be kind of a one-stop shop for our small business customers.

But I would say, Brian, the program is very recently launched. We need to get some performance data under our belt to determine its full potential. So, we'd be happy to share more on the next call. We've literally just launched that (multiple speakers).

Brian Hogan - ***William Blair & Company - Analyst***

Sure. And then, one last question for me is, obviously you paid a special dividend and you bought back some stock. Your TCE ratio down to 19%, or so, thereabouts. What are your capital plans? Is it still continue to buy back stock? And where does your TCE ratio go? Where are you comfortable with?

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

That's a good question. Leading into this capital planning, both on the buyback and on the dividend, of course our analysis included overlaying present and future capital and cash needs on top of available capital and cash. And that's how we derived the numbers that we wanted to accomplish.

And so, I would say that, going forward, our capital plan will dictate the availability of capital and cash. And so, like any other capital planning alternative, that could be in the works. But right now, we think we're in a good spot for both -- for our organic and inorganic growth, if that happens.

Brian Hogan - ***William Blair & Company - Analyst***

Okay thanks guys.

Operator

Chris York, JMP Securities.

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

Good morning guys and thanks for taking my question. Could you provide a little bit more detail on asset production, potentially by month during the quarter and then potentially production numbers in the month of October?

Ed Siciliano - ***Marlin Business Services Corp. - Interim CEO, EVP, and Chief Sales Officer***

We'd be happy to, Chris. So, July's production was $33.4 million. And again, July is the beginning of the summer. Typically, we fall off in new originations. But as I mentioned, we had a particularly large software vendor do a fair amount of business in that month; they were ending a promotion.

So, $33.4 million in July. August was $32.1 million. And September was $32.8 million. And what I'm quoting is really lease production. So, that's $98.3 million for those three months in lease. And then, you add into that the loan and syndication.

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

Helpful. And then, the trend in October, as well?

Ed Siciliano - ***Marlin Business Services Corp. - Interim CEO, EVP, and Chief Sales Officer***

So, October is still settling in, but it looks like we've done $32.5 million. But what's really encouraging about October was the number of applications we've taken through the door in October. That's quite important because that sets up November and December and kind of starts that fourth quarter ramp.

As you know, we usually finish the year very, very strong. Our vendors are closing out their years. We've got IRS 179 that kicks in. And it's usually a pretty robust period for us. So, we're expecting growth quarter over quarter as a result of those factors.

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

Great. That additional color is very helpful.

And then, maybe talk about the competitive environment for leases, specifically maybe on banks and captives? And then, how you guys are thinking about the exit from GE Capital on the business and potentially what you're seeing there? Maybe that's showing up in applications, but curious on how you're thinking about the competitive environment?

Ed Siciliano *- Marlin Business Services Corp. - Interim CEO, EVP, and Chief Sales Officer*

The competitive environment, with the exception of the big news around GE, has been pretty much the same. It is competitive out there based on this protracted period of excess capital and low interest rates.

We're being a little more opportunistic and flexible where we see the opportunities to grab some volume. There's a lot of opportunities for Marlin, given our bank depository and our low cost of funds. We've got a strong technology platform in place right now and, of course, our credit and operational platforms.

And that's one of the reasons we got into transportation. Now, there's a market where GE plays. Let me spend just a couple of minutes on that. So, for this new market, we went ahead and hired a new VP of what we're calling our transportation funding group about 90 days ago, and we've been building out a team.

It's a dealer-based model, with our team calling on regional truck dealers. New and used vehicles, kind of specialty vehicles, with average tickets that are above our standard -- about $70,000 to $80,000. And of course, A and B credits is what we're looking for.

Now, GE and Wells Fargo happen to be in that space. They do floor planning, and they're looking for the multi-unit, multi-truck opportunities in the $250,000 to $2 million range. And we're going to operate below that.

So, it's an example of playing where -- in a market that's just below where GE and some of the bigger guys are playing, Chris. But we feel like it's a great opportunity for us.

And we're going to continue to look for more opportunities like that, to expand our business in the channels that make sense for us.

GE, by the way, is also -- I think there's some talent on the street as a result of what's going on with General Electric, and we have three full-time recruiters. And we'll share that we are talking to a number of GE folks that are searching for a permanent home, given the disruption there.

Chris York *- JMP Securities - Analyst*

Sure. Great. That color is helpful.

And then, within transportation we saw the average ticket size increase nicely in the quarter. And so, was there a contribution from transportation in the current numbers? And then, maybe how you guys are thinking about the potential expansion in the average ticket size for your portfolio over time?

Ed Siciliano *- Marlin Business Services Corp. - Interim CEO, EVP, and Chief Sales Officer*

It's a good question. So, just in comparison to -- the second quarter, our average ticket was $14,600 and in the third quarter went to $15,700. And that's a pretty sizable jump. That means that we're doing some larger tickets mixed in with our core business, which will always be there, those small tickets.

And really, what's driving that, Chris, is our franchise tickets are higher. We did do some transportation, but that's just ramping up now. Expect a much bigger contribution in Q4 and then certainly as we head into 2016.

And then, our major accounts. That software business that I was alluding to earlier, those are $100,000 average tickets, but they're really large companies with exceptional credit.

So, I think that that migration to larger tickets, it will impact yields on lease origination slightly lower, but I think that's going to give us the lift in the portfolio that we're looking for. Add on fees, add on syndication fees, and we're looking to drive EPS that way.

Chris York *- JMP Securities - Analyst*

Great. Switching gears a little bit, maybe on funding stream. So, we have the monthly numbers here for leases in the quarter. You had a good quarter in terms of production for loans. I know it was small, but it did beat your guys' previous estimate.

So, maybe on the acceptance of the new product for your current customer base? And then, non-Marlin customers? And then, potentially if you could update us on your expectations? Previously, we received that $50 million could be achievable in 2016? And kind of would like to get your thoughts on momentum?

Ed Siciliano - ***Marlin Business Services Corp. - Interim CEO, EVP, and Chief Sales Officer***

That's a good question. To reiterate, demand from our existing customers, that robust set of small business customers that we've done business with over time, has been very, very strong. And we knew this was going to be the case, because we were well aware before getting into loan that these same customers were looking at alternative finance loans through our competitors.

The majority of the business that we're putting on the books right now is from our existing customers and a small amount from some broker relationships that we have that are longstanding, trusted broker relationships that we've had.

We have not gone really outside of our customer base yet, nor have we really turned up marketing with inside of our customer base. We want to make sure the credit underwriting staff is in place, operationally we were set, the funding stream website was working well. All those things we feel very, very confident about.

So, starting in the fourth quarter, we're going to turn up marketing on our existing customer base, and I think we'll look to [hit it in] non-customers in 2016.

I won't comment on the $50 million, but we do see a lot of potential for this product. But I think it's best that we pace ourselves from a credit perspective, do the right things, make sure underwriting is highly calibrated. And we're going to maintain within loss proxies and grow the business that way. That's really what I can share with you, Chris.

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

Got it. And then, lastly, expenses. So, what are your expectations for one-time charges related to Dan's severance? And then, potentially search fees related to the new search? And will that all be taken in Q4? Or, will some of that sprinkle in maybe in Q1? How are you guys thinking about that?

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

It's a good question, Chris. Clearly, as we move forward looking for a new CEO, there will be expense associated with finding that CEO. The amounts -- a portion of the search will come in the fourth quarter. It's about $400,000 pretax and about $300,000 after-tax -- I'm rounding. As far as expenses relating to Dan's retirement, it's about $2.7 million pretax and $1.7 million after-tax, and that will also be taken in the fourth quarter.

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

Helpful.

Operator

Brian Hollenden, Sidoti.

Brian Hollenden - ***Sidoti & Company - Analyst***

How would a rising interest rate environment affect your business? And how long of a lag would the impact take to either drive volume or widen the net interest margin on your portfolio?

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

Brian, I'll take a shot at that. Clearly, we're very aware of and anticipatory around the interest rate environment. And you've seen a little bit of the impact of that in our margins, as well as our cost of funds, for instance, this quarter increased a little bit.

Now, clearly, we're match funded. And so, as we put new business on and we have new deposits, we're trying to match -- we will match fund those. But we will -- have baked into our forward-looking planning some increase, with some NIM compression but slightly so. And we expect the working capital product to help mitigate that a little bit.

But we are expecting some increase in interest rates.

Ed Siciliano - ***Marlin Business Services Corp. - Interim CEO, EVP, and Chief Sales Officer***

From a sales perspective, as I mentioned earlier, the yields have generally stabilized by channel. If rates go up, we're very confident, given the nature of our business serving the underserved, that we're going to be able to pass on those increases to our customers.

And truth is, we favor interest rates a little higher than they are today. That's also going to level the playing field on the competitive front.

Brian Hollenden - ***Sidoti & Company - Analyst***

All right, thank you.

Operator

I'm showing no further questions at this time.

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a great day.