S&P Global
Market Intelligence

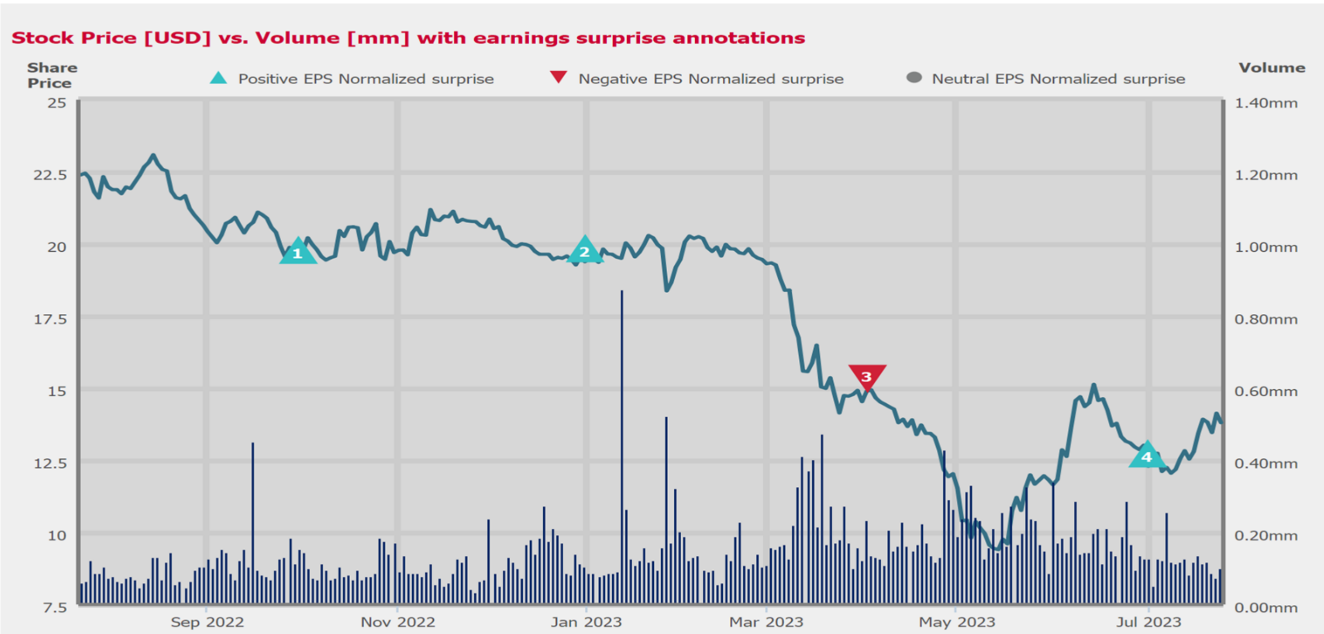
Flushing Financial Corporation NasdaqGS:FFIC FQ2 2023 Earnings Call Transcripts

Wednesday, July 26, 2023 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2023-			-FQ3 2023-	-FY 2023-	-FY 2024-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.19	0.26	▲36.84	0.23	0.70	NA
Revenue (mm)	45.51	47.75	▲4.92	41.80	170.90	NA

Currency: USD
Consensus as of Jul-26-2023 3:36 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2022	0.60	0.62	▲1 3.33 %
FQ4 2022	0.50	0.57	▲2 14.00 %
FQ1 2023	0.32	0.10	▼3 (68.75 %)
FQ2 2023	0.19	0.26	▲4 36.84 %

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Call Participants

EXECUTIVES

John R. Buran
President, CEO & Director

Susan K. Cullen
Senior EVP, Treasurer & CFO

ANALYSTS

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

Manuel Antonio Navas
D.A. Davidson & Co., Research Division

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Presentation

Operator

Good day and welcome to the Flushing Financial Corporation Second Quarter 2023 Earnings Conference Call. [Operator Instructions] Please note this event is being recorded. I would now like to turn the conference over to Mr. John Buran, president and CEO.

John R. Buran
President, CEO & Director

Good morning and thank you for joining us for our Second Quarter 2023 Earnings Call. Following my prepared remarks, Susan will review the financial trends and we will then answer any questions. During the first quarter, the company instituted a 6 step action plan to enhance the resilience of our business model and strengthen our financial performance.

We executed this plan well during the second quarter and are pleased with the progress we have made so far on key points. First, to move more towards interest rate neutral, we added more than $400 million of asset swaps. Additionally, $250 million of funding swaps became effective during the quarter. We're also increasing the percentage of back to back swap loans. These loans are over 35% of our loan pipeline and total floating rate loans are approximately 50%.

These actions significantly reduced our interest rate sensitivity position while providing additional income. Second, we increased our focus on risk adjusted returns and overall profitability. As a result yields on the loan pipeline rose 20 basis points and yields on loan closings increased 13 basis points.

In addition, our loan pipeline increased 56% quarter over quarter. While it will take time for new and repriced loans to have a significant impact on overall loan yields, we are encouraged by the results so far. Third, we're looking to expand our client base and build loyalty by emphasizing our excellent brand of customer service and deep community relationships. Late in the quarter, we hired a team of commercial real estate lenders with considerable experience and robust client rosters.

We also continue to see high single digit growth in checking account openings and robust CD growth. Fourth, we reviewed new and existing relationships resulting in improved credit metrics and normalized net charge offs. We also added further layers of analysis to our review process for any future deals. This review and actions reinforced our comfort with a low risk profile of our loan portfolio.

If we are preserving strong liquidity and capital, we are looking for ways to expand our liquidity sources despite having available liquidity of nearly $4 billion. Average deposits increased both year over year and quarter over quarter. Capital ratios were also stable during the quarter. Sixth, we are tightening our expense controls by placing greater scrutiny on operating and discretionary expenses. In a period of high inflation second quarter '23 core expenses are down approximately 1% year over year.

Overall, we expect these decisive actions to result in an improved financial profile over time. These actions along with our strong liquidity will also allow us to continue our long history of dividend payments into the future. In addition to our action plan, Slide four outlines our four areas of focus for long term success. First interest rate risk is a priority and the actions we have taken have resulted in a 64% reduction in this risk over the past year.

This is important given the outlook on rates. Second, we are focused on maintaining our credit quality. Our loan portfolio comprises low risk loans to stable borrowers. Over 88% of the loan portfolio is secured by real estate with an average loan to value of less than 36%. The current debt service coverage ratio is 1.8 times for our multifamily and investor commercial real estate portfolios.

The third area of focus is liquidity, which I touched on in a previous slide. We have significant liquidity and are looking to fully utilize our balance sheet to add more. The last area of focus is customer experience. Central to our ability to deliver exceptional services is our ties to our local communities. About a third of our branches are in Asian markets and we continue to implement community engagement initiatives and grow our presence in these areas to build on our loyal customer base.

We also continue to enhance our digital banking solutions which create a more convenient experience and allows us to engage with customers more seamlessly. We're confident that these four areas of focus will position the company to achieve long term success. Slide five represents our liquidity profile. We have approximately $3.7 billion of available liquidity from a variety of sources, including the Federal Home Loan Bank of New York, other commercial banks, cash on hand and free securities.

Today our available liquidity is 44% of assets and we're working to expand borrowing capacity from existing relationships by pledging several types of collateral. As a result, we have a high degree of comfort in the stability of funding and available liquidity.

Our loan portfolio is outlined on Slide six. We have structured our real estate loan portfolio to ensure stability with multifamily and investor commercial real estate comprising 66% of the total portfolio.

Manhattan office buildings are approximately 6/10 of 1% of net loans. In general, the real estate portfolio has strong sponsor support and excellent credit performance. Overall, we remain very comfortable with the quality of the loan portfolio. Slide seven provides the detail on our Asian markets. Once the Bensonhurst branch in Brooklyn opens later this year, a 1/3 of our branches will be in predominantly Asian markets. We have $1.2 billion of deposits and $764 million of loans in Asian markets.

These deposits are 18% of our total deposits and we have only a 3% share of market. There's substantial room for growth. Our approach to this market is supported by our multilingual staff, our Asian Advisory Board and our support of cultural activities. This market, which has total deposits of $36 billion, continues to be an important opportunity for us.

Slide eight depicts the growth of our digital banking platforms. We continue to see high growth rates and monthly mobile deposit users. Users with active online banking status and digital banking enrollment. The numerator platform, which digitally originates small dollar loans as quickly as 48 hours, continues to grow. We originated approximately $10 million of commitments in the first half of the year, which have an average rate greater than the overall loan portfolio yield.

We continue to explore other "fintech" product offerings and partnerships to further enhance our digital banking platform and customer experience. The second quarter had several notable events to highlight, as you can see on Slide nine. As pictured, we hosted a ribbon cutting ceremony at our Hauppauge branch which opened late in the first quarter in a vibrant industrial park.

Community involvement is what separates us from other banks. Here's a sample of the events we participated in during the quarter. Participating in these types of initiatives builds on our already strong ties with our local communities and drives customer loyalty. I'll now turn it over to Susan to provide more detail on our key financial metrics.

Susan K. Cullen
Senior EVP, Treasurer & CFO

The company reported second quarter 2023 GAAP earnings per share of $0.29 and core earnings per share of $0.26. The quarterly results were significantly improved compared to the first quarter. Average total deposits increased 7% year over year and 1% during the quarter.

We continue to grow our CD portfolio, which is now 30% of average deposits. The cost deposits totaled 2.68%, while the cost of funds was 2.8%. As expected, loan growth was muted, increasing only 1% year over year. However, the loan pipeline increased 56% quarter over quarter with pipeline yields and core loan yields also expanding.

Non-performing assets declined 6% during the quarter, reflecting our conservatively underwritten loan portfolio. Overall, the second quarter results were an improvement versus the first as we continue to adjust to the higher rate environment. Slide 11 depicts our deposit portfolio. Despite the Fed raising rates and industry deposits declining, our average deposits have increased 7% year over year and 1% quarter over quarter.

The growth is driven by the 150% year over year and 22% quarter over quarter increase in CDs which lengthened the duration of our liabilities, thus reducing our liability sensitivity. Growing non-interest bearing deposits is challenging in this high rate environment but remains a focus. Average non-interest bearing deposits declined both quarter over quarter and year over year, though checking account openings increased 10% year over year.

Our loan to deposit ratio has improved 102% from 105% a year ago. As a reminder, we generally have seasonality in certain segments of our deposit base and the summer months balances are generally lower than the remainder of the year. Slide 12 outlines our loan portfolio and yields.

Net loans increased 1% year over year but were down 1% quarter over quarter. Loan closings also declined year over year and quarter over quarter as customers adapt to the increased rate environment. The yield on the closings was over 7% for the second consecutive quarter. Core loan yields increased 19 basis points during the quarter and for the third consecutive quarter, yields on the loan closings exceeded the yields on the satisfactions at an accelerating pace. Prepayment penalty income declined to $278,000 in the quarter from $2.3 million a year ago and $610,000 in the prior quarter.

The loan pipeline increased 56% quarter over quarter with over 35% of the pipeline consisting of attractive back to back swap loans and approximately 50% are floating rate loans. Slide 13 provides more detail on the contractual repricing of the loan portfolio. Approximately $1.1 billion or 16% reprices with each Fed move.

During the quarter, we added $400 million of interest rate hedges on loans, which effectively increases the amount of loans that will reprice the Fed move $1.5 billion or over 21% of the loan portfolio. For the remainder of 2023 another $458 million is due to reprice at a rate of 210 basis points higher than the current yield.

In 2024 and 2025, about $1.5 billion of loans will reprice 220-230 basis points higher. These values are based on the underlying index value at June 30th, 2023 and do not consider any future rate moves. This repricing should drive net interest margin expansion once funding costs stabilize.

Slide 14 outlines the net interest income and margin trends. The GAAP net interest margin declined only nine basis points to 2.18% during the second quarter. This is the lowest amount of compression over the past four quarters and is consistent with the NIM for the month of March.

We expect the NIM will remain under pressure as long as the Fed raises rates, but the pressure should be more manageable based on the current forecasted rate hikes through the remainder of the year. After a lag, we expect the NIM would begin to expand as the pressure on funding costs ease and and loans continue to reprice higher.

Turning to slide 15. As John mentioned, one of our goals for 2023 is to significantly move more towards interest rate neutral. The goal for the balance sheet is to better match the duration of our assets, which is 3-4 years more closely to the duration of our funding, which is about 1-2 years.

We have made considerable progress over the past year. For an immediate rise of 100 basis points in rates. Our net interest income would decline by 3%. A year ago this impact was a 9% decline or almost 2/3 improvement. The addition of interest rate hedges and more floating rate assets are the key drivers of the reduced sensitivity.

The interest rate hedges are particularly important as they provide immediate income in addition to moving the balance sheet more towards neutral. Bottom line, we executed well on this strategy and expect to continue to improve in this area. Slide 16 provides more detail on our CDs. Total CDs are about $2 billion or 1/3 of the total deposits at June 30th 2023.

CDs helped to lengthen the duration of our funding to match the duration of our assets more closely. Excluding CDs with interest rate hedges, about 60% of our CD portfolio will reprice higher over the next year. We expect to retain a high percentage of our CDs. Our current CD rates range from 4.5% to 5.25%. All else equal, we expect the CD repricing to pressure our net interest margin.

Our net charge off history is on Slide 17. As you can see, we have a long history of solid asset quality because of our low risk credit profile and conservative underwriting. Net charge offs of nine basis points returned to normalized levels this quarter. We expect minimal losses in the loan portfolio if there's an economic downturn. Given the large percentage of our loan portfolio is secured by real estate with a low average loan to value.

Additionally, the weighted average debt service coverage is 1.8 times in the multifamily and investor real estate portfolios and 1.2 times in a stress scenario consisting of a 200 basis point increase in the rate and a 10% increase in operating expenses. These factors contribute to our expectation of minimal loss content within the loan portfolio.

Slide 18 shows our credit metrics trending in the right direction with declines in NPAs and an increase in the non-performing loan coverage ratio. Criticized and classified assets decreased during the quarter to a low 71 basis points. Historically, these levels have been significantly below our peers. Our allowance for credit losses is presented by loan segment in the bottom right chart.

The higher risk portfolios have reserves greater than 1% of that portfolio. Overall, the allowance for credit losses to loans ratio increased to 57 basis points during the quarter. Remain very comfortable with our credit risk profile. Our capital position is shown on Slide 19. Book value and tangible book value per share increased year over year. We repurchased nearly 530,000 shares at an average price of $12.94, which is a 43% discount to our tangible book value.

The tangible common equity ratio was stable at 7.71%. Our regulatory capital ratios are strong and overall we view our capital base as a strength and a vital component of our conservative balance sheet. Slide 20 provides our outlook. We do not provide guidance. This discussion is meant to give our high level perspective on performance in the current environment. Despite the robust increase in the loan pipeline, we expect loan growth to remain challenging.

However, the higher percentage of back to back swap loans in the pipeline will add more floating rate assets to our balance sheet and these assets have rates at 7% or higher. As a reminder, certain deposits are seasonally lower in the summer months before increasing by year end. There are several factors that will affect the net interest margin. First is the pressure from the Fed raising rates and the natural shift in the deposit mix. Second is the size and growth of the loan portfolio. Third is a repricing of both CDs and certain loans. Fourth, our interest rate hedges were favorable in the second quarter and an increase in rates by the Fed will benefit this portfolio.

Overall, we expect net interest margin pressure as the Fed increases rates, but all else equal, the pressure should be lower than what was experienced in the second half of 2022 and the first quarter of 2023. The core net interest margin was 2.19% for the month of June. Non-interest income should benefit from the back to back swap loan closings. Non-interest expenses were well controlled in the second quarter and extra scrutiny is placed on all expenses.

We expect the operating expenses to follow normal seasonal patterns. Lastly, the effective tax rate should approximate 26% to 28% for 2023.

John R. Buran
President, CEO & Director

On Slide 21, I'll wrap up with our key takeaways. We continue to execute our action plan, which is improving our profitability in the short and medium term and establishing a foundation for long term success. We're happy with the limited NIM compression for the quarter and have significantly improved our sensitivity to higher rates. Our asset quality and liquidity are conservative and sound. We continue to serve our clients and deepen relationships. Our overall financial metrics improved during the quarter, but we're remaining cautious given the environment.
The decisive actions we are taking to improve the overall performance will allow us to continue our long and consistent record of dividend payments. Operator I'll turn it over to you to open up the lines for questions.

Question and Answer

Operator

We will now begin the question and answer session. [Operator Instructions] At this time we'll pause momentarily to assemble our roster.

[Audio Gap]

The first question comes from Mark Fitzgibbon with Piper Sandler.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Hey, Susan, just to clarify one of your comments about the margin, you talked about the pressure being more manageable than what we saw in the second half of '22 and the first quarter of '23. Should we take that to mean that the margin you think will be down this quarter or something in the neighborhood of what we saw in the second quarter assuming the Fed raises rates 25 basis points later today?

Susan K. Cullen
Senior EVP, Treasurer & CFO

Given where the Fed is in their rate raising cycle, that's a primary driver of that comment. I would expect some compression probably closer to what we've seen in the second quarter than what we had seen in the previous three quarters.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Secondly, I wondered if you could share with us what iGO balances were at the end of the quarter?

John R. Buran
President, CEO & Director

We are at around $200 million.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

John, I wondered if you had any targets for either tangible common equity or CET1 going forward?

John R. Buran
President, CEO & Director

Well, I think we want to stay close to that 8% range. Obviously we're not there at this point in time, but we're very cognizant of of the importance there. I think that the Fed stopping its rising interest rates could help us a little bit there in terms of the securities portfolio valuations. We're comfortable where we are right now for the present. I think we'd like to move it up a little bit more.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

I saw that you had hired a team from Signature Bank. I guess I was curious roughly how large was their book of business and maybe how long you think it takes for them to be able to bring that over to Flushing?

John R. Buran
President, CEO & Director

We're really not disclosing that. It's a group that has a significant basis for their success in the past.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

I wonder if you could share with us the 30-89 day delinquencies. I know they come out in the queue, but if you had those handy, that would be great?

Susan K. Cullen
Senior EVP, Treasurer & CFO

They're down significantly from where they were in the prior period. I don't have them right at my fingertips.

Operator

Our next question comes from Chris O'Connell with KBW.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

Just to follow up on the on the margin discussion, do you have the spot in for June?

Susan K. Cullen
Senior EVP, Treasurer & CFO

June was 219.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

As far as the hedges that were put on this quarter, what was the timing?

Susan K. Cullen
Senior EVP, Treasurer & CFO

What do you mean? A duration or which month they were put on. What do you mean by the timing?

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

I believe last quarter the hedges were put on pretty late in the quarter.

John R. Buran
President, CEO & Director

Here again, they're put on pretty late. They put on in May predominantly.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

Do you have the duration?

John R. Buran
President, CEO & Director

Middle to the end of May.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

Do you have the duration?

Susan K. Cullen
Senior EVP, Treasurer & CFO

They were primarily five years. Three and a half to five.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

Do you have the rate as well?

Susan K. Cullen
Senior EVP, Treasurer & CFO

I think if you look at the presentation, we have the swaps all broken out in there Chris on, I'm flipping through the presentation because I know it's in here. Look at page 15 or so that has a lot of the information on the swaps that you may be looking for.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

Then on the credit side, can you just provide any color around the $1.7 million, I think or so of CNI net charge off this quarter?

Susan K. Cullen
Senior EVP, Treasurer & CFO

It was one relationship that had been downgraded. We've been watching very carefully over the last 6-9 months and, additional information became available that made us realize that the collectibility was questionable and we charged it off.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

Is that fully charged off?

Susan K. Cullen
Senior EVP, Treasurer & CFO

Yes.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

I noticed I think the Manhattan office exposure increased to 0.6% of loans from 0.1% last quarter.

John R. Buran
President, CEO & Director

No, the differential is the number we had been quoting in the past was midtown Manhattan office, which is 0.1%. We've expanded it to include really all of Manhattan. That's what the larger number is.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

And for the office?

John R. Buran
President, CEO & Director

We're not doing it. We're not doing office space. Just for the record.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

I figured. Yes, that's how it struck my eye. As far as office exposure, I know it's pretty low. I think ballpark $150 million or so. I was just wondering if you had the maturity schedule for how much is coming due, say over the next 12 -18 months? If you have, a specific reserve number against it?

John R. Buran
President, CEO & Director

I don't think we have a reserve against any of it.

Susan K. Cullen
Senior EVP, Treasurer & CFO

Not any additional reserve other than we have against the CRE portfolio in total. We know when these loans will be repricing, etcetera. That's not information we're sharing at this time. They all have a nice debt coverage ratio and have low LTVs.

John R. Buran
President, CEO & Director

There's nothing unusual about the structure it's typical. Our typical five year.

Susan K. Cullen
Senior EVP, Treasurer & CFO

They also have very strong sponsors behind these buildings.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

It sounds like based on the loan pipeline, with all the swaps in the pipeline that banking, service fees, could remain strong year after the pick up quarter over quarter this quarter. Would you expect it to remain in a similar range to that where you saw in Q2 or could it move up a little bit more or is Q2 particularly strong?

Susan K. Cullen
Senior EVP, Treasurer & CFO

I think if you're looking at our core that we would expect them to go up. Obviously our GAAP non-interest income has the fluctuations from the market valuations included in there, but we would expect our core fees to increase with the number of swaps deals we've been transacting.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

Based on what you were discussing on the TC target and relatively low balance sheet growth here and where the stock is trading, how are you thinking about buyback utilization going forward?

Susan K. Cullen
Senior EVP, Treasurer & CFO

Our capital planning has not changed at all, Chris. We still think the best thing to do with our excess capital is to redeploy it into the business to grow, followed by returning to shareholders through the form of dividends and finally share repurchases. We always take look at it and opportunistically take a take a look at the market and see if that's the best place to deploy our capital. Again, growing the business is, that is the first priority with capital.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

Taking a step back and thinking about things more strategically. I mean, obviously this quarter, you had good coverage. If NIM is down similar to Q2 levels, things become a little tighter. It seems in the back half of the year. How are you guys thinking about dividend coverage going forward and strategically what are the decision making factors around that?

John R. Buran
President, CEO & Director

We don't see any any any reason to change our dividend policy at this point in time.

Operator

Our next question comes from Manuel Navas with D.A. Davidson.

Manuel Antonio Navas
D.A. Davidson & Co., Research Division

Most of my questions have been answered, but just can you remind me the expected size of deposit seasonality? Is it just going to follow past year trends?

John R. Buran
President, CEO & Director

The typical trend is a downturn in seasonal balances in the summer months anywhere from $150 to $200 million. Then as we approach the fall, that starts to rebound.

Manuel Antonio Navas
D.A. Davidson & Co., Research Division

What are your current offers on the deposit side in the market?

Susan K. Cullen
Senior EVP, Treasurer & CFO

Our CD offerings are about 4.5 to 5.25.

Manuel Antonio Navas
D.A. Davidson & Co., Research Division

You're still seeing solid flows on your offers?

Susan K. Cullen
Senior EVP, Treasurer & CFO

Yes.

Manuel Antonio Navas
D.A. Davidson & Co., Research Division

I guess you talked about the CRE team. What's the pipeline going forward and what are the opportunities you're seeing in marketplace for talent?

John R. Buran
President, CEO & Director

We're always on the outlook. I think that there's, from what we understand, there may be some situations with respect to payments to individuals that may be coming to an end that may present an opportunity for additional staff to come our way.

Susan K. Cullen
Senior EVP, Treasurer & CFO

Well, Manuel, I just want to emphasize that this team also is deposit gatherers. They're not just loan gatherers. I think that's an important distinction.

Operator

[Operator Instructions]

[Audio Gap]

No further questions. This concludes our question and answer session. I would like to turn the conference back over to John Buran for any closing remarks.

John R. Buran
President, CEO & Director

Well, thank you, everybody, for joining us today on our second quarter 2023 earnings call. We appreciate your continued support of Flushing Financial and look forward to talking to you again next quarter. Thank you very much.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.