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PRESENTATION

Operator

Greetings, and welcome to the Marlin Business Services Corporation First Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Mr. Lasse Glassen of Addo Investor Relations. Please go ahead.

Lasse Glassen - *ADDO Investor Relations - Managing Director*

Good morning, and thank you for joining us today for Marlin Business Services Corp's 2017 First Quarter Conference Call. On the call today is Jeff Hilzinger, President and Chief Executive Officer; Ed Siciliano, Executive Vice President and Chief Operating Officer; Lou Maslowe, Senior Vice President and Chief Credit Officer; and Taylor Kamp, Senior Vice President and Chief Financial Officer. Before beginning today's call, let me remind you that some of the statements made today will be forward-looking and are made under the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those projected or implied due to a variety of factors. We refer you to Marlin's recent filings with the SEC for a more detailed discussion on the risks that could impact the company's future operating results and financial condition. With that, it's now my pleasure to turn the call over to Marlin's President and CEO, Jeff Hilzinger. Jeff?

Jeff Hilzinger - *Marlin Business Services Corp. - CEO, President and Director*

Thank you, Lasse. Good morning, and thank you, everyone, for joining us to discuss our 2017 first quarter results. I'll begin my comments this morning with an overview of the key highlights from this past quarter, including an update on our Marlin 2.0 initiative that is designed to transform our company from primarily a micro-ticket equipment lessor into a broader provider of credit products and services to small businesses. Ed Siciliano, our Chief Operating Officer, will provide additional remarks on our first quarter operational performance; Lou Maslowe, our Chief Credit Officer, will discuss portfolio performance; and Taylor Kamp, our Chief Financial Officer, will then discuss details about our financial results and business outlook.

Our first quarter represented a great start to 2017, highlighted by excellent new asset production, strong portfolio growth and solid asset quality, along with continued progress on Marlin 2.0 that we expect will help take the company to the next level of growth and profitability. Total origination volume increased more than 49% from a year ago and was an all-time record. This is particularly impressive for a first quarter, which tends to be our seasonally weakest quarter for origination volume. During the quarter, we benefited from continued strong demand in our Equipment Finance business, including a better-than-expected contribution from Horizon Keystone Financial, an acquisition we completed early in the first quarter. Funding Stream, our working capital loan business, continues to gain traction with $13.8 million or 8% of total first quarter origination volume. We also continued to enjoy solid contributions from our newer franchise and transportation finance channels. In total, our investment in leases and loans grew a record $824.9 million, up 18% from a year ago. Importantly, our focus on maintaining disciplined underwriting standards continues to be a top priority and credit quality remained within expectations during the quarter.

In addition to our strong financial and operational performance, we continue to fortify the Marlin management team with the addition of new talent as well as through well-deserved promotions from within the company. Subsequent to the end of the quarter, we announced the hiring of Timothy Bonagura, Michael Stanley and Matthew Manning, a sales team with more than 40 years of combined experience selling credit products and services directly to small businesses. The addition of Tim, Mike and Matt was part of a broader realignment of our sales organization that I will discuss in more detail in a moment. In their new roles, this team, along with other existing Marlin resources, will focus exclusively on offering Marlin's full suite of credit products and services directly to Marlin's existing small business customers.

Also, as part of this realignment, we promoted Mark Scardigli to Senior Vice President and leader of the Indirect Team that will remain focused on originating through our equipment dealers and other important intermediaries. And we also promoted Rick Henderson to First Vice President and leader of the Franchise and Direct Teams. I'm thrilled to have Mark and Rick in these important new roles and know that they, in partnership with Ed Siciliano, will accomplish great things for Marlin.

And finally, during the quarter, we announced the promotion of Kathy McGurk to Vice President and leader of our activities with broker intermediaries. Kathy came to Marlin almost 2 years ago with more than 25 years of experience in strategic planning, sales and new business development, including senior management positions at DLL and Advanta Business Services. Kathy will report to Mark Scardigli and continue to oversee the integration of Horizon Keystone while also continuing to manage Marlin's broker relationships for both our Equipment Finance and Funding Stream products. As with Mark and Rick, I'm grateful to have somebody of Kathy's experience leading this important part of our business.

Overall, I couldn't be more pleased with the world-class team we're assembling at Marlin and I want to thank and congratulate all of our employees for their efforts and strong execution during the quarter. We are very fortunate and I am indeed grateful to have such an engaged workforce that is open to new ways of thinking and extremely committed to our success.

I'd like to now move the discussion to an update on our Marlin 2.0 business transformation initiative. As you may recall, through Marlin 2.0 we expect to drive sustainable 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; and third, improving our operating efficiency by better leveraging fixed cost through scale and through operational improvements to reduce unit processing costs.

I'd like to share with you the progress we've made in each of these areas since our last call.

First, with respect to our strategic market expansion, historically, the company operated primarily as a micro-ticket lessor with a single product and vendor-centric model. At the heart of the Marlin 2.0 strategy is the company's transformation into a broader provider of credit products and services to small businesses. So rather than thinking of ourselves only as a single product micro-ticket lessor, we are now focusing on using multiple products to develop financing solutions for small businesses to help them grow and achieve their American dream.

To this end, we are quite pleased with the continued success of our working capital loan product, Funding Stream. While we are carefully managing the growth of this relatively new product, we continue to believe that Marlin is uniquely positioned to offer this product in a safe and sound manner, given our proven credit models and expertise in underwriting credit products to small businesses. Having said that, first quarter origination volume was a single quarter record and we expect volume to increase modestly throughout the year. In addition, our franchise and transportation finance businesses, which cater to the unique needs of franchisees and transport businesses, made solid contributions in the quarter and we expect activity to continue to increase throughout the remainder of 2017. Along with this current slate of products and services, we are also continuing to evaluate potential new products to further meet the financing needs of our small business customers.

As I've mentioned previously, our expansion activities go beyond organic growth to also include strategic acquisitions. As previously announced, early in 2017, we completed the acquisition of Horizon Keystone Financial to extend our existing Equipment Finance business into new and attractive markets, including office furniture, HVAC and the automotive aftermarket. Further, by providing the Horizon team with access to our technology, marketing resources and low-cost funding platform, we believe that the acquisition will further leverage our existing infrastructure while accelerating

Horizon's future growth prospects. The integration of Horizon has gone well and the Horizon team enjoyed a very productive first quarter, with origination volume exceeding expectations.

In addition to expanding our product offerings, we are also beginning to broaden our go-to-market strategy. Historically, Marlin has viewed its equipment dealers, distributors and manufacturers as its primary customers. An important component of Marlin 2.0 is acknowledging that our addressable customer base also includes our end-user customers. As I noted earlier, during the quarter, we realigned most of our origination resources into 2 teams, with one focused on our traditional indirect or intermediary customers, and the second team focused on our end-user customers. With approximately 350,000 lifetime end-user customers, almost 70,000 active end users and between 2,000 and 3,000 new end-user customers coming into the Marlin system every month, this is no small market for the company.

Like our traditional vendor model, Marlin's end-user strategy begins by providing equipment dealers, distributors and manufacturers with financing solutions to help them sell equipment to their small business customers. But under 2.0, the end user is then assigned to the end-user team, which immediately works with the end user to identify other financing needs they might have. Under this model, the indirect origination team creates a continuous flow of new end-user opportunities for the direct origination team and the direct origination team creates a continuous flow of new vendor opportunities for the indirect origination team. This dynamic creates a symbiotic, self-reinforcing relationship between the 2 teams. This model enables Marlin to present multiple products, including Equipment Finance, franchise finance, working capital and other potential products, directly to our end-user customers, thereby creating an ongoing relationship. Importantly, because we do not pay customer acquisition costs beyond the initial transaction, repeat business significantly lowers the blended customer acquisition costs on our total portfolio. This new model represents a dramatic shift for Marlin and is a critical factor in transitioning the company from a micro-ticket leasing company into a true small business lender. While this new go-to-market strategy is still in its early days, I'm very encouraged by the initial results.

We also made good progress during the quarter on our second key priority, which focuses on leveraging Marlin's capital and fixed costs through growth. Our continued strong origination volume and portfolio growth during the quarter allowed us to reduce our equity to assets ratio from 17.2% from 19.0% in the first quarter last year. To further leverage our capital base and increase return on equity in the future, we also still intend to establish a wholesale credit facility at the holding company level and expect to have this facility in place later this year. In addition, we also remain quite active with our secondary Capital Markets activities. During the quarter, we sold another 2 portfolios with attractive economics and successfully expanded our investor base for future portfolio sales. Along with providing Marlin another source of funding, we view these transactions as a means to optimize our portfolio by more precisely managing its overall size and composition in terms of returns, credit risk and exposure levels to particular customers, industries, geographies and asset classes.

And finally, we also continued to make progress during the quarter in better leveraging the company's fixed cost, as evidenced by our significant increase in origination volume with minimal changes to our production headcount. Our ability to further improve efficiencies and ultimately achieve our efficiency ratio goal of 45% by 2020, hinges on the success of our ongoing process improvement activities. Internal Marlin teams continue to work on process renewal initiatives with the overarching objective of achieving significant improvements in cycle times, quality and overall productivity. While our activities are not expected to be completed until later this year, many of the design team's early findings have been implemented and I'm quite pleased with what we are seeing in terms of the gains in throughput while maintaining current production headcount levels. Even with the record origination volume in recent quarters, many of our production teams are clearly working fewer late nights and weekends, compared to historical periods when we had much lower origination volumes. I look forward to updating you on our continued progress on future calls.

In conclusion, we had a terrific first quarter, as evidenced by our robust origination volume, portfolio growth and stable asset quality, along with excellent progress on our Marlin 2.0 initiatives. Momentum continues to build and puts us on track to achieve our strategic objectives for 2017. I look forward to continued strong execution of our strategy, enhancing our financial and operational performance and driving shareholder value as we move forward.

Before turning the call over to Ed, I'd like to provide some comments on the payment processing matter we first disclosed in our 10-K that was filed last month and then updated in the earnings press release we issued last night. As an FDIC-insured, state-chartered bank, Marlin Business Bank is subject to regular examinations by state and federal banking agencies, including the Federal Reserve and the Utah Department of Financial Institutions. In the course of an examination, we received notice in February 2017 from one of the banking regulators describing preliminary findings in connection with the timing of certain aspects of the payment application processes in effect prior to February 2016 related to the assessment of late fees. We believe that the resolution of this matter will require Marlin to pay restitution to some customers. Our initial estimate of the restitution amount is $4.2 million, which was charged against our first quarter earnings, along with certain related professional fees and costs, for a total first quarter charge of $4.4 million. Furthermore, because we revised our practices in February 2016, we do not believe this matter will have a negative impact on our operations going forward.

Consistent with our 2.0 initiative and the end-user strategy that I discussed previously, I want to emphasize that the company's new management team is fully committed to leading this company into the future with an unwavering commitment to our customers' success. I want to assure you that the senior leadership team and I are moving with a great sense of urgency to further enhance the governance framework and business practices that are in place.

With that, I'd like to now turn the call over to Ed Siciliano, our Chief Operating Officer, to discuss our first quarter operational performance in more detail. Ed?

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

Thank you, Jeff, and good morning, everyone. My comments today will focus on first quarter originations and Capital Markets activities.

First, I would like to briefly discuss a metric that will provide better clarity around Marlin's origination activities. As you may have seen in the first quarter earnings release, we are now reporting 'Total Sourced Originations' in conjunction with the previously reported 'Total New Originations Funded'. With the completion of the Horizon Keystone acquisition in the first quarter, along with our increased Capital Markets activities, a larger portion of our origination activity will not be held on Marlin's balance sheet, but rather referred to other financial institutions for a fee. This has historically been Horizon Keystone's business model, and as a unit of Marlin, we intend to maintain this model, then over time, migrate this business to our balance sheet. In the past, Marlin originated a small amount of referral volume. However, with the addition of Horizon Keystone, it is now a material amount of our overall new asset production. With that in mind, and in the hopes of being as transparent as possible with investors, going forward, we will be reporting both 'Total New Originations Funded' and 'Total Sourced Originations', with the latter including 'Referral Volume'. We believe the reporting of these new line items will more accurately reflect the growth within new originations and as such, will enhance our overall origination reporting.

New originations funded in the first quarter of $146.5 million broke the previous record established last quarter and was up 35% compared to the first quarter last year. Total sourced origination volume of $168.8 million also reached a record level and increased 11% from the prior quarter and 49% from the prior-year period.

Now let's look at our new originations funded during the quarter in more detail. Equipment Finance origination volume declined slightly from the prior quarter due to seasonal factors, but increased 30% from the prior-year period to reach $132.7 million.

Funding Stream, our working capital loan product, continues to gain momentum, as evidenced by first quarter origination volume of $13.8 million. This was up 22% from the prior quarter and more than 2x higher than a year ago. This past quarter, Funding Stream represented 8.2% of total sourced originations, up from 7.5% of total sourced originations funded in the fourth quarter of 2016 and 5.6% in the prior-year period. Due to the short Funding Stream tenors, the portfolio only increased by $3.4 million from the fourth quarter and still represents 2.7% of the total portfolio.

We are also very encouraged to see that the continued growth in Funding Stream also helped increase overall total yield on new originations funded. For the quarter, total yield on new originations funded of 11.86%, was up 36 basis points from the prior quarter and 17 basis points from the first quarter of 2016. The majority of Funding Stream's loans were originated with existing Marlin customers and cross-selling our known customers will remain the focus of our origination efforts. Referral volume was $22.3 million and increased over 4x from the previous quarter. Contributing to this strong growth was the acquisition of Horizon Keystone as well as some larger transactions best suited for a partners' portfolio. While nearly all of Horizon Keystone's volume was syndicated during the quarter, and we will continue to do so in the near future, over time, our intention is to begin putting the Horizon Keystone origination volume on our balance sheet.

While still in its early days, Marlin's process renewal initiative continues to produce promising results. During the quarter, the company processed over 7,000 finance transactions, an increase of 14% over the same period a year ago. We did this without adding any additional processing resources and with notably less friction on the system. As we have mentioned on previous calls, we believe process renewal will continue to have a positive impact on our processing capacity as a result of significant improvements in productivity and streamlining. Added benefits will include improvements in cycle times, service levels and quality.

During the quarter, we completed 2 portfolio sales totaling $7.6 million. This transaction in the first quarter generated an immediate gain on sale of $190,000 that was recorded in "Other Income". Once again, we continue to service the leases that were sold and will recognize servicing fees over the life of the leases.

In closing, we are pleased with our results in the first quarter and now have even more conviction that as we scale the business and continue to add operational improvements, we will realize our goals around growth and ROE, ultimately increasing shareholder value.

With that, I'll turn the call over to our Chief Credit Officer, Lou Maslowe. Lou?

Lou Maslowe - *Marlin Business Services Corp. - CCO and SVP*

Thank you, Ed. And good morning, everyone. I'm pleased to have the opportunity to provide an update on Marlin's portfolio performance. I will also explain the changes we are making to some of the credit metrics that are published in our supplemental quarterly data.

Our 30- and 60-plus day delinquencies were both slightly higher than the prior quarter but they remain consistent with our expectations. It's important to note that delinquency typically rises in the first quarter and the results in the first quarter of 2017 are on par with the first quarter last year. Given the growth in our portfolio, we monitor not only delinquency percentages but other metrics to confirm that there is no evidence of portfolio deterioration. These metrics include analysis of delinquency in terms of number of contracts, vintage analysis, by average credit score of booked portfolio and approval rates. Overall, we are pleased with the stability of the portfolio, as evidenced by the above-mentioned metrics.

Net charge-offs in the first quarter increased to 1.57% of average finance receivables on an annualized basis as compared to 1.40% of AFR in the prior quarter and 1.35% of AFR in the first quarter last year. We anticipate that net charge-offs will increase modestly over time as our high-yielding Funding Stream product grows as a percentage of the total portfolio. Hence, it will be important to monitor separately the performance of the portfolios and this information is disclosed in our supplemental data. Net charge-offs in the leasing portfolio increased by 11 basis points and 14 basis points compared to the fourth quarter of 2016 and the first quarter of 2016, respectively. It should be noted that the 146 basis points of net charge-offs for equipment leasing in Q1 2017 was equal to the average monthly net charge-offs since January 2013, which demonstrates consistent portfolio quality and performance. Funding Stream charge-offs of $294,000 in the quarter represented 5.51% on an annualized basis, which is in line with our expectations for this product and what we view as an acceptable and profitable level. Given the nature of the product and still relatively small portfolio size, Funding Stream results are subject to volatility from 1 quarter to the next, as evidenced by the range of charge-offs over the past 5 quarters from a low of 1.11% to a high of 5.51%.

As you may recall from the fourth quarter earnings call, Taylor mentioned that one of our initiatives during the first quarter of 2017 would be a review of the credit metrics that we disclose in our quarterly supplemental data. As a public company, it is our duty to provide sufficient transparency to Marlin's investors while protecting information that could be proprietary. As part of this process, we have reviewed the credit data disclosed by our publicly-traded competitors and other financial services companies. Overall, we have found that the data currently published by Marlin is in line with the market but we want to let you know of a few changes that we will make. Beginning with this first quarter earnings release, we will add for both our Equipment Finance and Funding Stream businesses -- business lines, non-accrual percentages as well as a risk adjusted net interest margin calculation. Beginning with our second quarter earnings release, we will no longer publish the static pool loss and delinquency by vintage data.

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

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

Thank you, Lou. Marlin delivered a strong first quarter led by record growth in originations, which drove portfolio size to an all-time high, while maintaining credit performance consistent with expectations. Excluding the charge, first quarter net income on an adjusted basis was $4.3 million or $0.34 per diluted share, compared to $3.7 million or $0.29 per diluted share for the first quarter last year.

Our investment in leases and loans grew approximately 4% from last quarter and 18% year-over-year to $825 million, an all-time record. It is important to note that through March 2017, Marlin has originated more than $5.1 billion in loans and leases since its inception.

Excluding the charge, return on equity on an adjusted basis was 10.44%, up 70 basis points from a year ago. The increase in adjusted basis ROE from a year ago was primarily the result of improvements from growth and scale, the contribution of Horizon Keystone and syndication fees. We expect ROE to continue to increase throughout 2017 as the business grows and we better leverage fixed costs through increasing scale and via benefits from process renewal.

For the quarter, net interest margin was 10.91%, 67 basis points lower than a year ago. The decrease in margin percentage from a year ago was primarily driven by the aforementioned reduction in late fees, the decrease in end-of-lease income, the roll-off of higher-yielding assets, growth in lower-yielding Equipment Finance channels and an increase in the company's cost of funds due to the series of Fed rate hikes. There is usually a small time lag between the repricing of new originations and new deposits.

For the quarter, the allowance for credit loss reserves was 1.42% of total finance receivables and 247.1% coverage of 60-day delinquencies. It is important to note that our reserving methodology is very sensitive to small, short-term changes in delinquency and loss emergence.

First quarter other expenses were $19.6 million compared to $12.7 million in the first quarter last year. In addition to the first quarter $4.2 million charge, the increase in other expense from the first quarter last year was due to an increase in salaries and benefits and legal and consulting costs. Legal and consulting costs for the aforementioned charge were approximately $300,000.

The company's efficiency ratio for the first quarter was 76.79% compared to 58.23% in the first quarter last year. Excluding the impact of the charge, the efficiency ratio in the first quarter of 2017 was 59.47%, up seasonally from the previous quarter.

Our capital position remained strong in the quarter with an equity-to-assets ratio of 17.22%, 181 basis points below last year. The continuing decrease in the capital ratio quarter to quarter, while accelerated by the charge, was by design and resulted from strong asset growth.

I am pleased to report that our Board of Directors declared a regular quarterly dividend of $0.14 per share payable on May 18, 2017, to shareholders of record as of May 8, 2017. We remain committed to carefully balancing our growth strategy while continuing to deliver strong returns, robust profitability and value to our shareholders. We will continue to evaluate capital investment alternatives and adjust our capital trajectory as needed with the best interests of our shareholders in mind. The continued development of our syndication capability and continuous monitoring of our capital account allows us to very precisely manage capital.

As communicated earlier, we have introduced new reporting in our supplemental package which better reflects our evolving Marlin 2.0 business model, our credit monitoring activities and our commitment to being transparent to our investors. You should expect that we will continue to evaluate the information we present and tailor it to best measure, monitor and report our progress toward our strategic objectives.

Now, turning to our business outlook. Full year 2017 new originations funded is expected to finish at least 20% above 2016 levels. Credit quality is anticipated to continue to remain within our expected range. Net interest margin is expected to move slightly lower in 2017, with the roll-off of higher-yielding legacy leases and continued growth in lower-yielding Equipment Finance channels partially offset by expected growth in the company's higher-yielding Funding Stream loan business.

And finally, we expect ROE to grow to the low teens on an adjusted basis by the end of the fourth quarter of 2017 as strategic initiatives gain traction and the company continues to improve operating scale.

In conclusion, Marlin's first quarter performance continued a trend of record origination volume, portfolio growth, improving EPS and achievement of strategic goals. This was a strong start to the year and we look forward to attractive growth and profitability in 2017 and beyond. And with that, I will turn the call over to the operator for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Chris York with JMP Securities.

Chris York - *JMP Securities - Analyst*

So I'm looking to get a little bit more color on production. So could you provide, maybe Ed, provide us with the monthly production numbers in the first quarter and then the numbers to date in April and then lastly, the breakout in Transportation and Franchise?

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

Sure, Chris. I'll start with the monthly production. So January was roughly $39 million, it moved to $41 million in February and we had a big March with $52 million. That's on the Equipment Finance side. I don't have Funding Stream, but it was pretty straight line through those 3 months, totaling $13.8 million. Transportation and -- so that was roughly $30 million growth year-over-year, about half of that came from the new investment channels, Transportation and Franchise, that was $17 million between the two channels, Chris, and the other $13 million came from our core channels, which also grew nicely. I think driving some of that growth across all channels was we were able to successfully move our average ticket up, which is something we have been focused on, to basically a 20-year high at $20.4 million. I forget the very last part of your question because the phone is chirping here.

Chris York - *JMP Securities - Analyst*

Yes, no, not a problem. April.

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

So April, I'll talk to you about demand in general, right now, for the first time in many, many years, I think I might have mentioned this on the last call, we're feeling a little bit of a tailwind. Small business confidence is up and demand across all of our channels is up, and we're kind of enjoying that. So our applications through the door have really continued, it's been 18 months now, 18 consecutive months, where applications through the door have increased and that is the case in April as well. So we've still got a little bit of time left in the month today to wrap up. I think as of yesterday, we were at $36 million or $37 million and then we usually have a big close. So we're continuing on the year-over-year substantial growth rate.

Chris York - *JMP Securities - Analyst*

Great. And then just to -- sorry, go ahead, Jeff.

Jeff Hilzinger - *Marlin Business Services Corp. - CEO, President and Director*

I would just say that I think -- so those numbers were all terrific and they're better than we expected. But I think the thing that I'm feeling is there's just -- you can feel the momentum building in the business. It's not like it's just one channel that's performing better than expectations. Whether it's Horizon Keystone, whether it's Transportation, Funding Stream, the core retail business, it's all benefiting, I think, from a lot of things that we've done in the company and I think a lot of macro sort of tailwinds that the business is experiencing now. So all in all, I think it's going to continue and I think it's going to particularly accelerate as we get to the second half of the year.

Chris York - *JMP Securities - Analyst*

That's great. Just to clarify, Ed, so the numbers you provided are on balance sheet originations, or are they now the new metric of sourced originations?

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

Yes, so $39 million, $41 million, $52 million is on balance sheet Equipment Finance. So on balance sheet, you add the $13.8 million for Funding Stream, that totals to the $146 million on balance sheet total.

Chris York - *JMP Securities - Analyst*

Perfect. Okay. And then switching gears, so have you had any updated discussions with your regulators that may have given you any indication that the 15% risk-based capital threshold may be revised in the future?

Jeff Hilzinger - *Marlin Business Services Corp. - CEO, President and Director*

Chris, this is Jeff. So we're -- we've obviously been working through the payment processing issue that we discussed before. That's sort of been our priority on the regulatory front over the last 6 weeks or so. We just -- we had an exam completed out in Salt Lake. We're close to having it completed in the next couple of weeks. So we wanted to let that happen, because we think that the results from that will be fine. And so we've got -- we've made some progress on refining the actual planned change to comm agreement and would hope that we'd be in a position to begin to advance that soon. It's -- there's a lot of dynamics around it at the moment. That's about as comfortable as I am in sort of talking about timing.

Chris York - *JMP Securities - Analyst*

Okay, fair enough. So the weighted average yield was up, the highest, I think, since the third quarter of '13. It appears to be from mix, is that correct? And then are there any other trends that are worth pointing out by product type?

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

Yes, very good question, Chris. I mean, let me just start by saying we're really pleased to have average weighted yield on new originations increase at the same time that we're increasing originations by 35% year-over-year. That really doesn't happen very often in our business. So it's really -- there are a couple of competing factors. One is mix. So we actually expected our first quarter yield to decline about 27 basis points in the first quarter based on what we expected to come in by channels -- by channel mix. But at the same time, we successfully implemented a 25-basis-point price increase generally on average across all channels in the quarter, which held equipment yields on new originations on the Equipment Finance side neutral, as you saw, at about 9.6%, 9.7%. And then add on top of that growing Funding Stream originations. And that's really why we wound up at the highest new origination yields over the past 5 quarters. So we're actually pretty pleased with that.

Chris York - *JMP Securities - Analyst*

Great, yes. The color's helpful. Switching to expenses. So we know there were some onetime expenses in salaries and bennies this quarter. So maybe, Taylor, could you quantify how much of that was onetime, or alternatively, the recurring level of expenses in the quarter?

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

Yes, thanks, Chris. I will do my best. When comparing to prior year, we had some really, I would say, continuing expense relating to senior executives. There was $700,000 year-over-year increase. We had some -- we also are obviously up in volume growth. So we had some commissions. So you would expect those to continue with the business. We did have stock-based and other types of comp come through the quarter. That is about $225,000. That's more of a seasonal expense that only occurs in the first quarter generally. Not all of that was taken in the first quarter. Much of our stock-based comp didn't get valued and priced in until right at the end of the first quarter. So we would expect to see some expense come through in the second quarter for that, probably a like kind amount come through the second quarter. We did have some non-payment processing issued charges come through -- not related to payment processing, some consulting charges, come through for about $100,000. We had some relo expense for some new executives come through in the first quarter. That was relo and temporary and recruiting expense. That was about $200,000. We had a data processing charge in the first quarter, which was about, almost $300,000, $280,000. We have a little bit of an uptick, which is more of a permanent uptick, in our FDIC insurance of $100,000. And then you need to note that, and we announced this in the third quarter, that we're now reporting our insurance product broadly across both revenue and expense. It used to be, up until the third quarter of '15, it used to be recorded basically as one number on the revenue side. And so there was about $300,000 in our expense account in the first quarter that is clearly an overage to the prior year. But that kind of expense will continue going forward.

Chris York - *JMP Securities - Analyst*

That's helpful. A lot in there. And so if I combine, I'll probably have to go back through that in the transcript. But if I combine some of those onetimers or exclude that going forward, then how should I think about the core run rate, because you've got some new hires and the new sales team that should probably drive up some expenses in Q2? And then I think last quarter, we talked about the efficiency ratio getting to maybe a 52% by year-end. So help me think about operating expenses, maybe just on an absolute basis, near term and then maybe efficiency ratio as well.

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

Let me take the second one first. I believe our guidance that it would be in the low 50s or 52, it falls into that category. By the fourth quarter of 2017, still holds true. It's not linear. It's -- we see some, really, the scale benefits and renewal benefits really start to come home to roost right at the -- in the last half of the year, especially in the fourth quarter. The -- I would say that our expense -- you take out the relo and recruiting and the DP expense and the consulting expense, that along with this RSU, some of our RSU expense, which are restricted options expense, you get to more of a consistent run rate. It will fluctuate, because we do have a ramp-up of volume throughout the year. And so that in any variable comp associated with commissions and credit bureaus and things like that, you will see a little bit of an uptick. But if you adjust out those other items, that gets you back to a better run rate for the company. And as Jeff has said, we do expect at the core that Marlin 2.0 will be a growth strategy without a lot of added expense.

Operator

Our next question comes from Brian Hogan with William Blair & Company.

Brian Hogan - *William Blair - Analyst*

First question is on the referral. I think in your comments, you said it's for a fee. So I guess my question is where does that show up and how much is the fee and how should we think about that line going forward?

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

Yes, the fees show up in the other income line. It's not in the NIM. So those are our syndication fees, our referral fees, along with our insurance, all shows up in that line. And so those are -- really, it's just a factor times a balance. So if you're referring $10 million, it's x times $10 million is basically is what the -- how those fees are calculated.

Brian Hogan - *William Blair - Analyst*

And what is the fee rate? I mean, what is the yield? I mean, I guess -- what was it in the quarter. I mean, I can calculate it myself, but...

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

Give me a second.

Brian Hogan - *William Blair - Analyst*

The referral fee income.

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

I mean, it does move around by asset class. Give me a second here. The -- in the quarter, the syndication income and gain on sale in other revenues, you're looking at $1.25 million, something like that. The -- and those, as I said, those factors that are applied to the volume that is basically referred, ranges from 2 points to 7 points on that -- on those. And I would say that Horizon Keystone is a large portion of that from a referral standpoint. And those, I don't want to get into particulars of the pricing on those, but they're at the higher end of that range.

Brian Hogan - *William Blair - Analyst*

Okay. So I guess, I mean, if you said $1.25 million from the syndication and gain on sale, then if that other income was $2 million, the balance, $775,000, was the referral? Is that, the way I'm thinking about it, right? I'm just trying to get a sense of like how to think about this line going forward?

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

Okay, let's -- so if the total other income line was $2 million and let's say syndication income and gain on sale of syndications was about $550,000 of that, the rest of it was pure referral, so that was about $800,000. And so -- yes, the $500,000 should be a continuing number, and then there's some insurance policy fees in there to the tune of about $400,000.

Jeff Hilzinger - *Marlin Business Services Corp. - CEO, President and Director*

So I think about -- Brian, this is Jeff -- I think about $800,000 of it is from either Horizon Keystone or from -- we had a couple of large transactions that we were able to originate and syndicate for a fee. Those, we'll do those as often as they come, but I wouldn't consider them to necessarily be recurring. They're not central to the strategy. They just are -- we're able to accommodate them, given that we've got this Capital Markets capability now. And on the piece that comes from Horizon Keystone, that's going to be shifting over time, because as Ed had said in his comments, we're going to be shifting that volume on balance sheet over the course of the year. And so what will end up happening is, is that the gain on sale, which is less efficient than having it on our balance sheet for its life, will migrate towards interest income over time, really beginning 100% in 2018. So it's -- it could be a little confusing, I know, because we're kind of in a transition with respect to that flow, which we manage purposely that way, because it's critically important that the platform continue to experience the same composite approval rate being part of Marlin as it has been independently, in order to maintain its competitiveness. So we let them continue to sell while we're confirming that as we bring those flows on balance sheet, they'll get the same approval rates that they've gotten before and get the same operational support that their customers are used to getting as well. So we want -- we just want to be very careful and deliberate in the integration process. And that's why we're taking our time here. So it's less about wanting the gain on sale on that volume. We want to put it on balance sheet as quickly as we can without disrupting Horizon Keystone's value proposition to its customer base.

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

Yes, and before you ask the question, I'll try to answer it here. Horizon Keystone was accretive in the first quarter net-net, and that was through, really, a referral strategy. We would expect it to clearly be accretive when we bring it on balance sheet as well. So it's been a very positive acquisition.

Brian Hogan - *William Blair - Analyst*

And the credit quality of those originations? I mean, obviously, it's referral, but I mean -- but you've got to have some indication?

Jeff Hilzinger - *Marlin Business Services Corp. - CEO, President and Director*

Yes, the good news is, Brian, that their partners, their syndication partners are banks. So they're originating pursuant to a set of bank credit boxes, and we've back-run the, certainly, the January and I think maybe even the February origination volume through Marlin's models and the approval rates are comparable. And we're not even giving them the benefit in this back-testing of the -- of personal guarantees, which there's a significant amount, because we don't have the authority to rerun it with personal guarantees, so that's -- those are corp-only approval rates. So I think it's -- I think everybody is feeling good about the fact that Marlin's credit approval box, when it's layered on top of the Horizon Keystone flows, will give them at least the approval rate that they've gotten historically. And in fact, they might actually have an improved approval rate, certainly potentially at the top of the box, given that we still have this Capital Markets capability.

Brian Hogan - *William Blair - Analyst*

I appreciate the measured pace at which you're migrating to on balance sheet there, and the credit clause seems like a nice little transition. Switching gears, syndication volume was less than what I had expected and lower than last quarter. Is it just a function of the markets, I mean, and what to expect for the year?

Jeff Hilzinger - *Marlin Business Services Corp. - CEO, President and Director*

I think the -- we definitely have a budget in terms of the amount that we're assuming we're going to sell and there is an implicit gain on sale that's in the P&L. Having said that, every quarter, what we're selling is really driven by the portion of the portfolio that we think would reside more efficiently on other people's balance sheet. So if the budget says we're going to sell x, we're not necessarily focused on selling just x. We're focusing on selling those assets that make the most sense to be on somebody else's balance sheet. And so I think in this particular quarter, there was -- when we did the sorts to figure out what the pools were that were -- that might make sense to be on somebody else's balance sheet, we just ended up with a little smaller pool than what we had thought when we put the plan together. It's nothing other than that.

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

As the year progresses, Brian, we're going to be trying to over-originate, knowing that we want to syndicate some of this business. It'll bounce a little bit, but I think overall, the objective is, on average, $10 million a quarter.

THOMSON REUTERS

Brian Hogan - *William Blair - Analyst*

All right, appreciate that. Lou, you're -- welcome, one. And then, and two, what are your views of Marlin's credit systems? I mean, what changes do you think that need to be made? And then just your broad views of -- about the credit trends.

Lou Maslowe - *Marlin Business Services Corp. - CCO and SVP*

Yes, well, thank you for the question. Yes, I have to say that in the now almost 4 months that I've been here, I really was very impressed with what I found, both from a really overall risk management perspective, but also importantly, risk culture. The company is really expert at lending to small businesses. The credit models that have been developed and validated over a number of years perform very well. And our underwriting is really very consistent. We've got a veteran team of underwriters and management that really, I have to say, do an excellent job. And I think the results demonstrate that, the consistency that we've seen over the years. They do a great job, or we do a great job, slicing and dicing the portfolio on a monthly and quarterly basis to see what the trends are and to tweak as necessary the models on an ongoing basis. So I think that as we move forward, we're constantly looking to see what improvements we can make to get greater efficiency. So with our scorecards, for example, we put in one change this quarter, in Q1, to raise the auto decision or what we call the instant auto decision rates. In Q2, we'll do another one. We've implemented recently a large ticket scorecard to continue to, again, focus on improving efficiency while maintaining quality. So I think that yes, both from the portfolio analysis perspective and underwriting perspective, Marlin does a great job. In terms of looking forward, you know, we see continued -- all the evidence we have is that the numbers and performance will remain consistent to where we are. As I mentioned in my comments earlier, Funding Stream, which has actually performed better than we anticipated, but we expect a general increase in the overall credit losses as that portfolio becomes a bigger part of the total. But again, we're really pleased with how that is performing and really focused on providing that product to our existing customers. And roughly 80% of the applications that we have in Funding Stream are to existing Marlin customers. So we know those customers. And that's probably a big part of the reason why that portfolio is performing as well as it is. But it's still early, and we're continuing to monitor that very closely. So I would say those were the key points.

Brian Hogan - *William Blair - Analyst*

Sure. Continuing on that credit quality, obviously, the loans loss rate increased in the quarter to 5.5%, thereabouts. What -- is that the appropriate run rate? Do you expect it to go higher? I mean, the yield came down a little bit. What is the appropriate mix there?

Lou Maslowe - *Marlin Business Services Corp. - CCO and SVP*

We actually think that around the 600 basis points is probably where it's going to be in these current economic times. And that gives us a pretty good profitability on the product. But as we've seen, this is the first quarter where we experienced that. And a lot of that was due to, we had one large charge-off in January, and that can happen. That's the nature of the product. Relatively large for Marlin. So -- but to answer your question, yes, I think that we can -- we would expect to see, and our plan is that we would see risk costs along the lines of what we saw in Q1.

Brian Hogan - *William Blair - Analyst*

All right. And then just taking even a step back and looking at the credit quality trends in general and comparing that with actually with yields. You're originating in the lease business, bigger tickets, transportation, hopefully, it's better credit quality, comes with some lower yields. But I mean, the credit quality actually -- charge-offs increased in the quarter. So I'm just going to get a -- trying to balance and even looking at the static pool analysis there, I'm trying to get a grasp of the trends there. Can you help with that?

Lou Maslowe - *Marlin Business Services Corp. - CCO and SVP*

Well, again, I wouldn't consider Q1 on its own a trend. I mean, if you look back -- again, as I said in my statement -- back to beginning of 2013, what we experienced in Q1 is really right in line with the averages. And the charge-offs will fluctuate 18 to 20 basis -- or standard deviation of in the 15 to 20 basis point range. So I think it's too soon to really characterize what we see, particularly on the leasing side, as a trend. We'll just have to monitor that.

Brian Hogan - *William Blair - Analyst*

I guess I'm trying to reconcile your comments about it, you expect credit quality, even charge-offs to increase from here a little bit, I guess.

Lou Maslowe - *Marlin Business Services Corp. - CCO and SVP*

That was for Funding Stream.

Brian Hogan - *William Blair - Analyst*

That was for Funding Stream?

Lou Maslowe - *Marlin Business Services Corp. - CCO and SVP*

That was -- we were talking specifically about Funding Stream, yes. And then, well, the Funding Stream influence on the overall portfolio, but of course, as Funding Stream grows, so will the, I would expect if all else being equal, the yield of the portfolio, because it's a higher-yield business.

Brian Hogan - *William Blair - Analyst*

Right, right. The number of sales personnel in the quarter, normally you have that in your press release. Maybe I missed it, but I didn't see it.

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

Yes, so I mean, Brian, we no longer consider sales headcount as a metric for growth. It was basically completely flat. For the foreseeable future, sales headcount will be flat. Overall headcount in the company increased by 12, but that was purely from the Horizon Keystone acquisition. The only thing that's likely to change going forward in terms of sales headcount is a slight reduction, just through normal attrition on the vendor side, and moving those headcount over to the direct side focused on small business customers directly. So there'll just be no changes going forward, but it's -- sales headcount is not going to drive origination growth on a go-forward basis. We've got a couple of years' headroom here with basically the same sales headcount.

Jeff Hilzinger - *Marlin Business Services Corp. - CEO, President and Director*

I think that's right, for the next couple of years, it's not a linear relationship. I never thought that sales people and origination volume really ever were in a linear relationship. So I think as with everybody else in the company, we're asking people to do more with what we have. And whether that's process renewal on the operations side or sales force effectiveness on the front end, it's all -- there's an expectation that the existing infrastructure will be scaled over the next couple of years.

Brian Hogan - *William Blair - Analyst*

Okay. This is probably a quick one. The tax rate was 24% in the quarter, but 38% going forward, is that thereabouts?

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

Yes, Chris, I would say that it's -- it might be a little less than 38%. This is a permanent change, but we had a catch-up in the -- really, it was a catch-up in the [firm]. And also the quarter has -- this all pertains to the stock comp accounting, and we had a fair amount of stock comp accounting in the quarter. And so really, the difference is that the tax piece is fair valued at vesting. The book piece is fair valued at the grant date, which the grant date would have been the end of March. And so it was, had a big impact on the quarter. But I would expect 36%, 37% tax rate going forward.

Brian Hogan - *William Blair - Analyst*

Okay. Competition. Can you discuss competition and the environment out there? Banks coming back in or your other competitors being rational?

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

Yes, I mean, before I speak to competition directly, Brian, I would say -- and we've mentioned it before, but overall, the environment is very good for us right now, and I think it's good for our industry. So I think all funding sources right now are seeing a slight uptick, based, again, on business confidence or what have you, the economy picking up a little bit. Having -- so everybody is doing a little bit better right now. I think Marlin is doing a little bit better than average, and I think that's because some of the head-to-head competitors we compete with on the indirect space have had a few issues, and we've been able to capture some market share, banks continuing to move up-ticket from our perspective, so we've picked up some market share. And right now, our offering is just very, very solid. I mean, we're feeling extremely competitive in the marketplace right now. I think the sales force is energized. The business is growing, we're moving tickets up. We're adjusting price (inaudible) share. The value proposition is very strong. So we look at competition, but it's really -- we're in such big markets that it's kind of blue sky for us. And that's what you're seeing in terms of origination growth. So we track it. It's a good market. Some of our competitors are weaker than others. But for us, for Marlin, we're just doing quite well right now. I don't know if you'd add anything, Jeff?

Jeff Hilzinger - *Marlin Business Services Corp. - CEO, President and Director*

Yes, I would just -- I mean, Marlin's market share, Brian, is -- I mean, it's a speck. So if we were 3x as big as we are today, we would still be a speck. So it's just such a teeny amount of such a large market that we're clearly taking share, because the industry didn't grow by 49% year-over-year. But having said that, I think the market is so huge that we can -- there's a lot of room for us to take share before we sort of run into competitive issues.

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

And the biggest change, Brian, is taking share from that existing captive base of customers we already have. And that's the pivot point we just made, we're really excited about how big that could be for us in terms of a market, in terms of yields we can get from that business. So we look forward to reporting that over the next few quarters on our progress there.

Jeff Hilzinger - *Marlin Business Services Corp. - CEO, President and Director*

Yes, that's an excellent point. And I agree with that completely, that it's -- the marketing objective here is to try to convince our existing end users that they should do more business with us. That's what we want. And so that -- you're going to see us -- the reorganization of the sales resources is the first of, I think, a whole series of changes that you're going to see over time that are designed to allow that to happen, whether that's more products, whether that's making the sales force more effective, whether that's improving the customer experience through, or the end-user experience, through process renewal. I mean, all these things are geared towards sort of supporting this strategy of becoming the preferred lending source to small businesses in the U.S.

Brian Hogan - *William Blair - Analyst*

Sure. And then I guess, the originations and the market share you're taking today, I mean, the ROE that you're generating on originations today, is that in line with your 15% to 20%? Or what are ROEs today on today's originations?

Jeff Hilzinger - *Marlin Business Services Corp. - CEO, President and Director*

Yes, I don't -- we really don't need an expansion of current yields or NIM to be able to get to the objectives, the ROE objectives that we've set for ourselves. It's as much about leveraging our fixed cost and better utilizing our capital. Those 2 things are just as important as trying to optimize yield or optimize NIM. I think we need to make sure that NIM -- that risk-adjusted NIM is correct. If we get risk -- if we can make sure that risk-adjusted NIM is right, which we talked about on this call a few times, and that's really the partnership between Lou and Ed making sure that we've got that right balance. As long as we've got that and we're growing and leveraging our fixed cost and leveraging our capital, the road is going to take us to our ROE goals.

Operator

(Operator Instructions) There are no further questions at this time. I would like to turn the call back over to Mr. Jeff Hilzinger for closing remarks.

Jeff Hilzinger - *Marlin Business Services Corp. - CEO, President and Director*

Thank you, operator. Thank you, everybody, for your support and for joining us on today's call. As always, we look forward to speaking with you again when we report our 2017 second quarter results at the end of July. Thank you very much.

Operator

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