Watchlist Investing Newsletter

Patiently finding and following great public companies to own at the right price.

Issue #21 | November / December 2022

"One person said to me, 'I have a list of 300 potentially attractive stocks, and I constantly watch them, waiting for just one of them to become cheap enough to buy.' Well, that's a reasonable thing to do. But how many people have that kind of discipline? Not one in 100."
– Charlie Munger

In this issue:

Companies in this issue: Hingham Institution for Savings (HIFS), Triumph Financial (TFIN)

Deep Dive

Triumph Financial
(Ticker: TFIN | Disclosure: Long)

TFIN first came on my radar earlier this year in a top banks listing in *Bank Director* magazine. I've since had the good fortune to speak to someone more familiar with TFIN's history and management, which helped me see through some of the fog of my initial peek under the hood.

Usually, the words entrepreneurial and banking don't go well together – even though, paradoxically, every bank came from the mind of *someone* hanging out a shingle. The problem with eager bankers is a tendency to overdo it: whether in accepting credit risk they were unable to properly assess/price, or getting into areas outside of their core competency, or growing too fast. And sometimes all three. Good bankers recognize the Sword of Damocles over their head that is a highly leveraged balance sheet. One wrong twitch and you're gone.

If I am to eat any words in the future, here they are: TFIN is different. It's a bank, yes. But it's also a startup trying to modernize a very fragmented and old system of trucking payments. TFIN as it is situated today is a combination of community bank, transportation factoring company, and payments network. TFIN's history is relatively short, and it has taken some time to determine where it was going. Today it's squarely focused on modernizing transportation payments. I like that management has both entrepreneurial tendencies and a healthy fear of losing money. I also like that at today's price one is only paying for TFIN's legacy businesses.

In short, TFIN is a well-run banking operation with an interesting startup business that, if successful, could revolutionize a multi-billion-dollar industry. It deserves a spot on the Watchlist.

INDUSTRY OVERVIEW & BUSINESS MODEL:

TFIN competes in three different areas of financial services:

1. Community banking
2. Factoring
3. Payments

Community Banking:

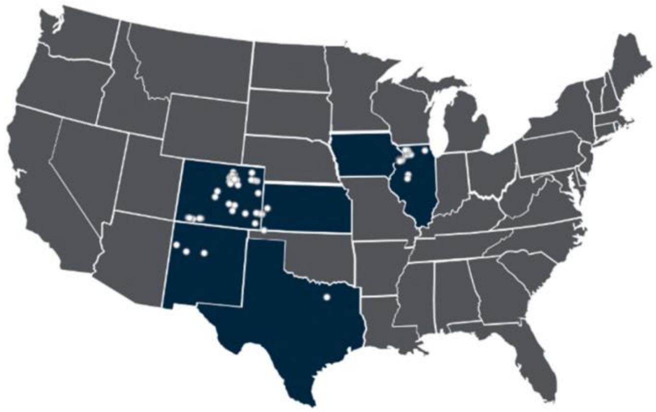
The banking business in the United States is huge. TFIN's $4.4 billion in deposits pale in comparison to the roughly $20,000 billion ($20 trillion) in US banks today. The term monopolistic competition certainly applies here. Smaller participants like TFIN are market-takers that buy money at one price (paying interest on deposits) and sell it to others (lending to consumers and/or businesses). Even industry behemoths JP Morgan, Bank of America, Wells Fargo, Citigroup, and US Bank, with half of all banking assets in the United States, have questionable influence on the market price for money. The key, then, is operating efficiently and having loan losses appropriate to the types of credits being underwritten, something TFIN appears to do well.

TFIN's community banking arm spans three disparate geographies with 63 branches. First is its mid-western division with ten branches in the Quad Cities area of Iowa (Davenport and Bettendorf) and Illinois (Rock Island, Moline, and East Moline).[1] The division has seven other branches in Iowa and Illinois for a total of 17. TFIN's operations here stem from its 2013 acquisition of THE National Bank. The western division consists of 31 branches in central and eastern Colorado plus two branches in western Kansas. These came to TFIN through its 2016 acquisition of ColoEast Bancshares. Finally, its mountain division consists of seven branches in southern Colorado and three branches in New Mexico. These came from its 2017 acquisition of Valley Bank & Trust and its 2018 acquisitions of First Bancorp of Durango and Southern Colorado Corp. TFIN also has one branch in its headquarters city of Dallas.

These three divisions largely operate in the traditional "boring" business of collecting low-cost deposits and lending them out to a diverse group of consumer and business customers. Business loans also include secured equipment loans in the transportation, construction, and waste industries. These categories were deliberately chosen because of their essential nature and the ease with which collateral can generally be resold if necessary and are a part of TFIN's transportation focus.

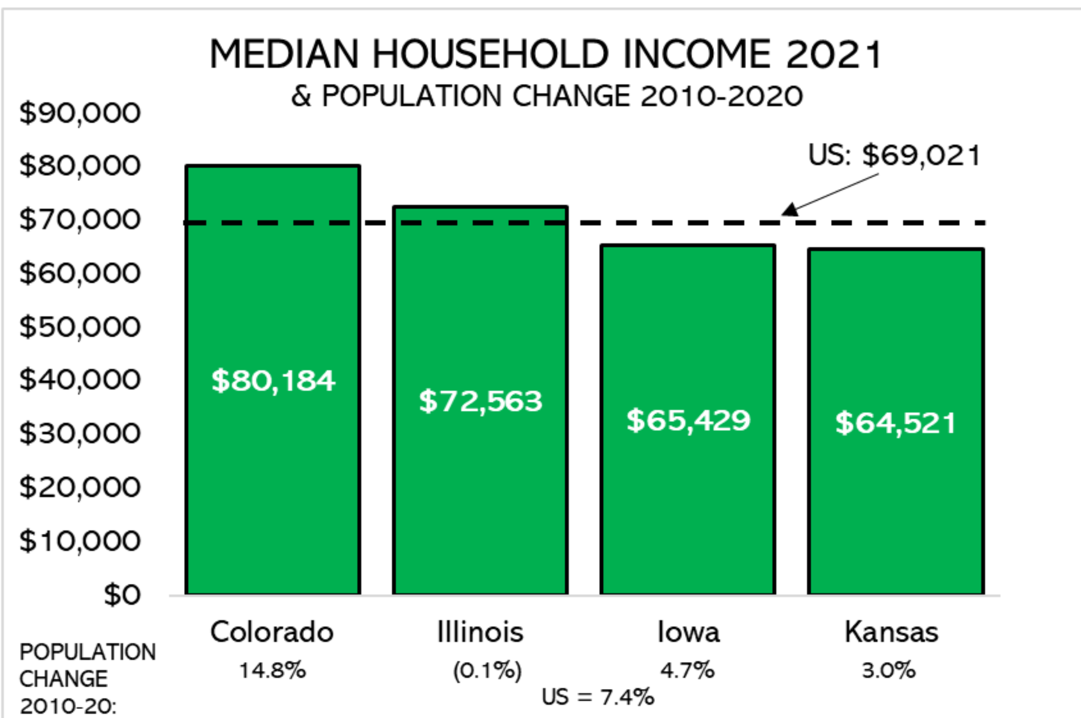
The question is: why three non-contiguous community banking operations? The answer has less to do with creating any economies of scale in community banking than it does with serving as a source of stable earnings and low-cost funding for TFIN's other operations. Moreover, the acquisitions came to TFIN opportunistically, in some cases with TFIN taking over troubled institutions from the FDIC.

[1] I'm counting five, not four cities. I couldn't find a definitive history. East Moline was incorporated after Moline, so maybe it was considered part of its parent, I don't know for sure. Not a rabbit hole I can chase today.



TFIN Branches

TFIN operates in more secondary cities and rural areas than the larger regional or money center banks. I'd consider TFIN's western branches to have the most potential. Colorado in particular features higher-than-average household income and is growing its population at nearly double the national average.



Factoring:

Factoring is a business that provides companies with quick capital by buying their invoices at a discount. The types of companies that need to do this are usually smaller and undercapitalized, such as those in the trucking industry in which TFIN focuses.

Truckers have many upfront costs such as labor and fuel but might not get paid for 30 to 60 days. A factoring company steps in and takes a haircut off the original invoice amount (typically between 1% and 5%) in exchange for waiting to be paid. In most cases this is an outright sale of the receivable with no recourse back to the original owner of the invoice should collection prove difficult. That means TFIN faces two kinds of risks.

The main risk is fraud. A trucker might be short on cash and decide to present a doctored invoice without having delivered a service. The second, lesser type of risk is counterparty credit risk. Credit losses are generally very low (<1%) as invoice amounts are small and the counterparties usually larger, reputable companies.

As of 2021, 90% of TFIN's factoring portfolio was in the transportation industry. With an average invoice size of approximately $2,000 and a largely paper (including scanned or photos) system of tracking loads, it is a very labor-intensive process. That upfront discount fee might annualize to 20% or more but it is necessary to pay for all the labor that goes into making sure an invoice is legitimate and tracking it from presentation to ultimate collection. It is this very cost structure and friction that led TFIN to invest in technology to streamline the process for all industry participants.

TFIN estimates that roughly half of the $800 billion trucking industry could be served by factors. Today over 250,000 long-haul truckers serve 10,000 logistics companies with almost 400 factors providing financial support to them.

The top 10 factors control 65% of the market and the top 20 control 75%. The remainder of the market is split between 365 other factors. According to TFIN, the largest factor, with a 20% share, is Ryan Transportation Services. RTS is a subsidiary of Pilot Flying J the soon-to-be Berkshire Hathaway-owned truck stop company. TFIN has a 15% share. Next is Apex at about 7.5% followed by Love (another truck stop company) at around 3.5%. You can see a clear power-law effect here. TFIN maintains that RTS and Love are more interested in the truck stop / fuel relationship. Additionally, these companies don't want to own a bank and be subject to bank holding company rules.

TFIN is already much more efficient than other factors. Its net funds employed (NFE) per employee, an industry term, is $3 million compared to the industry average of $1.5 million.[2]

Importantly, the funding for factored receivables comes from the community bank, which holds the receivables on its balance sheet. The business is best thought of as a lending segment within the context of a loan portfolio. As a bank, TFIN doesn't face single carrier or broker

[2] Source: 3Q2021 conference call.

concentration limits like other factors that in turn rely on a money center bank for funding of their factored receivables portfolio.

The factoring segment also generates noninterest income in the form of fuel advances, wire fees, and other ancillary services. Transportation invoice factoring is clearly tied to overall economic activity but not in a neat linear way. Average invoice sizes and volumes decline in recessionary environments but other dynamics can come into play, such as money center banks shutting off financing to carriers that must then turn to factoring to finance their operations. Factoring also dips ~6% in the first quarter of the year as truckers take time off for the holidays, followed by low double-digit increases in the second quarter as activity resumes.

Payments:

TFIN's payments business, TriumphPay, stemmed from its involvement in factoring transportation invoices. It realized the huge potential to serve an essential industry still using antiquated methods. With three to four or more parties involved in any given transaction (shippers, brokers, carriers, factors, and receiving parties) and each with their own methods of processing paperwork, on top of small invoice sizes, TFIN estimated that 13 percentage points of its yield was necessary just to breakeven.

Adapting Jeff Bezos's famous remark to banking: that yield is TFIN's opportunity. By creating a platform that all parties can access, with structured data that all can see, and opening it up to all parties including other factoring companies, TFIN stands to eliminate a huge amount of waste and share the resulting efficiencies with everyone in the value chain. The process of integrating TPay into freight brokers and factors is time consuming and invasive, sometimes taking up to nine months to complete. However, once integrated transactions become as easy as tapping a credit card to purchase an item at the store: simple and nearly instantaneous.

TFIN earns transaction fees and interest income on factored receivables (including offering brokers extended payments options). While TriumphPay isn't yet at breakeven, sitting in the middle of a huge payments ecosystem can be hugely profitable. Just ask Visa, Mastercard, American Express, and others.

TFIN HISTORY[3]:

TFIN is the brainchild of founder, Aaron Graft. Graft and a group of investors acquired a failed bank from the FDIC in 2010, recapitalized it, and used it as a platform to acquire other banks and financial companies. The bank went through what I'd describe as a period of soul searching, looking for a model that would create significant shareholder value. The most basic model paired the low-cost funding source of bank deposits with higher-yielding assets such as factoring. Along the way it got into other business lines, such as healthcare finance and asset management. Those businesses were jettisoned to focus on transportation factoring and then the related payments business that seeks to disrupt the transportation industry by significantly reducing friction and costs.

[3] History source: Company website.

2010: In November, Triumph acquires Equity Bank, a failed Texas state savings bank. Triumph, as the bank's new owner injects $35 million of fresh capital into the bank but remains under an FDIC cease and desist order for one year until it cleans up its balance sheet.

2012: In January, acquires Advance Business Capital and enters the transportation factoring business as Triumph Business Capital

In May, launches Triumph Commercial Finance to enter the asset-based lending and equipment financing business

2013: In March, launches Triumph Capital Advisors to generate fee income originating and managing collateralized loan obligations (CLOs)

In October, acquires THE National Bank operating in the Quad Cities area of Illinois and Iowa, eventually rebranding as Triumph Community Bank

2014: In June, acquires Doral Healthcare Finance, which is rebranded Triumph Healthcare Finance

In September, launches Triumph Insurance Group, focusing on the transportation and equipment industry

In November, TFIN goes public on NASDAQ, raising $84 million

2015: In September, launches Triumph Premium Finance, providing financing of property/casualty insurance premiums

In October, merges Triumph Community Bank into Triumph Savings Bank forming TFIN Bank SSB

2016: Acquires Doral Money, Inc. for $136 million, expanding its collateralized loan obligations (CLO) business

Acquires Southern Transportation Company (insurance) for $2.1 million

Acquires ColoEast Bancshares, a community bank in Colorado, for $70 million

2017: Acquires Valley National Bank, another Colorado community bank, for $40 million

Sells Triumph Capital advisors for $23 million

2018: Acquires First Bancorp of Durango, Colorado, for $135 million and Southern Colorado Corp. for $13 million

Acquires Interstate Capital Corp (factoring) for $180 million

Sells Triumph Healthcare for $74 million

2020: Acquires Transportation Factoring Solutions for $108 million

2021: Acquires Hubtran, a provider of automation and back-office software for the transportation industry, for $97 million

2022: Announces a $50 million share repurchase program in May

Announces a new $100 million share repurchase program in October

Changes its name from Triumph Bancorp (TBK) to Triumph Financial (TFIN)

MANAGEMENT/OWNERSHIP:

Aaron P. Graft (Founder, Vice Chairman, CEO, 45): Graft founded TFIN in 2010. Prior to that he founded Triumph Land & Capital Management in 2006, which sought to buy distressed real estate. He has a law degree from Baylor University and worked for a law firm doing distressed loan workouts.

Graft's roots in banking are deeper than at first blush. He serves as Chairman of The Bank of the West in Thomas, Oklahoma. I found this a bit odd and did some digging. Turns out his father and a group of investors purchased the failed bank in 1984. Hmm…I see a pattern… The now $167 million bank generates a consistent ~2% ROA, proving size is not an impediment to great returns in banking.[4] TFIN paid Graft a base salary of $700,000 in 2022 and he has various performance goals. His total compensation in 2021 was $2.4 million.

Carlos M. Sepulveda, Jr (Chairman, 65): Sepulveda is retired as president and CEO of Interstate Batteries. Sepulveda was an early investor and has been a mentor to Graft dating to the early 2000s.

Charles A. Anderson (Co-Founder, Director, 61): Anderson cofounded Bandera Ventures, which focuses on distressed real estate acquisitions and development.

W. Bradley Voss (EVP, CFO, 47): Chief Financial Officer since 2021. Has held various financial roles at TFIN since 2012. Prior to TFIN he worked at CSG Investments, which is an affiliate of Beal Bank. (If you're not familiar with Andy Beal, here's a nice Forbes article from 2009.)

In terms of ownership, insiders own 5.3% of commons shares and 2.7% of preferred shares. Sepulveda is the largest insider owner at 1.41% followed by Graft at 1.10%. Major institutional owners include: Blackrock (14%), Vanguard (8.2%), Luxor Capital (7.8%), and Wellington Management (5.5%).

[4] Here's an interesting 2011 interview with Bank of the West president, Matt Jackson, and his assistant, Linda Christensen, who was at the bank when the FDIC took over.

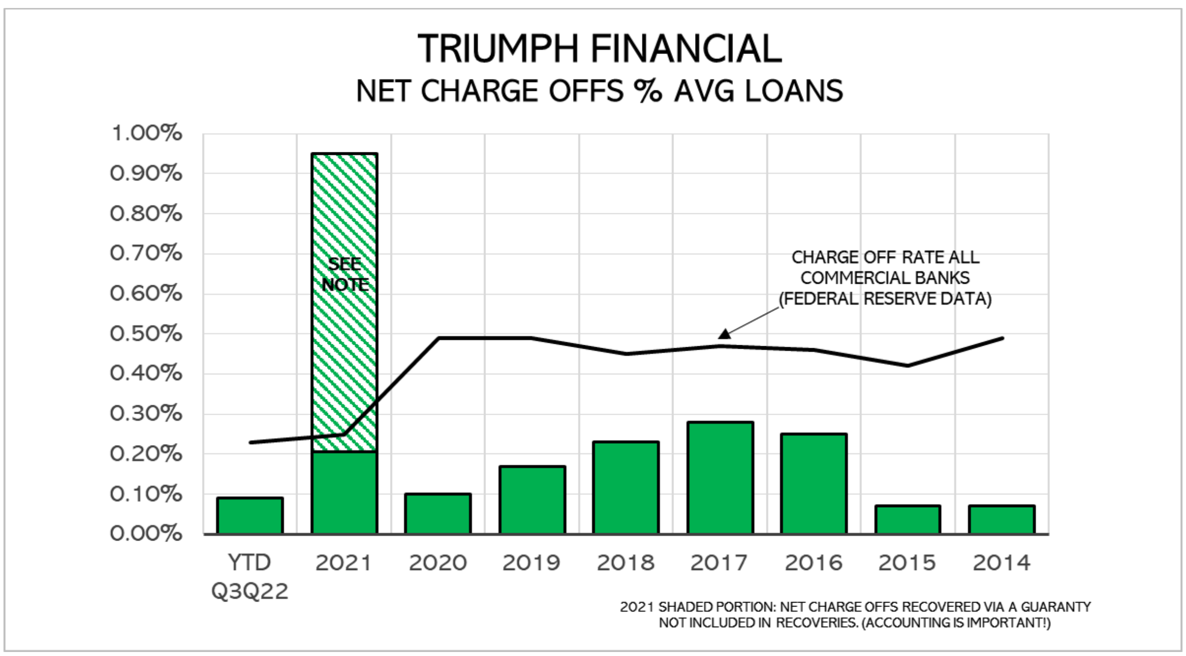
KEY VARIABLES-METRICS:

A well-run bank does two things: It focuses on keeping overhead and loan losses low[5]. These are really the two primary drivers that feed into return on assets. TFIN is a bit different than a traditional bank but I think it would be straying too far to say that it shouldn't be viewed from these lenses (at least not yet).

Key Metric # 1: What is the history of actual loan losses?

Actual loan losses (as compared to reserves) are all-important. TFIN's history isn't long enough to make a definitive statement about a trend extending into the future, though I generally like what I see. Qualitative factors like management's statements on credit risk and shrinking the loan book during a period in which growth could easily have been achieved gives me clues.

Two things stand out in the table below. One is the spike in charge-offs in 2021. That was management touching the proverbial hot stove. A $41.3 million portfolio of over-formula advances was determined to be uncollectible. On the plus side, the bank had a guarantee from the seller that ultimately recovered $35.6 million. Demonstrating just how important it is to understand accounting, the guaranteed portion was not booked as a credit recovery but as an indemnification asset that was subsequently collected. The economics were the same as a recovery but the accounting meant it skewed the charge-off ratio higher. Even with the remaining bump in 2021, a trend might be observed from 2016/17 to today of improving credit, though as noted above, the timeframe was one of better credit quality and not long enough to say for sure.

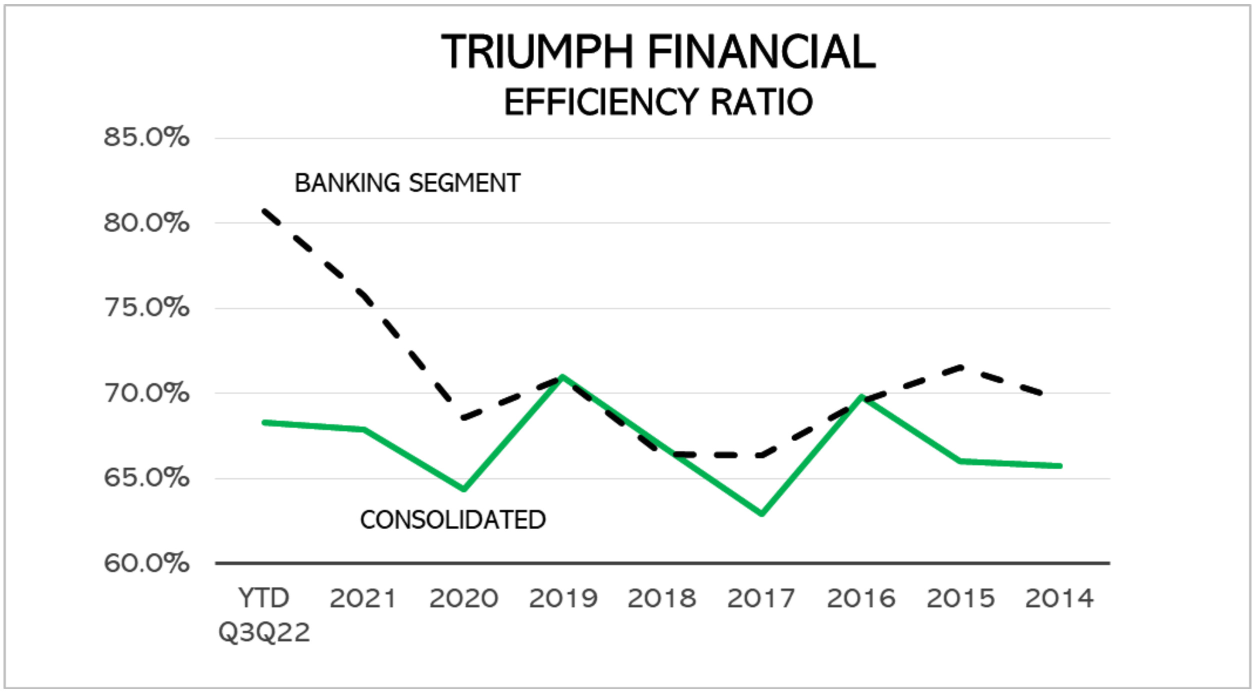


[5] To put a finer point on this, "low" means in relation to expected losses for the type of business in which the institution is engaged. A subprime auto lender is going to have much higher losses than a low-LTV single-family home lender, but both can be good businesses.

Key Metric # 2: Efficiency

Not all banks can have efficiency ratios in the 20s like **Hingham Institution for Savings (HIFS | Disclosure: Long)**. Business models within banking differ. But efficiency is important. TFIN's consolidated efficiency ratio fluctuated between 65% and 70% since 2014. Growth spending on TriumphPay is keeping the ratio higher than it otherwise would be.

The deterioration in the banking segment over the last few years is a direct result of the decision to tighten credit standards. A shrinking loan book with overhead that doesn't adjust as quickly will generate less interest income and cause a poorer efficiency ratio.



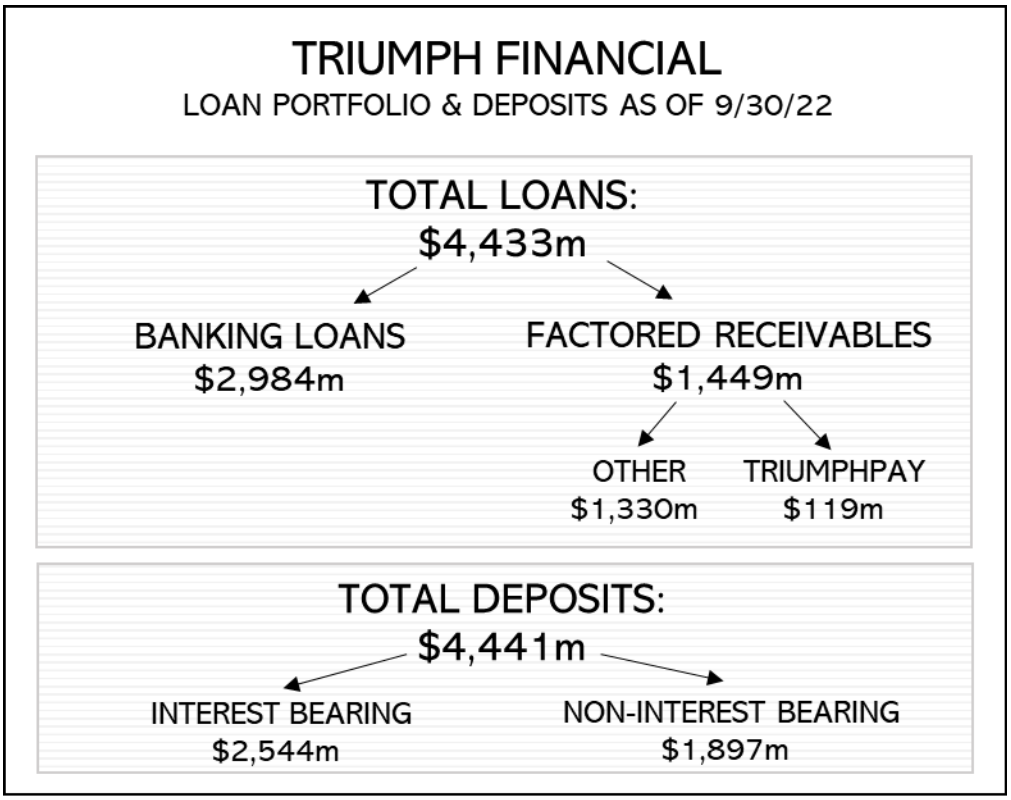
Key Metric # 3: TriumphPay volume

Normally the first two metrics would be sufficient to tell most of the story of a bank. TriumphPay requires another key metric. Okay, I've cheated and thrown in one *table* with a few metrics. The term conforming means the transactions use structured data and all parties are on the TriumphPay system. These are the low-cost transactions that benefit all parties. While early, growth in overall volume and conforming transactions are encouraging.

TFIN management's focus is on getting total payment volume to the $75 billion annual threshold it believes will result in the segment showing a profit. Annualized volume is currently in the $25 billion range. Expectations are for annualized volume to hit the $75 billion mark in 2024.

TriumphPay	Sep 30, 2022	Jun 30, 2022	Mar 31, 2022	Dec 31, 2021	Sep 30, 2021
Invoice volume (#)	4,676,249	4,388,711	3,978,174	4,027,680	3,760,948
Payment volume (000s)	$5,951,706	$6,033,898	$5,700,849	$5,242,051	$4,191,424
Conforming invoice volume (#)	144,253	118,580	52,182		
Conforming payment volume (000s)	$288,410	$253,312	$129,569		
Conforming invoice % total	3.1%	2.7%	1.3%		
Conforming payment % total	4.8%	4.2%	2.3%		

TFIN FINANCIAL ANALYSIS:



- At TFIN's core is a $4.4 billion loan portfolio supported by a deposit base of the same magnitude.

- The loan book can be broken down into two major components: Banking loans and factored receivables. Banking loans are the more traditional community bank lending activities that include real estate, commercial and industrial and asset-based lending, plus a mortgage warehouse business. Virtually the entire loan portfolio is comprised of business loans with just $11 million in consumer loans.

- One-third of the total loan book is a portfolio of factored receivables concentrated in the transportation (primarily trucking) industry. This portfolio can be further delineated between the factored receivables originated under TriumphPay, TFIN's payments network. It's important to view TFIN's loans in this way to understand its earning power, which is discussed below.

- The table below from the 2021 annual report tells a good story. We see the average balance of each of the loan segments and their yields. Banking yields are the lowest but require less overhead to support compared to factored receivables. Both factoring and payments consist of factored receivables, however, the yield on payments is lower for a few reasons. One is because of QuickPay revenue sharing with brokers. Additionally, receivables originated on the TriumphPay network carry less fraud risk and lower servicing costs. These savings can be passed along to those using the TPay system while maintaining similar economics.

The following table presents loan yields earned on our loan portfolios:

	For the Years Ended December 31,		
(Dollars in thousands)	2021	2020	2019
Average Banking loans	$3,410,732	$3,690,727	$3,249,046
Average Factoring receivables	1,302,702	733,687	574,977
Average Payments receivables	109,176	41,477	8,216
Average total loans	$4,822,610	$4,465,891	$3,832,239
Banking yield	5.38%	5.37%	6.02%
Factoring yield	14.26%	14.99%	17.40%
Payments Yield	11.08%	10.79%	14.78%
Total loan yield	7.91%	7.00%	7.75%

- Supporting loans are a base of interest-bearing deposits (57% of total deposits) that include demand deposits, savings, money market, and time deposits. Nothing out of the ordinary. TFIN has a nice base (43%) of non-interest-bearing deposits that bring its total cost of funds to 0.42% as of 3Q22.

Banking Segment:

The table below provides a high-level overview of the community banking segment. It's somewhat imperfect because total assets include assets eliminated in consolidation. Using total assets to calculate ratios understates the economics while using just loans slightly overstates it. I've chosen to use loans to calculate the ratios since it excludes all factoring loans, which are examined separately. The exact figures aren't as important as the trends.

- Looking at assets and loans we can see the significant level of growth since 2014. A large part of this is due to acquisitions. My mind typically goes to asset quality first. Loan loss reserves in 2020 were higher due to the pandemic and some of those reserves were released in 2021. I like the trend and magnitude of charge-offs (a better indication of asset quality, in my view), although it's important to remember this has been a period of better credit quality industry-wide.

- Over the last year TFIN tightened credit standards and allowed the loan book to shrink 18%. The table below examines the banking segment loan book in more detail, with equipment and asset-based lending the other two loan classes experiencing growth in 2021.

- Of note, liquid credit is simply another name for syndicated national credits aka leveraged loans. According to TFIN, the team managing the leveraged loans are incented to keep credit quality high and its portfolio of leveraged loans contain protective covenants. A related note is appropriate here: the team managing the CLO securities portfolio participates in bank credit committee discussions to bring their expertise and broader vantage point to the table.

(Dollars in thousands)	December 31, 2021	December 31, 2020	$ Change	% Change
Banking				
Commercial real estate	$ 632,775	$ 779,158	$(146,383)	(18.8)%
Construction, land development, land	123,464	219,647	(96,183)	(43.8)%
1-4 family residential	123,115	157,147	(34,032)	(21.7)%
Farmland	77,394	103,685	(26,291)	(25.4)%
Commercial — General	295,662	340,850	(45,188)	(13.3)%
Commercial — Paycheck Protection Program	27,197	189,857	(162,660)	(85.7)%
Commercial — Agriculture	70,127	94,572	(24,445)	(25.8)%
Commercial — Equipment	621,437	573,163	48,274	8.4%
Commercial — Asset-based lending	281,659	180,488	101,171	56.1%
Commercial — Liquid Credit	134,347	184,027	(49,680)	(27.0)%
Consumer	10,885	15,838	(4,953)	(31.3)%
Mortgage Warehouse	769,973	1,037,574	(267,601)	(25.8)%
Total banking loans	$3,168,035	$3,876,006	$(707,971)	(18.3)%

- The bank is probably carrying higher overhead in 2022 as its assets shrink. Again, while the magnitude might be slightly off, I'd expect noninterest expense to adjust to historical levels of about 4.25% of average loans, absent any structural change in lending lines.

- Looking at its historical record the banking segment appears to have a current earning power of about $50 million per year. Averaging 2020 and 2021 adjusted operating income we come to $61 million per year, but that's on a higher base of loans/assets. I think $50 million is on the safe side.

Banking Segment ($ millions)	Q3Q22	2021	2020	2019	2018	2017	2016	2015	2014	2013
Total assets	$5,162	$5,569	$5,792	$4,976	$4,458	$3,444	$2,589	$1,601	$1,210	
Total banking loans	$2,984	$3,168	$3,876	$3,575	$2,991	$2,436	$1,789	$1,077	$825	
Total interest income	138	190	208	211	171	130	91	66	60	25
Intersegment interest allocation	7	10	13	12	20	8	5	3	4	2
Interest expense, net	8	10	30	49	30	16	10	7	5	4
Net interest income	137	190	191	173	161	122	86	62	58	24
Loan loss provision	3	(19)	20	5	12	9	6	3	4	3
Gain on sale of subsidiary	0	0	10	0	1	0	0	0	13	0
Noninterest income	34	33	29	27	18	14	9	10	9	3
Noninterest expense	139	169	151	142	119	91	66	51	47	18
Operating income	31	73	59	53	49	37	23	17	29	6
- Gain on sale	0	0	(10)	0	(1)	0	0	0	(13)	0
Adjusted operating income	**31**	**73**	**49**	**53**	**48**	**37**	**23**	**17**	**16**	**6**
Net charge offs	0.4	0.0	1.6	4.5	6.2	4.6	3.3	0.3	0.7	1.7
Net charge offs % loans	0.01%	0.00%	0.04%	0.14%	0.23%	0.22%	0.23%	0.03%		
Ratios to average banking loans:										
Interest income	6.28%	5.68%	5.93%	6.76%	7.04%	6.56%	6.66%	7.25%		
Interest expense	0.33%	0.29%	0.80%	1.49%	1.10%	0.77%	0.69%	0.73%		
Net interest income	5.96%	5.39%	5.12%	5.28%	5.94%	5.79%	5.97%	6.52%		
Non interest income	1.50%	0.95%	0.79%	0.82%	0.68%	0.68%	0.63%	1.01%		
Non interest expense	6.01%	4.80%	4.06%	4.32%	4.40%	4.29%	4.59%	5.39%		
Adjusted operating income	1.32%	2.08%	1.31%	1.61%	1.77%	1.73%	1.58%	1.81%		
	3Q22 annualized									

Factoring Segment (ex. TriumphPay):

The factoring portfolio represents factored loans originated under Triumph Business Capital outside of the TriumphPay network. Factoring has been TFIN's growth engine, growing from an $8 million revenue business in 2014 to over $100 million in 2021.

- A key driver of the factoring segment is volume. Purchase volumes (# invoices) has risen at a 24% CAGR since 2016 as a result of organic growth efforts and acquisitions. That has driven a 36% CAGR in dollar volume purchases over the same period of time, with the difference being an increase in the average invoice size.

- Transportation invoices make up 90% of the factoring portfolio. The average invoice size in that category has risen from $1,470 in 2017 to $2,213 in 3Q22. The company and analysts seem to spend a lot more time than necessary focusing on the factors that drive transportation invoice sizes over the short run. These aren't unimportant, but I don't think they provide value to an examination of the long-term outlook of this business for TFIN.

- Trucking is a basic business that, over the long term, will compete with other forms of freight transportation. In my view, the more relevant factors would be the share of truck freight compared to substitutes such as rail and the degree of concentration in the industry (larger, more well-capitalized carriers don't require factoring as a source of financing).

- Factoring yield and charge off rates jump out of the table as being somewhat incongruous if you're looking at TFIN through the lens of an ordinary banking profile. That's because the yield is driven by the higher cost structure needed to process a high number of lower dollar invoices.

- The jump in charge-offs in 2021 is a result of the charge off of a portion of a purchased portfolio noted in the key variables section. Adjusting for the recovery accounted elsewhere the charge-off rate was closer to the historical average.

- Volume in 2022 declined because of lower freight volumes and spot rates. Absent a significant reversal of the growth trend the business should continue to earn north of $100 million.

- Of note, included in the factored portfolio is $19.4 million of assets currently in litigation with the USPS. This Misdirected Payments asset is carried unimpaired and represents invoices the USPS should have paid TFIN as factor. It instead remitted payment to the original vendor, a mail hauler, who did not turn the payment over to TFIN.

Factoring Segment ($ millions)	YTD Q3Q22	2021	2020	2019	2018	2017	2016	2015	2014
Accounts receivable purchased	$11,665	$13,125	$7,135	$5,675	$5,120	$2,766	$1,828	$1,625	$1,413
Factored receivable period end balance	1,330	1,546	1,037	573	589	346	213	187	170
Number of invoices purchased (000s)	5,011	5,795	3,909	3,452	2,897	1,810	1,401		
Average invoice size	$2,328	$2,265	$1,825	$1,644	$1,767	$1,528	$1,305	$1,465	$1,678
Average transportation invoice size	$2,213	$2,152	$1,682	$1,508	$1,662	$1,460	nm		
Yield on average receivable balance	14.2%	14.3%	15.0%	17.4%	18.4%	17.1%	17.7%		
YTD charge-off rate	0.19%	3.49%	0.42%	0.40%	0.37%	0.41%	0.32%		
Interest income	162	186	109	98	90	45	33	32	27
Intersegment interest allocation	(6)	(10)	(12)	(11)	(20)	(8)	(5)	(3)	(4)
Interest expense	0	0	0	0	0	0	0	0	0
Net interest income	155	176	97	87	70	37	28	29	24
Credit loss expense	2	10	16	2	4	2	0	1	2
Noninterest income	20	13	21	5	3	3	2	2	2
Noninterest expense	66	75	54	52	43	23	20	18	15
Operating income	107	104	48	37	26	15	10	12	8
- Covenant gain	0	0	(11)	0	0	0	0	0	0
- Gain on Covenant indemnification	0	(4)	(5)	0	0	0	0	0	0
- Gain on sale of factored rec. portfolio	(14)	0	0	0	0	0	0	0	0
Adjusted operating income	**93**	**100**	**32**	**37**	**26**	**15**	**10**	**12**	**8**

Payments Segment:

TriumphPay needs to be viewed in two ways. Part of the business is its factoring portfolio. These are factored receivables no different than those above just originated on the TPay system. Management's stated focus for TPay is to generate fee income and not necessarily grow the factoring portfolio, since the network includes other competing factors.

- Looking at the increase in net interest income since the data began in 2019, it's clear the increase in average period end balances is contributing to profitability.

- Fee income increased from nil to $17 million through 3Q22 as the amount and volume of payments process exploded to almost $18 billion.

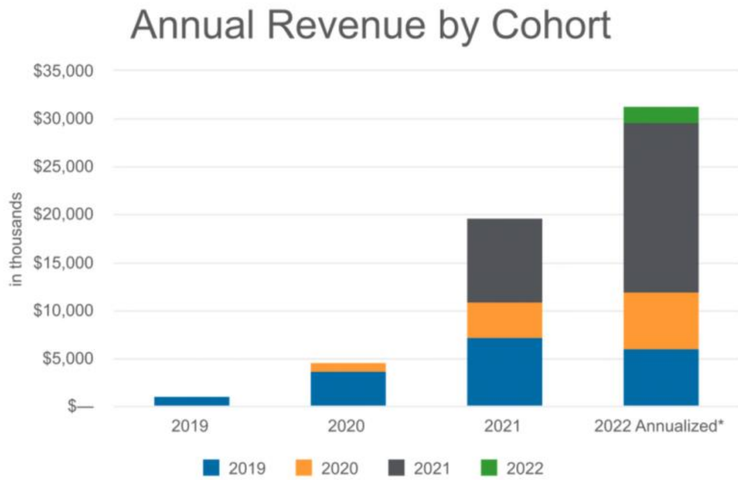
- I see the trend of declining noninterest expense to dollar volume and payment count, as well as the increase in revenue to those items, as evidence the platform is gaining necessary scale.

- Management expects overall profitability by the end of 2024 with volume around the $100 million mark. The key question is the magnitude of profits at that level and beyond. Management expects its life-to-date investment of $200 million to be more than justified, stating that it could be worth more than the current market cap of TFIN by the end of 2024. I can't say whether that is realistic, optimistic, or anything else.

- What is clear is the growth trend and the work the company is doing bringing on what it calls Tier 1 brokers, or those with > $500 million in annual freight spend. Clients now include large names like Schneider and BNSF Logistics.

- TPay as of 3Q22 had 584 freight brokers and 70 factors on its network. The company also provides audit and other services to enhance the value of its network and provide another integration point to the system. Like any network, the value of TPay will grow exponentially as additional users are brought on. The key source of value for all participants on the system is structured data so all can see – and have confidence in – everything from load origination data, remittance information, tracking, and audit services. Already the network serves the most carriers, which gives TPay insights into trends not available elsewhere.

- In 2021, TFIN paid $97 million cash to acquire Hubtran, a cloud-based provider of automation software for the trucking industry. Hubtran was the final all-in move committing TFIN to becoming the industry leader in payments for trucking.



*Excludes $7.0 million net gain on minority investment mark-to-market

Payments Segment ($ mil)	Q3Q22	2021	2020	2019	2018
Net interest income	$13	$12	$4	$1	
Provision for credit losses	0	0	0	0	
Non interest income	17	7	0	0	
Non interest expense	46	40	13	7	
Operating income (loss)	(17)	(21)	(9)	(6)	
+ Intangible amortization expense	4	3	0	0	
+ Hubtran transaction costs	0	3	0	0	
- Gain on equity investment	(10)	0	0	0	
+ Loss on impairment of warrants	3	0	0	0	
Adjusted operating income (loss)	**(20)**	**(15)**	**(9)**	**(6)**	
Amount of payments processed	$17,686	$15,162	$4,235	$975	$328
Factored receivable period end balance	119	153	84	11	
Number of invoices processed (000s)	13,043	13,483	4,439	875	
Conforming invoice volume (000s)	315				
Conforming payment volume	$671				
Noninterest income / $ volume payments	$ 0.97	$ 0.49	$ 0.03	$ 0.05	
Noninterest income / # volume payments	$ 1.31	$ 0.55	$ 0.03	$ 0.06	
Non-interest exp. / $ volume payments	$ 2.35	$ 2.23	$ 3.04	$ 6.89	
Non-interest exp. / # volume payments	$ 3.19	$ 2.51	$ 2.90	$ 7.68	
# employees		93.3	45.7		
Note: Cost per $ and # payment volume adjusted for intangible amortization and Hubtran transaction costs.					

Other Balance Sheet Assets:

I've so far only touched on loans, the biggest and most important asset on TFIN's books. Other assets include cash, securities, goodwill, premises, and other assets.

Perhaps most important to examine in more detail is the securities portfolio. While only 4% of assets it nonetheless represents about half of tangible equity. Over 70% of the portfolio or 35% of tangible equity are CLO securities. In reading the public filings we don't know much more about them other than they are "investment grade positions in high raking tranches". In speaking to investor relations, I was told that the CLO investments are made opportunistically when

TFIN Consolidated Balance Sheet as of Sept. 30, 2022		
Cash	$422	7%
Securities	$247	4%
Loans	$4,389	78%
Premises	$104	2%
Goodwill & Intangibles	$269	5%
Other assets	$211	4%
Total assets	$5,642	100%
Noninterest-bearing deposits	$1,897	34%
Interest-bearing deposits	$2,544	45%
Other	$310	5%
Preferred	$45	1%
Common equity	$846	15%
Total liab. & equity	$5,642	100%

market dislocations occur, and the portfolio is not managed for growth. Additionally, the team of four managing the CLOs sit on internal credit committees to provide their perspective. It's also worth highlighting that CEO Graft's background is in distressed debt. Putting these pieces to together the CLO investment appears less of a yield grab than an intentional asset allocation decision.

The remainder of the portfolio appears straightforward.

(Dollars in thousands)	September 30, 2022	December 31, 2021
Mortgage-backed securities, residential	$ 44,675	$ 37,449
Asset-backed securities	6,476	6,764
State and municipal	14,262	26,825
CLO Securities	169,708	106,634
Corporate bonds	1,249	2,056
SBA pooled securities	2,064	2,698
	$ 238,434	$ 182,426

Deposits:

TFIN has a nice base of deposits split between interest bearing (57%) and noninterest bearing (43%) sources. Deposits have grown over time through acquisitions and organic growth across its 63 branches. I don't see anything special about TFIN's deposits and would expect its funding costs to fluctuate with changes in market rates.

	Nine Months Ended September 30, 2022		
(Dollars in thousands)	Average Balance	Weighted Avg Yields	% of Total
Interest bearing demand	$ 861,753	0.28 %	19 %
Individual retirement accounts	80,437	0.51 %	2 %
Money market	536,130	0.22 %	12 %
Savings	516,972	0.16 %	11 %
Certificates of deposit	461,862	0.49 %	10 %
Brokered time deposits	102,793	1.37 %	2 %
Other brokered deposits	109,684	0.83 %	2 %
Total interest bearing deposits	2,669,631	0.35 %	58 %
Noninterest bearing demand	1,924,556	—	42 %
Total deposits	$ 4,594,187	0.20 %	100 %

Other Funding Sources & Equity Accounts:

As of September 30, 2022, TFIN had $30 million of FHLB advances, $108 million of subordinated notes, and $41 million of junior subordinated debentures. It also has $45 million of preferred stock. Common equity of $846 million gives TFIN a capital ratio of 15%; on a tangible basis the ratio falls to 10%.

CAPITAL ALLOCATION:

TFIN's capital allocation story over the past nine years is a busy one but worth examining in detail. I'll ignore the change in loans / deposits for now – an element that might look strange for readers used to looking at non-financial companies.

The table below tells a simpler story: In Q3 2022 TFIN cross the threshold of earning more than it had raised from capital providers.

TFIN Capital Raised (Returned/Earned)

$ millions	2013-21	2013-3Q22
Subordinated notes	105	105
Preferred stock	32	32
Issuance of common	385	385
Share repurchases	(103)	(155)
Retained earnings	(343)	(374)
Net	**76**	**(8)**

TFIN Major Capital Allocation 2013-21 ($ millions)			
Sources		*% Total*	*% NI*
Net income	394	*8%*	*100%*
Amortization of intangibles	52	*1%*	*13%*
Dispositions	277	*6%*	*70%*
Subordinated notes	105	*2%*	*27%*
Preferred stock	32	*1%*	*8%*
Issuance of common	385	*8%*	*98%*
Change in deposits	3,602	*72%*	*914%*
FHLB Advances	159	*3%*	*40%*
Total sources	5,006	*100%*	*1270%*
Uses			
Growth capex	(43)	*1%*	*11%*
Acquisitions	(441)	*9%*	*112%*
Share repurchases	(103)	*2%*	*26%*
Change in loans	(3,950)	*84%*	*1002%*
Change in other liabilities	(94)	*2%*	*24%*
Change in investment portfolio	(62)	*1%*	*16%*
Total uses	(4,692)	*100%*	*1190%*
Change in cash	336		
Unaccounted	(23)		

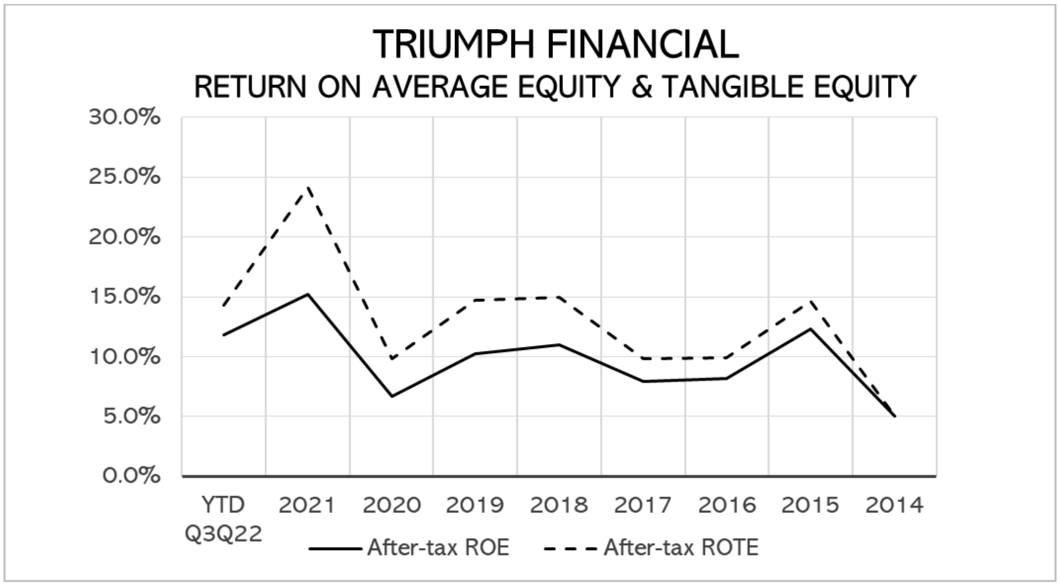
Early issuance of common equity to fund acquisitions and organic investments turned into capital returns in the form of share repurchases. In fact, in November TFIN announced another $100 million of buybacks that was completed in early December. That action returned half of the $200 million of excess capital management stated it carried as of the third quarter.

The inherent leverage of banking institutions is seen in the change in deposits and loans as a percentage of net income. Both grew about ten times, which is a typical bank leverage ratio.

I should also reemphasize a point made about regarding TriumphPay. To date management has invested $200 million in the operation, which I believe includes the $20 million YTD adjusted loss in payments. I wouldn't be surprised to see TFIN's net investment top out around $250 million before it begins returning profits.

TFIN's acquisition history can be summed up as succinctly as follows: Its early history consisted of acquiring banking operations as a source of low-cost funding. It then looked to round out its offerings and entered the healthcare finance, premium finance, and asset management businesses. As its focus turned to transportation financing, it sold those businesses and invested more heavily in transportation factoring. Finally, TFIN bolstered its internal investment in transportation payments with the purchase of Hubtran in 2021. *For more detail, please see the timeline in the history section and the capital allocation table in the appendix.*

Judging by TFIN's (albeit short) history of return on equity, its capital allocation activities have been successful.



VALUATION:

TFIN currently trades from a 20% to 50% premium over the KBW index of banks (KBWB) and the KBW index of regional banks (KBWR). Since 2014, TFIN has traded in the 1.75x book value range, except when it dipped to 1.32x in 2018 and 1.50x in 2019 before jumping to 3.86x in 2021. I believe the 2021 valuation was a result of the post-pandemic excitement of the potential of payments companies. TFIN's potential is still there but I think the market has pulled back on its enthusiasm.

	TFIN	KBWB	KBWR
Price/book	1.68x	1.19x	1.41x
Price/earnings	13.48x	9.03x	10.41x
As of December 7, 2022			

So, what is TFIN worth? I think it makes sense to look at its component parts.

Banking: Banking should continue to earn ~$50 million to $60 million pre-tax per year. The segment earned about $40 million in 2018 and 2019 when it was smaller than today. Averaging 2020 and 2021, the two years with fluctuations in reserves, gives you $61 million. Does the trend in asset runoff continue? Flatten? Reverse? I think $50 million is a fair bet.

That's $37.5 million in after-tax earnings for banking at a 25% tax rate.

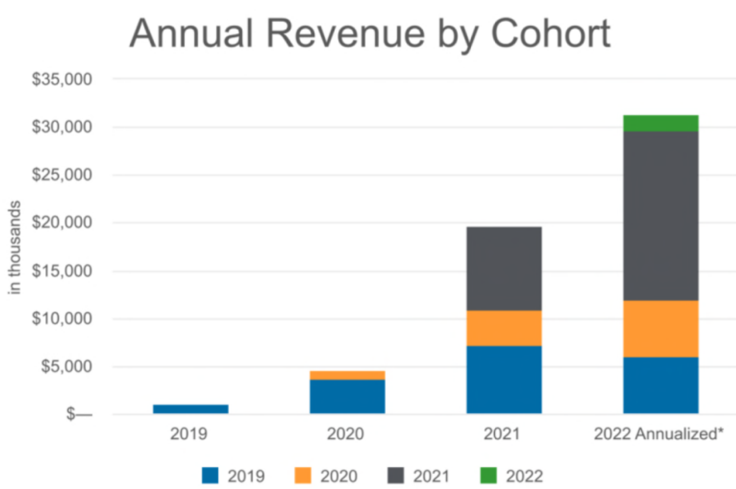
Factoring: Even with the slight pullback in factoring volumes the segment should easily earn $100 million of adjusted (my adjustment, downward) of pre-tax earnings in 2022. Take off 25% for taxes that's $75 million of after-tax earnings.

Corporate: Corporate overhead, including interest expense on borrowings, is running at $12 million per year, or about $9 million after-tax.

Combine banking, factoring, and deduct corporate and you get $104 million. At a KBW-like valuation of 10x that's worth about $1 billion or $41 per share on 24.5 million shares as of 3Q22. Judge the current enterprise-level ROTE of 15% as sustainable and it might deserve a 15x multiple, or $1.5 billion or $61 per share.

BUT…

What about TriumphPay? The segment lost $15 million last year and $20 million YTD. Will it achieve profitability? Yes, I think so and soon. Management expects breakeven profitability by the end of 2024, which would entail $75 billion in payment volumes translating into $100 million of revenue. Crucially, value creation increases as customers stay with TPay as evidenced by this chart:



*Excludes $7.0 million net gain on minority investment mark-to-market

Here are William Voss and Aaron Graft discussing TPay in response to an analyst's question during the 3Q22 conference call:

William Voss

Brad, thanks for that. I'll take that one. What we're aiming to do with TriumphPay exiting 2024 is 3 key metrics: number one, $100 million in revenue, as you mentioned; number two, EBITDA positive, so we want that number to be a contributor rather than a drag on our earnings; and number three, we think that it takes about $75 billion in payment volume to get there. But the expense load that we have to add between now and then, that provides some guardrails and it's going to force some discipline in order to be EBITDA positive at that point. But the margins are -- at that level are not going to be 50%. That's for another day when we're at bigger scale.

$75 billion in payment volume should result in $100 million of revenue and breakeven profits

Aaron Graft

And a couple of things to add on to that, Brad, is as we think about TriumphPay and we think about long-term targets, we think this business will -- should and it will operate at over a 70% gross margin, which is different than how -- bank investors talk about efficiency ratios. Payment investors and fintech investors talk about gross margins. And this is a SaaS or a payments network business. That's our target. So that's number one.

Number two, if you just step back and do unit economics, if you take $75 billion in payments, and you assume you're going to generate $100 million in revenue, and you assume the average invoice size is $1,800, and none of us know what it will be but if you just assume that to be true, that's 42 million invoices. And to get to $100 million, that's $2.40 of revenue per invoice.

Unit economics: $75bn volume and $100m revenue = $2.40 on an $1,800 invoice

Our firm conviction is that the revenue per invoice as the value proposition continues will be far greater than that. And you can see that if you look at the revenue per cohort. The longer we stay with a customer, the more value proposition that is born. And so in year 1, at that volume, could it take $75 billion to generate $100 million in revenue? Yes. Do I think it's plausible that, that same volume of payments generates 1.3x that revenue in the subsequent year? I do. I do because we see fraud mitigation and carrier visibility and some other things we haven't even talked about that are value propositions we deliver back to our payers and our payees.

More time with a customer = higher revenue

So the short answer is, in exiting 2024, it will not be a 50% efficiency ratio. And as we said, that's not a terminal goal, that's an interim goal of being EBITDA positive and delivering the brand promise to the market. But over the longer term, every decision we make goes through the grid of can we do this at scale, and can we do this at the profit margins required to get the valuation we think this deserves. And I'm absolutely convinced we will achieve that.

Is TriumphPay worth the $200 million put into it? Could it be worth the $1 billion I've seen in one place, or the $5 billion management suggested at one time? Could it be worth zilch? I don't know. I don't assign it any explicit value here because any guess would be just that, a guess. I do feel comfortable knowing that if the value proposition delivers even a fraction of promised cost reductions to a massive industry the worth of such a payments system could be very large.

That brings us back to the valuation of non-payment parts. Paying today's valuation of about $1.1 billion or $46/share is, for all intents and purposes, getting the upside of payments for nothing. That upside, and the potential for growth in those other segments, provides enough of a margin of safety in my view to pay current market prices.

RISKS (in order of perceived importance):

- **Loss of focus on banking:** Management is clearly excited about TriumphPay, to the extent of excluding discussion of the banking business in some communications. That could be a recipe for disaster if a 10x leveraged business begins to go sideways. Managing *any* bank requires continual diligence. I believe that TFIN management understands the risk and pays more attention to the bank internally, but this risk cannot be entirely discounted.

- **CLO / Leverage Loan Portfolio:** The bank holds collateralized loan obligations as a large part of the securities portfolio, and leveraged loans ("liquid credit") are a meaningful part of the loan book. Not much is disclosed in public filings.

- **Factored loan portfolio:** The TFS/Covenant portfolio that went south was probably a "hot hand on the stove" moment for management, meaning it won't happen again. The USPS misdirected payments situation highlights the risk that a misdirected payment can't be recovered from the factoring customer.

- **TriumphPay:** There's a risk that TriumphPay doesn't reach scale or that something happens to negate the benefits of scale that no one can currently foresee. Management might succumb to the sunk cost fallacy and spend good money chasing an unworkable product. I see this as a tail-risk since both TPay would have to prove unworkable and management would have to continue to act irrationally.

SUMMARY/CONCLUSION: TFIN provides a rare opportunity to partner with a management team running a solid core business with meaningful upside potential should its plans to disrupt a sleep industry come to fruition. This is no moonshot fintech idea but a reasonable, almost boring proposition of reducing costs in an industry stuck in its analog days. TFIN's relatively short history and the fact that it is pursuing a new strategy poses risks. Management appears rational and shareholder friendly, seeking to limit dilution when making acquisitions and buying back shares when attractively priced. Today's valuation appears to provide reasonable downside protection without relying on any growth or upside potential to justify it. TFIN is a great addition to the Watchlist.

Stay rational! —Adam

SUMMARY FINANCIALS:

TFIN - Balance Sheet 12/31/xx ($ millions, rounded)	2022Q3	2021	2020	2019	2018	2017	2016	2015	2014	2013
Cash and equivalents	$422	$383	$314	$198	$235	$134	$115	$105	$161	$86
Securities	247	193	236	263	350	264	304	163	163	185
Total loans, net	4,389	4,833	4,926	4,168	3,583	2,792	2,012	1,281	1,000	883
Premises and equipment, net	104	106	103	97	83	63	45	22	22	23
OREO	0	1	1	3	2	9	6	5	8	14
Goodwill	234	234	163	159	159	44	29	16	16	14
Intangibles, net	35	43	27	32	41	20	18	12	13	14
Other assets	211	164	165	142	107	173	112	87	65	69
Total assets	5,642	5,956	5,936	5,060	4,560	3,499	2,641	1,691	1,448	1,288
Noninterest-bearing deposits	1,897	1,925	1,353	810	725	564	363	168	180	150
Interest-bearing deposits	2,544	2,721	3,364	2,980	2,726	2,057	1,652	1,081	985	895
Total deposits	4,441	4,647	4,717	3,790	3,450	2,621	2,016	1,249	1,165	1,045
FHLB advances	30	180	105	430	330	365	230	130	3	21
Subordinated notes	108	107	88	87	49	49	49	0	0	0
Junior subordinated debentures	41	41	40	40	39	39	33	25	24	24
Other liabilities	131	123	260	77	55	34	24	20	18	38
Preferred stock	45	45	45	0	0	10	10	10	10	10
Common stockholders' equity	846	814	682	637	637	382	280	258	228	151
Total liabilities and equity	$5,642	$5,956	$5,936	$5,060	$4,560	$3,499	$2,641	$1,691	$1,448	$1,288
Shares outstanding (millions)	*24.5*	*25.2*	*24.9*	*25.0*	*26.9*	*20.8*	*18.1*	*18.0*	*18.0*	*9.8*
Notes:										
Other assets: 2021 and 2020 include indemnification asset of $5 and 36, respectively.										

TFIN - Income statement 12/31/xx ($ millions, rounded)	YTD Q3Q22	2021	2020	2019	2018	2017	2016	2015	2014	2013
Loans	$130	$184	$198	$196	$161	$122	$84	$62	$56	$23
Factored receivables	175	198	114	101	92	47	35	34	28	18
Other	9	6	9	14	10	8	5	3	3	1
Total interest and div. income	313	388	322	311	263	177	124	99	87	43
Total interest expense	13	18	37	55	36	22	12	8	7	4
Net interest income	300	369	285	256	227	156	112	91	80	39
Loan loss provision	6	(9)	38	8	16	12	7	5	6	3
Noninterest income	72	55	60	32	23	41	21	33	25	13
Noninterest expense	254	288	222	204	167	124	93	82	69	33
Earnings before taxes	112	145	85	75	67	61	34	38	30	16
Taxes	27	32	21	17	15	25	13	8	10	2
Net income before pref. divs	85	113	64	59	52	36	21	29	20	13
Dividends on preferred & noncontrol	(2)	(3)	(2)	0	(1)	(1)	(1)	(1)	(3)	(2)
Net income to common	$82	$110	$62	$59	$51	$35	$20	$28	$17	$12
Effective tax rate	*24.2%*	*22.1%*	*24.4%*	*22.4%*	*22.2%*	*40.7%*	*38.2%*	*22.4%*	*34.4%*	*13.7%*

TFIN - Capital Allocation 12/31/xx ($ millions, rounded)	YTD Q3Q22	2021	2020	2019	2018	2017	2016	2015	2014	2013
Net income to common	$82	$110	$62	$59	$51	$35	$20	$28	$17	$12
Net addition to PP&E	1	(2)	(7)	(13)	(13)	(4)	(2)	(0)	(1)	(1)
Amortization of intangibles	9	11	8	9	7	5	4	4	3	1
Acquisitions and contingency pmts	0	(97)	(130)	0	(142)	45	(14)	(128)	(49)	75
Dispositions of subsidiaries/div.	0	0	99	0	74	10	0	37	57	0
Change in subordinated notes	0	18	0	38	0	0	49	0	0	0
Change in preferred stock	0	0	42	0	0	0	(11)	0	0	0
Issuance of common stock	0	1	(0)	0	192	66	0	0	84	42
Repurchase of common stock	(52)	(1)	(36)	(65)	(0)	(0)	(1)	(0)	(0)	0
Notes:		$97mm Hubtran	$108mm TFS acquisition + $22m contingent consideration related to 2018 Interstate Capital Corp.; $95mm sale of Triumph Premium Finance		$134.7mm First Bancorp of Durango; $13.3mm Southern Colorado Corp; $180.3mm Interstate Capital Corp. ($160mm cash); less net cash acquired of $166mm; Sold Triumph Healthcare for $74.0mm	$40.1mm Valley National Bank less $38.5mm cash acquired; $45.3mm cash received for Independent Bank branches plus $1.6mm cash acquired. Sold Triumph Capital Advisors for $22.7mm (cash portion $10.6mm)	Southern Transportation Company for $2.15mm; ColoEast Bancshares for $70mm cash less $57.7mm cash plus $10.5mm TARP preferred (accounted for in preferred line).	$135.9mm Doral Money, Inc. acquired including $8.3mm cash; sold $36.8mm loans on Doral's books immediately after purchase.	$57mm sale of Wisconsin branch; $84mm issuance of common from IPO; acquired assets from Doral Healthcare Finance for $49.5mm.	Acquired National Bancshares (NBI) for $15.3mm cash, $11.9mm stock, assumption of $25.9mm preferred stock; bargain purchase gain of $9.0mm related to NBI.

Banking Segment ($ millions)	YTD Q3Q22	2021	2020	2019	2018	2017	2016	2015	2014	2013
Total assets	$5,162	$5,569	$5,792	$4,976	$4,458	$3,444	$2,589	$1,601	$1,210	
Total banking loans	$2,984	$3,168	$3,876	$3,575	$2,991	$2,436	$1,789	$1,077	$825	
Total interest income	138	190	208	211	171	130	91	66	60	25
Intersegment interest allocation	7	10	13	12	20	8	5	3	4	2
Interest expense, net	8	10	30	49	30	16	10	7	5	4
Net interest income	137	190	191	173	161	122	86	62	58	24
Loan loss provision	3	(19)	20	5	12	9	6	3	4	3
Gain on sale of subsidiary	0	0	10	0	1	0	0	0	13	0
Noninterest income	34	33	29	27	18	14	9	10	9	3
Noninterest expense	139	169	151	142	119	91	66	51	47	18
Operating income	31	73	59	53	49	37	23	17	29	6
- Gain on sale	0	0	(10)	0	(1)	0	0	0	(13)	0
Adjusted operating income	**31**	**73**	**49**	**53**	**48**	**37**	**23**	**17**	**16**	**6**
Net charge offs	0.4	0.0	1.6	4.5	6.2	4.6	3.3	0.3	0.7	1.7
Net charge offs % loans	0.01%	0.00%	0.04%	0.14%	0.23%	0.22%	0.23%	0.03%		
Ratios to average banking loans:										
Interest income	6.28%	5.68%	5.93%	6.76%	7.04%	6.56%	6.66%	7.25%		
Interest expense	0.33%	0.29%	0.80%	1.49%	1.10%	0.77%	0.69%	0.73%		
Net interest income	5.96%	5.39%	5.12%	5.28%	5.94%	5.79%	5.97%	6.52%		
Non interest income	1.50%	0.95%	0.79%	0.82%	0.68%	0.68%	0.63%	1.01%		
Non interest expense	6.01%	4.80%	4.06%	4.32%	4.40%	4.29%	4.59%	5.39%		
Adjusted operating income	1.32%	2.08%	1.31%	1.61%	1.77%	1.73%	1.58%	1.81%		
	**3Q22 annualized*									
Efficiency ratio	80.7%	75.8%	68.6%	70.9%	66.4%	66.3%	69.5%	71.5%	69.7%	68.8%
Net interest margin on banking loans	4.3%	5.4%								
Pre-tax ROA	0.8%	1.3%	0.8%	1.1%	1.1%	1.1%	0.9%	1.1%	1.3%	
After-tax ROA (25% rate)	0.6%	1.0%	0.6%	0.8%	0.8%	0.8%	0.7%	0.8%	1.0%	
ALL % loans		0.9%	1.9%							
Interest income / avg. assets	2.70%	3.52%	4.10%	4.71%	4.84%	4.59%	4.55%	4.91%		
Interest expense / avg. assets	0.14%	0.18%	0.56%	1.03%	0.76%	0.54%	0.47%	0.50%		
Noninterest expense / avg. assets	2.59%	2.98%	2.81%	3.01%	3.02%	3.00%	3.14%	3.65%		

Factoring Segment ($ millions)	YTD Q3Q22	2021	2020	2019	2018	2017	2016	2015	2014
Accounts receivable purchased	$11,665	$13,125	$7,135	$5,675	$5,120	$2,766	$1,828	$1,625	$1,413
Factored receivable period end balan	1,330	1,546	1,037	573	589	346	213	187	170
Number of invoices purchased (000s)	5,011	5,795	3,909	3,452	2,897	1,810	1,401		
Average invoice size	$2,328	$2,265	$1,825	$1,644	$1,767	$1,528	$1,305	$1,465	$1,678
Average transportation invoice size	$2,213	$2,152	$1,682	$1,508	$1,662	$1,460	nm		
Yield on average receivable balance	14.2%	14.3%	15.0%	17.4%	18.4%	17.1%	17.7%		
YTD charge-off rate	0.19%	3.49%	0.42%	0.40%	0.37%	0.41%	0.32%		
Interest income	162	186	109	98	90	45	33	32	27
Intersegment interest allocation	(6)	(10)	(12)	(11)	(20)	(8)	(5)	(3)	(4)
Interest expense	0	0	0	0	0	0	0	0	0
Net interest income	155	176	97	87	70	37	28	29	24
Credit loss expense	2	10	16	2	4	2	0	1	2
Noninterest income	20	13	21	5	3	3	2	2	2
Noninterest expense	66	75	54	52	43	23	20	18	15
Operating income	107	104	48	37	26	15	10	12	8
- Covenant gain	0	0	(11)	0	0	0	0	0	0
- Gain on Covenant indemnification	0	(4)	(5)	0	0	0	0	0	0
- Gain on sale of factored rec. portfo	(14)	0	0	0	0	0	0	0	0
Adjusted operating income	**93**	**100**	**32**	**37**	**26**	**15**	**10**	**12**	**8**
Noninterest expense / avg. balance	4.62%	5.79%	6.71%	8.91%	9.30%	8.10%	9.79%	10.01%	
Noninterest expense / avg. # invoices	$13.25	$12.90	$13.82	$15.00	$15.01	$12.51	$13.95		
Noninterest income / avg. # invoices	$4.06	$2.24	$5.38	$1.37	$1.20	$1.51	$1.61		

Payments Segment ($ mil)	YTD Q3Q22	2021	2020	2019	2018
Net interest income	$13	$12	$4	$1	
Provision for credit losses	0	0	0	0	
Non interest income	17	7	0	0	
Non interest expense	46	40	13	7	
Operating income (loss)	(17)	(21)	(9)	(6)	
+ Intangible amortization expense	4	3	0	0	
+ Hubtran transaction costs	0	3	0	0	
- Gain on equity investment	(10)	0	0	0	
+ Loss on impairment of warrants	3	0	0	0	
Adjusted operating income (loss)	**(20)**	**(15)**	**(9)**	**(6)**	
Amount of payments processed	$17,686	$15,162	$4,235	$975	$328
Factored receivable period end balan	119	153	84	11	
Number of invoices processed (000s)	13,043	13,483	4,439	875	
Conforming invoice volume (000s)	315				
Conforming payment volume	$671				
Noninterest income / $ volume paym	$ 0.97	$ 0.49	$ 0.03	$ 0.05	
Noninterest income / # volume paym	$ 1.31	$ 0.55	$ 0.03	$ 0.06	
Non-interest exp. / $ volume paymen	$ 2.35	$ 2.23	$ 3.04	$ 6.89	
Non-interest exp. / # volume paymen	$ 3.19	$ 2.51	$ 2.90	$ 7.68	
# employees		93.3	45.7		
Note: Cost per $ and # payment volume adjusted for intangible amortization and Hubtran					

Misc. Adjustments and Ratios	YTD Q3Q22	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012
EBIT	112	145	85	75	67	61	34	38	30	16	6
+/- loss (gain) on securities	(3)	(0)	(3)	(0)	0	(0)	0	(0)	(0)	0	0
-/+ (gain) loss on sale of loans	(18)	(2)	(4)	(1)	(0)	0	(0)	(2)	(1)	(1)	(0)
- Gain on sale of subsidiary	0	0	(10)	0	(1)	(21)	0	0	(13)	0	0
- Bargain purchase gain	0	0	0	0	0	0	0	0	0	(9)	0
+ Amort. Of intangibles	9	11	8	9	7	5	4	4	3	1	1
- Gain on Covenant transaction	0	0	(11)	0	0	0	0	0	0	0	0
- Gain on Covenant indemnification	0	(4)	(5)	0	0	0	0	0	0	0	0
Adjusted EBIT	100	150	60	84	73	45	37	40	19	6	6
Effective tax rate	24.2%	22.1%	24.4%	22.4%	22.2%	40.7%	38.2%	22.4%	34.4%	13.7%	0.0%
Adjusted NI after tax & pref.	**73**	**114**	**44**	**65**	**56**	**26**	**22**	**30**	**10**	**4**	**6**
Tangible assets	5,374	5,679	5,746	4,870	4,360	3,435	2,595	1,663	1,419		
Tangible equity	533	492	447	446	437	309	223	221	189		
Tangible assets / tang. Equity	10.1	11.5	12.9	10.9	10.0	11.1	11.6	7.5	7.5		
Capital ratio	9.9%	8.7%	7.8%	9.2%	10.0%	9.0%	8.6%	13.3%	13.3%		
After-tax ROA	1.7%	1.9%	0.8%	1.4%	1.4%	0.9%	1.0%	1.9%	0.7%		
After-tax ROE	11.8%	15.2%	6.7%	10.2%	11.0%	7.9%	8.2%	12.3%	5.0%		
After-tax ROTE	14.3%	24.2%	9.8%	14.7%	15.0%	9.8%	9.9%	14.6%	5.1%		
Pre-tax return on avg. tang. Assets	2.4%	2.6%	1.1%	1.8%	1.9%	1.5%	1.7%	2.6%	1.3%		
Pre-tax return on avg. tang. Equity	26.0%	31.9%	13.5%	19.0%	19.5%	17.1%	16.7%	19.4%	10.0%		
Yield on avg. assets	5.40%	6.52%	5.86%	6.47%	6.53%	5.77%	5.75%	6.29%	6.38%	3.31%	
Int. exp. / avg. assets	0.23%	0.31%	0.68%	1.15%	0.89%	0.70%	0.56%	0.52%	0.49%	0.31%	
Net interest margin	5.17%	6.21%	5.18%	5.32%	5.63%	5.07%	5.19%	5.78%	5.88%	3.00%	
Loan loss provision / avg. assets	0.10%	-0.15%	0.70%	0.17%	0.40%	0.38%	0.31%	0.29%	0.43%	0.26%	
Salaries & benefits and occupancy / a	2.92%	3.34%	2.72%	2.72%	2.59%	2.69%	2.85%	3.60%	3.48%	1.80%	
Deposit service charges / avg. assets	0.09%	0.13%	0.10%	0.15%	0.14%	0.14%	0.16%	0.17%	0.22%	0.05%	
Other non-interest income / avg. asse	0.88%	0.68%	0.41%	0.49%	0.41%	0.51%	0.80%	1.83%	0.55%	0.19%	
Adjusted non-interest expense / avg. a	1.30%	1.32%	1.16%	1.33%	1.39%	1.17%	1.27%	1.37%	1.36%	0.69%	
Pre-tax return on average assets	2.30%	3.19%	1.33%	2.13%	2.22%	1.79%	2.08%	3.14%	1.55%	0.58%	
Avg. assets / avg. equity	6.99	7.95	8.34	7.56	7.91	9.28	8.05	6.46	7.23	8.54	
Pre-tax return on average equity	16.1%	25.3%	11.1%	16.1%	17.6%	16.6%	16.7%	20.3%	11.2%	5.0%	
After-tax ROAE (25% rate)	12.1%	19.0%	8.3%	12.1%	13.2%	12.5%	12.5%	15.2%	8.4%	3.7%	
Net charge-offs to average loans	0.09%		0.10%	0.17%	0.23%	0.28%	0.25%	0.07%	0.07%	0.45%	0.12%
Adjusted for Covenant indemnification		0.21%									
Covenant recovery		0.74%									
Gross or headline charge-off ratio		0.95%									
Charge off rate all commercial banks	0.23%	0.25%	0.49%	0.49%	0.45%	0.47%	0.46%	0.42%	0.49%	0.69%	1.13%
Consolidated efficiency ratio	68.3%	67.9%	64.3%	71.0%	66.9%	63.0%	69.8%	66.0%	65.8%	63.3%	

The following table shows the recorded investment of our loans by portfolio categories as of the dates indicated:

(Dollars in thousands)	December 31, 2021	% of Total	December 31, 2020	% of Total	$ Change	% Change
Commercial real estate	$ 632,775	13%	$ 779,158	16%	$(146,383)	(18.8%)
Construction, land development, land	123,464	3%	219,647	4%	(96,183)	(43.8%)
1-4 family residential	123,115	3%	157,147	3%	(34,032)	(21.7%)
Farmland	77,394	2%	103,685	2%	(26,291)	(25.4%)
Commercial	1,430,429	29%	1,562,957	32%	(132,528)	(8.5%)
Factored receivables	1,699,537	34%	1,120,770	22%	578,767	51.6%
Consumer	10,885	— %	15,838	— %	(4,953)	(31.3%)
Mortgage warehouse	769,973	16%	1,037,574	21%	(267,601)	(25.8%)
Total Loans	$4,867,572	100%	$4,996,776	100%	$(129,204)	(2.6%)

The following table shows the recorded investment of our loans by portfolio categories as of the dates indicated:

(Dollars in thousands)	December 31, 2020	% of Total	December 31, 2019	% of Total	$ Change	% Change
Commercial real estate	$ 779,158	16%	$1,046,961	25%	$(267,803)	(25.6)%
Construction, land development, land	219,647	4%	160,569	4%	59,078	36.8%
1-4 family residential properties	157,147	3%	179,425	4%	(22,278)	(12.4%)
Farmland	103,685	2%	154,975	4%	(51,290)	(33.1%)
Commercial	1,562,957	32%	1,342,683	31%	220,274	16.4%
Factored receivables	1,120,770	22%	619,986	15%	500,784	80.8%
Consumer	15,838	—%	21,925	1%	(6,087)	(27.8%)
Mortgage warehouse	1,037,574	21%	667,988	16%	369,586	55.3%
Total loans	$4,996,776	100%	$4,194,512	100%	$ 802,264	19.1%

(Dollars in thousands)	December 31, 2018	% of Total	December 31, 2017	% of Total	December 31, 2016	% of Total
Commercial real estate	$ 992,080	27%	$ 745,893	27%	$ 442,237	22%
Construction, land development, land	179,591	5%	134,812	5%	109,812	5%
1-4 family residential properties	190,185	5%	125,827	4%	104,974	5%
Farmland	170,540	5%	180,141	6%	141,615	7%
Commercial	1,114,971	31%	920,812	33%	778,643	39%
Factored receivables	617,791	17%	374,410	13%	238,198	12%
Consumer	29,822	1%	31,131	1%	29,764	1%
Mortgage warehouse	313,664	9%	297,830	11%	182,381	9%
Total loans	$3,608,644	100%	$2,810,856	100%	$2,027,624	100%

Source: Company filings

WHAT'S COMING NEXT ISSUE:

Next month will be the annual update issue. I'll pause to provide short updates on the companies covered over the past two years and put down on paper some thoughts for the year to come.

As always, I appreciate your thoughts, comments, feedback, and of course recommendations for companies to look at.

Watchlist

As of December 19, 2022

WATCHLIST Count: 25

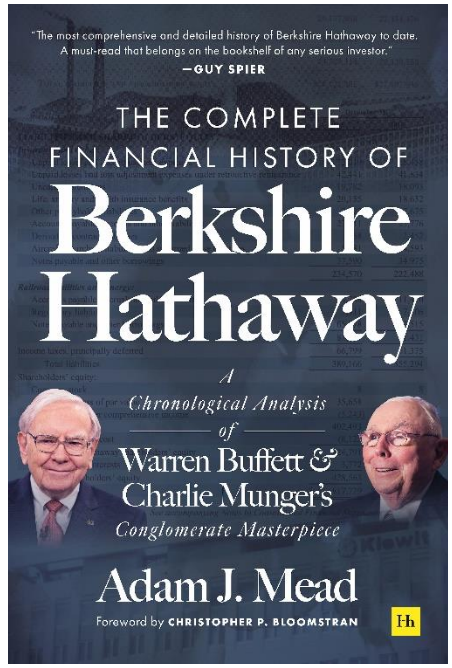
Company Name	Industry	Ticker	Current Price	Market Cap	See Issue #
AAON, Inc.	Building Products	AAON	$77	$4,092,640,628	1
Berkshire Hathaway	Conglomerate	BRK.B	$300	$662,272,044,443	14
Hingham Institution for Savings	Banking	HIFS	$270	$580,073,262	1
Monarch Cement	Building Products	MCEM	$106	$399,732,600	2
International Flavors and Fragrances	Foods/Seasonings	IFF	$103	$26,235,610,769	3
McCormick	Foods/Seasonings	MKC	$84	$22,560,032,588	3
Bank7	Banking	BSVN	$26	$237,829,605	4
Plumas Bancorp	Banking	PLBC	$36	$209,810,031	4
Auburn Bancorp	Banking	AUBN	$23	$82,073,493	5
Waste Management	Waste Management	WM	$160	$65,471,081,500	6
Republic Services	Waste Management	RSG	$131	$41,317,117,675	6
Waste Connections	Waste Management	WCN	$135	$34,711,446,860	6
Boston Beer Company	Alcoholic beverages	SAM	$341	$4,212,804,648	7, 12
Constellation Brands	Alcoholic beverages	STZ	$234	$43,201,842,957	7, 12
Anheuser-Busch InBev	Alcoholic beverages	BUDFF	$60	$103,371,207,862	7, 12
Heineken	Alcoholic beverages	HKHHY	$38	$41,793,169,266	7, 12
Old Dominion Freight Line	Logistics	ODFL	$290	$32,040,769,894	8
Saia, Inc.	Logistics	SAIA	$224	$5,923,886,311	8
Fastenal	Industrial Distributing	FAST	$48	$27,613,213,084	9
Jack Henry & Associates	Banking Software	JKHY	$178	$13,009,799,295	11
Home Depot	Home Improvement	HD	$321	$326,709,941,111	18
Lowes	Home Improvement	LOW	$205	$123,806,813,645	18
Sherwin-Williams	Paint/coatings	SHW	$239	$61,823,842,836	19
Copart	Vehicle remarketing	CPRT	$61	$29,075,732,627	20
Triumph Financial	Bank	TFIN	$46	$1,132,121,000	21

Click here to see the latest Watchlist and Suspect List on Google Sheets.

About

After nearly two decades as an individual investor, a decade in commercial credit at various banks, and a few years managing money for friends/family in the background, I decided to go full-time managing money for clients in 2020. Watchlist Investing is an extension—albeit separate and distinct—of what I do day-to-day as a practicing capital allocator. Inverting the margin of safety principle, I hope to add value to readers above and beyond the nominal cost of the newsletter.

My investing style is influenced by my background growing up in a family of business owners. I followed suit selling firewood through high school and founding a welding business in college. Looking at stocks as businesses is natural to me. My investing approach rests on fundamental value investing tenets, but it's adapted to suit my style. I'm 100% certain I'm not the best investor or analyst, but I hope to improve over time.



Between 2016 and 2021, I wrote a book on Berkshire Hathaway. *The Complete Financial History of Berkshire Hathaway* was and is my passion project. I hope it brings new shareholders up to speed on the company and provide a fresh look to longtime shareholders, in addition to serving as a resource/reference book. It can be purchased here. I also created www.theoraclesclassroom.com as an extension of the book, which includes an archive of a lot of BRK material.

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