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MRLN - Q4 2015 Marlin Business Services Corp Earnings Call

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Bob Napoli *William Blair & Company - Analyst*

Chris York *JMP Securities - Analyst*

Don Destino *Harvest Capital - Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Marlin Business Services Corp's fourth-quarter and year-end 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 this 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 filings. Listeners are cautioned not to place undue reliance on these forward-looking statements. Such forward-looking statements speak only as of the date on 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. - Chief Sales Officer & Interim CEO*

Thank you. Good morning, everyone, and welcome to today's call. Let me begin by providing some highlights of our progress that we have made during the past year.

In 2015 we have set out to make deliberate investments in our business to leverage three of our most valued company assets: our bank funding model, our strong capital position, and our enviable small ticket originations platform. We invested in sales headcount, a large market opportunity, and in support of two new equipment leasing channels, franchise and transportation.

We also entered the small business loan market by developing our Funding Stream product. In doing so, we are providing working capital to our many small business customers in a fast and convenient manner, just as we have done with our leasing offerings over the past 18 years.

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As part of our loan product launch, we introduced a comprehensive and easy-to-use website, FundingStream.com, which allows customers to apply for a loan online while simultaneously and securely moving credit data to our underwriting system. The result is a rapid credit decision for our customers, which is what they have come to expect in this new day of technology-centric product offerings. We are pleased with what we've accomplished during the year and confident that our investments will not only pay off, but will be a catalyst for our new multiyear growth plans.

A few comments on our business results. We ended the year with net income of $18.3 million before one-time executive separation charges. Net earnings were impacted by higher-yielding asset run-off within our portfolio and by our planned investment spending. Total lease and loan originations grew $381 million and the year-ending net investment in leases and loans grew approximately 8% to $682 million.

Credit quality was a bright spot once again with year-ending 60-day delinquencies at 41 basis points, down 10 basis points from a year ago. Early loan results are also strong as we continue to refine and validate our underwriting models for this new product.

We were particularly pleased with our fourth-quarter origination momentum. We booked approximately $108 million in new leases and loans, which is an 18-year quarterly high for Marlin and was 21% higher than the same period a year ago.

Yields on new lease business increased 18 basis points from the third quarter and even more dramatically when you include the $3.7 million of new loan volume. Lease yields were driven higher by channel mix and by repricing of our under $10,000 tickets. Increasing pricing on our smallest leases was a conscious effort to offset our slightly rising cost of funds.

Looking forward you can expect a slowing of sales hiring as we focus on sales productivity; steady originations growth; prudent credit, underwriting, and expense management; and an optimization of capital management. The future looks bright and the entire company is excited about our prospects.

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

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

Thank you, Ed, and good morning. As Ed mentioned, Marlin had a strong quarter and a strong finish financially and strategically. We expect to retain some of that momentum into the next quarter and into 2016, although the first quarter will be tempered by seasonality and continued investment in our new initiatives.

We had very solid operating results in the fourth quarter with unadjusted net income of $3 million and EPS of $0.24 per diluted share. As we signaled on our last call, in the fourth quarter we booked a one-time after-tax charge of approximately $2 million for the CEO retirement and new CEO search expense. Without this one-time charge, net income would have been $4.9 million and EPS would have been $0.40 per share.

Total origination volume, including lease, loan, and syndicated volume, finished at a record $107.9 million for the quarter, up 21% from a year ago. Our net investment in leases and loans grew 3.5% from last quarter and 8.4% year over year to $682.4 million. ROE for the quarter was 7.96%, down from 11.21% a year ago. ROE, excluding one-time charges, was 13.26%.

For the quarter, net interest margin was 11.52%, 44 basis points below the third quarter. While it is true new business is being booked at better rates than last quarter, there are still headwinds for the portfolio yield due to liquidation of older, higher rate business.

In addition, cost of funds increased to 98 basis points from 89 basis points last quarter. This is mostly due to increases in marginal rates resulting from the December rate increase and also to the change in leverage resulting from the special dividend and stock buyback activity, which increased the amount of deposits.

Fee income decreased in the quarter, primarily due to year-end true-ups in certain fee estimates done earlier in the year and to volatility and residual realization the quarter. We do not expect either of these to be a reoccurring issue.

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As noted in our previous call and is shown in the numbers in our supplemental information, our funding stream product continues to help mitigate NIM compression as new business is originated.

On an annual basis, Marlin's income trend began to improve in the second half from lower-than-expected results in the first half. Annual net income was $18.3 million, excluding one-time charges relating to the CEO and CFO departure expense. Adjusted EPS was $1.44 per diluted share. For reference, second-half 2015 adjusted net income was 17% higher than first-half income.

As Ed highlighted, credit quality remained strong in the fourth quarter. 30-plus day delinquencies were 73 basis points versus 75 basis points in the third quarter. Charge-offs increased somewhat to 1.60% of average finance receivables as compared to a much better than planned 1.23% last quarter. Our charge-offs for the year were 1.59% of average finance receivables and well in line with expected annual charge-off levels.

For the year-end the allowance for credit loss reserve was 1.24% of total finance receivables and 266% coverage of 60-plus day delinquencies. Additional information on static pool losses and delinquencies is available on our investor relations website.

Fourth-quarter 2015 expenses were $14.6 million as compared to $10.6 million a year ago. As previously noted, the quarter included $3.2 million of one-time pretax costs relating to executive departures. Without this cost, expenses would've been in line with the third quarter. The increase from prior year reflects continued investment in new initiatives and higher-than-planned origination volume in the quarter.

Yesterday we declared a regular dividend of $0.14 per share and, as you are aware, we also declared a special dividend of $2 per share on September 14. Consistent with our stock buyback plan announced in 2014, the Company repurchased approximately 188,000 shares of stock in the fourth quarter, bringing the total buyback for the year to almost 600,000 shares at a total cost of about $10 million.

Our capital position remains strong with an equity-to-assets ratio of 19.4%, slightly higher than last quarter. The special dividend and continued execution on our stock repurchase strategy further demonstrates 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. We will continue to monitor our capital position and consider additional capital management activities on a quarter by quarter basis.

As we communicated last quarter, we will periodically introduce enhancements to the information we publish. This quarter we have added annual supplemental data trending to better facilitate investor analytics.

In closing, while the numbers tend to speak for themselves, it is worth noting again that Marlin had very solid adjustments for the fourth quarter and generated positive momentum for originations. We continue to be energized by the performance of our core business, the opportunities for growth in our new products and for the potential of our prospective strategies.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Bob Napoli, William Blair.

Bob Napoli - *William Blair & Company - Analyst*

Thank you, good morning. Nice to see the loan growth that you are getting or the origination growth. Within that, how much of that is franchise finance versus transportation finance versus your historical core leasing product?

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Ed Siciliano - *Marlin Business Services Corp. - Chief Sales Officer & Interim CEO*

On the loan side, Bob?

Bob Napoli - *William Blair & Company - Analyst*

No, on the -- the franchise and transportation, that's all in the lease originations, right?

Ed Siciliano - *Marlin Business Services Corp. - Chief Sales Officer & Interim CEO*

Yes, yes. We don't break that out. I [could] comment on it.

Bob Napoli - *William Blair & Company - Analyst*

Is it material? Can you give me, give us some idea?

Ed Siciliano - *Marlin Business Services Corp. - Chief Sales Officer & Interim CEO*

It is becoming more material. I will comment on both channels. First on franchise, Bob.

Based on the early results we are seeing, we've actually expanded that team to seven individuals. We have hired an experienced VP of sales and we actually took a step to open a small regional office in Portsmouth, New Hampshire, because we saw some top franchise talent up in that area.

So results are very good. We are investing more in that and we're getting traction. That's all I can say on that right now.

On transportation, we kind of set early drivers up for ourselves and that's also doing -- we are very happy we entered that market as well. Application volume through the door has exceeded our expectations, but our book volume has not.

And the reason for that is these truck dealerships, when you first bring them on, kind of test you. You don't necessarily get the best credit in the door. In fact, the transportation channel impacted our overall approve rates a little bit, because approve rates were lower in that channel. But we will rectify that as we demonstrate service levels and get the better quality.

They are both very important channels for us. They don't contribute a lot of profitability to 2016, but for our long-term plans they are right on track.

Bob Napoli - *William Blair & Company - Analyst*

Okay. Then having covered Marlin for more than a decade, one thing that you could -- as an investor, you could be confident in was that the Company was going to manage credit. They were not going to make -- the Company was not going to make any big mistakes on the credit side.

With the changes in management, how can investors be confident? Who is the Chief Credit Officer today? How are you managing credit? And how can investors be confident that, while it's great to see accelerating loan growth, that the true downside protection on the credit is still there?

Ed Siciliano - *Marlin Business Services Corp. - Chief Sales Officer & Interim CEO*

We have a very seasoned credit management team. We have four seasoned Vice Presidents that have been with the Company, many of which from the inception.

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I would really point to the results. If anything, I think folks right now would argue that we are being too tight on credit still. 60-day delinquencies dropping 10 basis points year over year to 41 is quite tight and responsible. You also look at -- our volume which grew in the fourth quarter, but approval rates declined.

So we are clearly not -- and we have repeated this on multiple calls, Bob -- going to use credit as the accelerator for the business. That is something that we are steadfast on. We've got the right people in place and the results speak for themselves.

I would also comment on the loan side, look at the loan credit quality results: zero delinquencies again in the past quarter. We are taking a very disciplined and paced approach to that product. I think we've got now three quarters under our belt on the loan side so you are going to start to see us accelerate that product a little bit because we have a lot of confidence in the credit underwriting models.

But I can assure you that companywide that's one of the tenets that will not change for Marlin.

Bob Napoli - *William Blair & Company - Analyst*

Okay. Then I guess would love your view -- dealing with small businesses I think you have a pretty unique view into the economy that maybe we don't get from some other companies. Can you give --? What are your thoughts on the economy? Where do you see strength? Where do you see weakness?

Ed Siciliano - *Marlin Business Services Corp. - Chief Sales Officer & Interim CEO*

I will say a couple things. Taylor, if you want to add, go ahead. Again I must point back to credit quality results.

We do consider ourselves a small bellwether to small businesses in the United States. We take a look at -- we take a hard look at delinquency levels, both 30 and 60 day, and that's performing exceptionally well right now.

We've been asked the question, hey, is any of this oil segment impacting Marlin? Of course, we are not in the petroleum asset categories and we are highly diversified. We're keeping an eye on Texas and states that are maybe impacted by that, but thus far we are not seeing much noise there. But we will watch it very, very closely.

Again, when I say diversified I mean by state, equipment types, SIC code. We just don't have any concentrations. So far, Bob, things are -- we don't see noise in the small business community. We are hoping that continues.

The other thing is, on the demand side, we continue to reach new milestones on applications through the door. We are not approving them all, but it's growing steadily. And, frankly, it should because we've made substantial investments in the business. If we didn't see application volume growing it would be an issue.

Last year we almost eclipsed $1 billion, $990 million through the door. This year we will be well in excess of $1 billion if we are doing our job. So demand is still strong.

Bob Napoli - *William Blair & Company - Analyst*

Okay. Then do you have a target return on equity that we should think about for Marlin to deliver or certainly be a target or that management would be thinking about so investors would have a good idea?

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

Bob, this is Taylor. Generally speaking, you saw where our adjusted ROE was in the quarter. Generally speaking, we would target the mid-teens and north of that although depending on how we implement our strategies. One of the things that we plan on doing or are doing is trying to generate more non-spread income, non-spread income in the form of syndication fees and other kinds of fees from servicing and so on and so forth. So, they are sort of capital-light with the generation of more non-spread income. We haven't -- we aren't baking a lot of that into our future thinking from a tangible point of view, but we do plan to do more of that.

Bob Napoli - *William Blair & Company - Analyst*

Thank you very much.

Operator

(Operator Instructions) Chris York, JMP Securities.

Chris York - *JMP Securities - Analyst*

Good morning, guys, and thanks for taking my questions. One of the biggest residuals to our estimates was the interest income and fee yield, which declined about 50 basis points sequentially, yet the weighted average yield on new leases was up sequentially.

Taylor, you commented in your prepared remarks that there is still headwinds from these repayments, but I'd like to get maybe a little bit more color on your expectation for the future impact to the yield.

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

That's a great question and it's one of the first that I addressed when I came on board. We came out of a cycle in 2010 through 2013 where we had a unique position in the market and we were able to put on business that might have been higher than some of our competitors and so on and so forth. And most of that business has liquidated off but is still liquidating.

As you put new volume on, it's only a fraction of the percent of the total portfolio each month. And so, while we're starting to see a lift in those new business yields, it's not enough just yet to turn the ship on the overall portfolio yield. So we would expect that as we progress through 2016 you have some different dynamics there; you have a little bit of an increase in market rates. We would expect our NIM to begin to flatten out in 2016.

In addition to that we have the working capital Funding Stream product, which has a significantly higher new business yield, which will also help to mitigate that and might turn that ship a little earlier. But we are going in in a conservative manner.

Chris York - *JMP Securities - Analyst*

Yes, that's helpful. So kind of just trending it out, we should expect some potential pressure on the yield, maybe for second quarter see a trough and then expand, clearly depending on Funding Stream?

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

I don't want to give you specific sort of timing of that, but that's the general shape of the curve.

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Chris York - *JMP Securities - Analyst*

Got it, okay. And then maybe, I was hoping if you could give some more color on the demand for new equipment leases, specifically in the month of December and January. Because we noticed that the ELFA January Confidence Index declined significantly month over month and year over year in January.

Ed Siciliano - *Marlin Business Services Corp. - Chief Sales Officer & Interim CEO*

I can comment on that, Chris. Let me give you the quarter breakdown in terms of new originations. In October we did $32.5 million. It was a light November -- it was a very short month with the way the Thanksgiving holiday rolled in -- at $28.1 million.

But we had a December that was exceptionally large. We did over $43 million in lease business and another $2 million in loan business for a total of $45 million. So that beat our monthly high by a lot over our 18-year history.

A little color on January, just starting the new year, January originations were up 20% from a year ago. So the demand has continued. As I was mentioning earlier to Bob, we are not seeing that waning quite yet and we are at all-time highs in applications through the door.

Again, some of that is from the investment that we have made in sales. We've got a larger salesforce that is out there working and bringing in more applications, but we're also seeing demand still strong for our business, for micro-ticket.

Chris York - *JMP Securities - Analyst*

Great, that color is very helpful. Thanks for that.

Operator

Bob Napoli, William Blair.

Bob Napoli - *William Blair & Company - Analyst*

As we think about 2016, do you have -- in the past Marlin has put out some origination targets. Do you have an origination target for 2016 we could think about growth rate or dollar target?

Ed Siciliano - *Marlin Business Services Corp. - Chief Sales Officer & Interim CEO*

We do not, Bob. We have not really given out forward-looking guidance on that. We're just looking for quarter-over-quarter steady growth in both lease and loan. And we hope to see that; we expect to see that.

On the loan side, you might see a little more acceleration on that product so a little color on that. In the fourth quarter we did $3.7 million in new loan originations, but we did $2 million of that in December. And then, as I just mentioned, in January we actually did $2 million in loan again and that tends to be kind of a hangover month in our business.

The reason for that is, again, we've got enough under our belt on the loan side in terms of sales capabilities, our systems, the new technology we put in place, and most importantly, credit underwriting that we felt it prudent to turn up originations a bit. So we started to initiate much larger marketing efforts in terms of direct mail and email and we are seeing great results from that.

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The group, by the way, that we are focused on is a prequalified basis. These are customers that we already have in house that we have credit history on and we are marketing to them and offering them a loan at this point based on some modeling we've done. So we're really expecting that to grow through the year.

Bob Napoli - *William Blair & Company - Analyst*

Now are you planning to hold all of that on the balance sheet or are you going to sell some of it off and retain servicing or -- to generate some fee income and less pressure on the balance sheet? What are your thoughts on managing that business? It sounds like it could ramp pretty substantially.

Ed Siciliano - *Marlin Business Services Corp. - Chief Sales Officer & Interim CEO*

It's a great question, Bob. Initially are putting it on balance sheet and keep the loans in-house going out to our best customers. They are great credits that are in need of working capital and we can command a very good yield on that.

As the year unfolds, you are spot on; we will look to syndicate some of that business. We've aligned ourselves with some syndication partners to sell assets and preserve capital in doing so, as well as mitigate the risk a little bit.

Bob Napoli - *William Blair & Company - Analyst*

What are you seeing on a competitive (multiple speakers)? I'm sorry, go ahead.

I was going to say just to sort of finish that out I think, in keeping with the words I said earlier, any option is a possibility as we have increased volume. Some of it will stay on balance sheet, just like we always have, and some of it could go off balance sheet, Bob.

Bob Napoli - *William Blair & Company - Analyst*

Now what have you seen on a competitive front near broadly? And that product is as well as -- in your historical core business. Obviously were a lot of startups and kind of fintech, so called fintech commercial finance origination businesses; a lot of companies hit that market.

Have you seen --? What are you seeing? Are you seeing any of those companies disappear? Are you seeing that there's a lot of room for new players? Are you seeing any change in a competitive environment broadly outside of that, the Funding Stream product?

Ed Siciliano - *Marlin Business Services Corp. - Chief Sales Officer & Interim CEO*

I will start, Bob. You used the term fintech, and of course, we use it as well. We are the fin part of that. A lot of these companies, as you well know, are technology that are getting into fin. We're a fin that is getting more and using more technology to service our customers.

What we are seeing, frankly, is those alt lenders getting a little more aggressive on the credit side and with pricing. I think they've got some pressures, certainly the public companies do, and with all due respect, we think it's a mistake. We're not taking that approach.

We came out with this product primarily to service our customers and we think it's working exceptionally well for us. It accounts for less than 10% of our overall originations in our 2016 plan, so we're not putting a huge weight toward that. As for those other companies, they are very aggressive out there right now, but we are staying clear. We're not getting in that dogfight.

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Bob Napoli - *William Blair & Company - Analyst*

Great, that's good to hear. It's a marathon, not a sprint, and those that are sprinting today will probably not be here tomorrow or next year.

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

Couldn't agree more, Bob.

Bob Napoli - *William Blair & Company - Analyst*

Thank you.

Operator

(Operator Instructions) Don Destino, Harvest Capital.

Don Destino - *Harvest Capital - Analyst*

Great job on the quarter. I guess I am going to ask kind of a sprinting question, referring back to Bob's last couple questions.

There does seem to be just a tremendous amount of demand on the institutional side for small business, very high-yielding paper. And you guys obviously are -- have a direct origination salesforce and a tremendous amount of credit history which really distinguishes you from all these marketplace lenders that you were referring to in the answer to your last question.

What is the opportunity there to do something more aggressive and to say, look, there's lots of loans that we don't want to make for our balance sheet, but we know that there's lots of people with the risk appetite to want to invest in those loans. So why not provide them with access to our network and raise some outside capital and generate some agency-type income that would be very, very accretive to ROE?

Is that -- I know you are talking about syndications and the like. Is that a bridge too far or is that something that we could see?

Ed Siciliano - *Marlin Business Services Corp. - Chief Sales Officer & Interim CEO*

That's a good question, Don. Clearly, because we're a bank, we have to be prudent in who our partners are and how we do this, and our plans are not to change the demographics and the profile of the assets we put on balance sheet. Many times we pass on assets that are -- if the exposure is to large or if there's some other attribute that doesn't make sense for us given our capital.

And so we will actively be looking or are looking for and have talked to potential partners that we could share the funding with and share the upside on those assets. And so that is definitely -- not only syndications, but certainly some sort of partnering with facilities and things like that; we will be doing that. And you are absolutely right that there are institutional investors out there that are looking for higher return types of business.

So we will generate incremental assets to what our core growth plan is and be [hiding] those off in some form or fashion through syndication and/or partnering.

Don Destino - *Harvest Capital - Analyst*

Great, thank you. I guess while I've got you here, any update on the CEO search?

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Ed Siciliano - *Marlin Business Services Corp. - Chief Sales Officer & Interim CEO*

Sure, Don. Our Board has formed a search committee and has interviewed many good candidates with the help of Korn Ferry. There's some great talent available and interested that would complement the current executive team. Things are progressing and hopefully an announcement will be coming later this quarter.

Don Destino - *Harvest Capital - Analyst*

Great, thank you.

Operator

There are no further questions. Ladies and gentlemen, thank you for participating in today's conference. This does conclude your program and you may all disconnect. Everyone, have a great day.

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