S&P Global
Market Intelligence

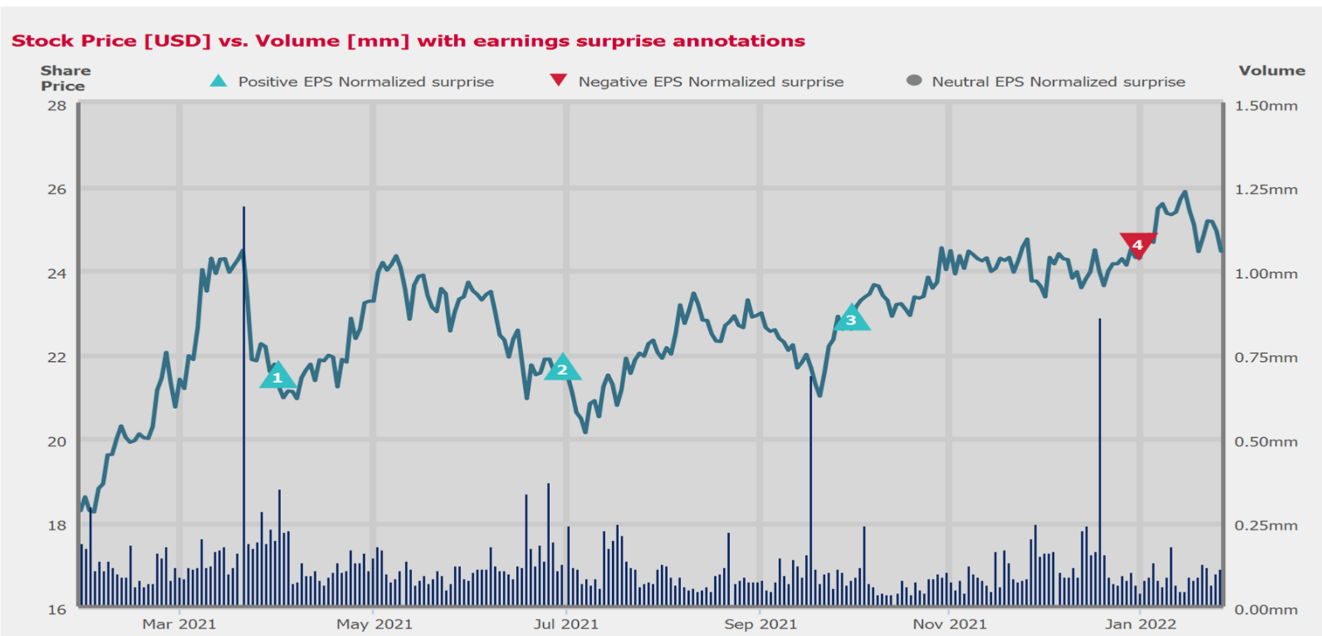
Flushing Financial Corporation NasdaqGS:FFIC FQ4 2021 Earnings Call Transcripts

Friday, January 28, 2022 4:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2021-			-FQ1 2022-	-FY 2021-			-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	0.68	0.67	(1.47 %)	0.56	2.80	2.81	0.36	2.44
Revenue (mm)	65.48	67.65	3.31	65.14	257.33	264.37	2.74	262.52

Currency: USD
Consensus as of Jan-10-2022 9:20 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2021	0.47	0.54	1 14.89 %
FQ2 2021	0.64	0.73	2 14.06 %
FQ3 2021	0.64	0.88	3 35.38 %
FQ4 2021	0.68	0.67	4 (1.47 %)

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Call Participants

EXECUTIVES

John R. Buran
President, CEO & Director

Michael Bingold
Senior EVP, Chief Retail & Client Development Officer

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

Presentation

Operator

Welcome to the Flushing Financial Corporation's Fourth Quarter 2021 Earnings Conference Call. Hosting the call today are John Buran, President and Chief Executive Officer; Susan Cullen, Senior Executive Vice President, Chief Financial Officer and Treasurer; and Mike Bingold, Senior Executive Vice President, Chief Retail and Client Development Officer.

Today's call is being recorded. After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] A copy of the earnings press release and slide presentation that the company will be referencing today are available on its Investor Relations website at flushingbank.com.

Before we begin, the company would like to remind you that discussions during this call contain forward-looking statements made under the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Such statements are subject to risks, uncertainties and other factors that may cause actual results to differ materially from those contained in any such statements, including as set forth in the company's filings with the U.S. Securities and Exchange Commission to which we refer.

During this call, references will be made to non-GAAP financial measures as supplemental measures to review and assess operating performance. These non-GAAP financial measures are not intended to be considered in isolation or as a substitute for the financial information prepared and presented in accordance with U.S. GAAP. For information about these non-GAAP measures and for a reconciliation to GAAP, please refer to the earnings release and/or the presentation.

I'd now like to introduce John Buran, President and Chief Executive Officer, who will provide an overview of the strategy and results. Please go ahead.

John R. Buran
President, CEO & Director

Thank you, operator. Good morning, everyone, and thank you for joining us at our fourth quarter and full year 2021 earnings call. On today's call, I'll discuss fourth quarter earnings and ongoing strategic objectives before turning the call over to Mike Bingold, Chief Retail and Client Development Officer; and Susan Cullen, Chief Financial Officer. Following our prepared remarks, we'll answer your questions.

There are 2 main items I want to talk to you about today: First, a review of our record earnings for 2021; and second, the outlook for 2022. For the fourth quarter, GAAP and core return on average assets increased 71 and 12 basis points year-over-year, respectively, and GAAP and core return on average equity increased 850 and 82 basis points, respectively.

The net interest margin improved 21 basis points on a GAAP basis and 18 basis points on a core basis. We remain focused on executing on our strategic objectives, and we are pleased with our performance in the fourth quarter of '21 and very happy with the full year results.

The first objective is to ensure appropriate risk-adjusted returns for our loans while optimizing the cost of funds. The average noninterest-bearing deposits increased 34%. We had record low cost of deposits at 25 basis points. Loan yields were compressed 2 basis points quarter-over-quarter.

The second objective is to maintain strong historical loan growth. Loan closings were up significantly 49% for the linked quarter. Loans, excluding PPP, increased 3.7% annualized quarter-over-quarter. The loan pipeline began the season after a record third quarter level and ended the year at a very solid $429 million. Excluding the effects of PPP loan forgiveness, we expect positive loan growth in 2022.

The third objective is to enhance core earnings power by improving scalability and efficiency. Earnings per share improved 427% year-over-year on a GAAP basis and 16% on a core basis. Our digital banking efforts continue to gain traction with customers, and we're seeing opportunities to expand technology-supported products and services. There is a significant organic growth opportunity over the next 12 to 18 months from merger disruption. And so far, we've added 24 people from these institutions, 9 of which are revenue producers.

Our fourth strategic objective is to manage asset quality with consistent and disciplined underwriting. Low levels of nonperforming assets and criticized and classified loans are only 87 basis points of loans. We have reserve coverage of nearly 250%. And greater than 87% of our loans are real estate based, and those loans have an average loan-to-value of less than 38%. We have a low level of credit risk in our portfolio as a result.

On Slide 4, we outline our strategic objectives for 2022. Most objectives are the same as in past years as we want to improve the funding mix, generate appropriate loan growth and maintain strong asset quality. We also recognize the need to invest in the long term while managing short-term results. Examples include enabling customers to transact in Bitcoin and eliminating consumer overdraft fees, both of which should help expand our noninterest-bearing demand deposits. Also, through our small business lending platform, we're improving the customer experience through automation and faster decision-making.

Merger disruption is one of the most significant opportunities presented to us over the next 12 to 18 months, as shown on Slide 5. As these mergers get approved and integration begins, we expect to add people and new business. In 2021, we added 24 people from the institutions on this slide, 9 of which are revenue producers. We expect to focus on organic growth opportunities.

We had a record loan pipeline at the end of the third quarter, as shown on Slide 6. The loan pipeline is balanced between real estate and business banking, as business banking activity has increased significantly. Prepayment speeds rose over 50% in 2021 and nearly doubled in the fourth quarter. With the yield curve steepening, we expect refinancing volume to slow in 2022. So between the strong pipeline and the shape of the curve, we expect loan growth will improve.

I'll now turn it over to Mike Bingold to provide more color on our digital banking strategies, and then Susan will follow with more details on key financial metrics.

Michael Bingold
Senior EVP, Chief Retail & Client Development Officer

Thank you, John. We recognize the importance of technology as it improves the customer experience, enhances our product set and creates efficiencies.

Slide 7 outlines some of our key statistics and technology plans. We upgraded our digital banking platform just before the pandemic started and continued to see significant gains, including a 31% increase in monthly mobile active users and a 37% increase in active online banking users year-over-year. We recently adopted Zelle across our bank and digital platforms, and customer usage has been significant. We also made a strategic investment in JAM FINTOP. This investment allows an early look at emerging technology, and we are excited about the offerings we have seen so far.

In the fourth quarter, we launched a numerated platform to digitally originate small dollar SBA loans, and to date, we are pleased with the offering. We recently announced our plan to enable customers the ability to transact Bitcoin through a partnership with NYDIG. We will have an opportunity to acquire new customers and grow noninterest-bearing deposits while generating noninterest income. NYDIG access custodian and executes the trades. The bank will not hold any Bitcoin or have any price risk. We view this as an attractive opportunity as interest in Bitcoin remains strong. And according to research, customers who want to transact in Bitcoin prefer to do business through a bank. We are working on several other digital initiatives as well.

I will now turn the call over to Susan to discuss the key financial metrics.

Susan K. Cullen
Senior EVP, Treasurer & CFO

Thank you, Mike. I'll begin on Slide 8. Average noninterest-bearing and total deposits increased 34% and 17%, respectively, year-over-year and comprised 15% of average deposits, an improvement from 13% in the fourth quarter of 2020. We continue to focus on optimizing the deposit mix and look for ways to reduce the cost of funds. The cost of deposits decreased 4 basis points quarter-over-quarter and 22 basis points over the past 12 months to a record low of 25 basis points. Branch business activity continues to pick up, with fourth quarter checking account openings up 35% year-over-year and 13% from the fourth quarter of 2019.

Slide 9 outlines the loan portfolio and yields. Loans, excluding PPP, increased 3.7% annualized quarter-over-quarter. With a strong pipeline and a steepening yield curve, we are optimistic that loan growth will improve in 2022. The steepening of the yield curve should help rates on loan originations to move higher over time.

Core loan yields, which include pre-penalty income, decreased 4 basis points quarter-over-quarter, while base loan yields were stable. However, there is still pressure on loan yields as the yield on satisfaction exceeded the yield on loan closings by 40 basis points in the fourth quarter. PPP loans declined 41% to $77 million during the quarter as the SBA continues to forgive loans. During the quarter, the company recognized approximately $1 million of PPP fees.

Slide 10 outlines net interest income and margin trends. GAAP net interest margin was 3.29% and declined 5 basis points during the quarter. Net interest income declined 1% linked quarter to $63 million.

Core net interest income, which removes the impact of net gains from fair value adjustments and purchase accounting accretion, also declined with core net interest margin compressing 6 basis points to 3.21% in the fourth quarter. Excluding the impact from net prepayment penalty income, net gains from fair value adjustments and purchase accounting accretion, which totaled 16 basis points in the fourth quarter and 19 basis points in the third quarter, the net interest margin declined by 2 basis points quarter-over-quarter. For modeling purposes, we encourage you to start with the base net interest margin of 3.13%, which includes 3 basis points of positive PPP impact and that then add in your own assumptions for the adjustments previously mentioned.

Slide 11 discuss our current balance sheet position. Assuming the yield curve at year-end in a static balance sheet, net interest income would increase over time. This increase is primarily driven by the repricing of the funding of the swaps, slightly lower funding costs and higher rates on originations given the steepening yield curve. This is shown by the light blue bar. We are adding more floating rate assets to the balance sheet. Depending on the timing of adding floating rate assets, net interest income is projected to increase by $3 million to $12 million annually and help negate the liability sensitivity position. This is depicted by the dark blue bar.

Turning to Slide 12. We provide more detail on the impact of rising rates. The timing and pace of rising rates is a key driver for net interest income. The slower the rate increase over a longer period of time is better than an immediate shock of 100 basis points, for example. Currently, approximately 25% of loans will mature or reprice within 1 year while our liabilities tend to reprice quicker.

The chart on the left depicts the impact of a 200 basis point increase in rates over the first 2 years without any balance sheet growth in the base case and adding the floating rate initiative in the other scenario. Clearly, the floating rate asset initiative benefits net interest income and helps reduce the liability sensitivity. We are also emphasizing the growth of noninterest-bearing deposits. While our net interest margin may compress in the near term with these rate increases, we expect to see net interest income growth in 2022, driven by the expansion of the balance sheet. The modeling on this slide is based on lagging deposit rate increases and the Fed funds curve as of early December 2021.

Moving on to Slide 13. Net charge-offs were only 5 basis points for 2021, and we had net recoveries of $29,000 for the fourth quarter. Historically, our losses have been better than industry, and we expect this to continue. Our underwriting is conservative, and we are not a price leader. The average loan-to-value on our real estate portfolio is less than 38%, and less than 1% of the loan portfolio has an LTV of 75% or more.

Slide 14 outlines the company's solid credit metrics. Nonperforming assets declined 26% linked quarter, and the LTV on these assets is 30%. The company increased reserves in the fourth quarter related to the current period on originations and the increased risk from the Omicron variant of COVID-19. While the overall reserve to loans ratio is 56 basis points, on the bottom right of this slide, you can see the reserves by loan type. Overall, we remain very comfortable with our credit risk profile and continue to expect minimal loss contact.

Slide 15 shows our strong capital ratios. Book value and tangible book value per share increased 11% each in 2021. The tangible common equity ratio improved 18 basis points during the fourth quarter to 8.22%. During the quarter, the company repurchased 151,000 shares at an average price of $23.75, resulting in 56% of the company's earnings being returned to the shareholders during the quarter.

Our capital priorities are unchanged and are to profitably grow the balance sheet, pay dividends to shareholders and opportunistically repurchase shares. We view the stock as attractively priced given the approximately 3.4% dividend yield and a significant opportunity for future growth.

Slide 16 outlines key points in the outlook for the first quarter of 2022 and for the full year. We start with net interest income and net interest margin. While there are many moving pieces, overall, we expect growth in net interest income in 2022 based on rate increases and profitably growing the balance sheet. Core net interest margin will depend on the level of loan growth, deployment of liquidity and the pace of floating rate asset additions.

The fourth quarter reported margin includes elevated levels of purchase accounting accretion, net prepayment penalty income and positive fair value marks, while PPP fees added 3 basis points to the margin in the fourth quarter as well. We expect these items to normalize in 2022. Loan growth, excluding PPP, should improve in 2022 given the strong pipeline.

There are 2 items to note for noninterest income. First, there was a $2 million dividend received on our retirement plan investment in the fourth quarter that is not expected to repeat. Second, the elimination of overdrafts, insufficient funds and transfer fees on consumer checking accounts is expected to reduce noninterest income by $200,000 in 2022. Fourth quarter noninterest expense includes a onetime $4 million increase in compensation and benefits for all employees as a reward for achieving record earnings and for the performance during pandemic. We are continuing to invest in the franchise and our people, resulting in high single-digit percent core expense growth year-over-year.

For modeling purposes, first quarter core expenses should increase low single-digit percentage compared to the fourth quarter due to normal growth of the bank and seasonal expenses largely offsetting the onetime compensation and benefit increase. Expenses for the remainder of 2022 should follow the normal seasonal patterns, with some of the seasonal expenses in the first quarter falling out in the second.

Lastly, the effective tax rate for 2022 should approximate 26.5% to 27%.

I'll now turn it back over to John.

John R. Buran
President, CEO & Director

Thank you, Susan. On Slide 17, we provide our key messages. Loan growth is expected to increase in 2022 as we have a strong pipeline and the economy is growing. We're benefiting from the merger disruption as we've added 24 people, 9 of which are revenue producers in 2021, and we expect to add more as deals close and the integration begins. We are investing in the business and our people.

New services in Bitcoin and reduction in overdraft fees are set to launch in 2022. Our employees are our competitive advantage, and we're rewarding them for their efforts during the pandemic.

Our expense base will be higher as we invest in the company in 2022. We're preparing for rising rates. We're adding floating rate assets immediately and floating rate loans over time. We'll be emphasizing low-cost deposit growth, and these initiatives should improve our interest rate risk profile. Overall, we expect to grow net interest income in 2022 based on expected balance sheet growth.

We have a low-risk business model with conservative average LTVs, low credit risk and a stock that has an approximate 3.4% dividend yield. We'll be maintaining, through the cycle, return on average assets and return on average equity goals. We have several initiatives in place to help drive results over the long term.
Operator, I'll now turn it over to you to open up the lines for questions.

Question and Answer

Operator

[Operator Instructions] And our first question will come from Chris O'Connell of KBW.

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

So I just wanted to confirm the expense guide here. I thought you said just in the prepared comments there, the first quarter will be up low single digit. And the thing I'm seeing in the slides, up high mid-single-digit inflation plus the $45 million of the $34.4 million base. Just hoping to confirm kind of where we're starting off the year here.

Susan K. Cullen
Senior EVP, Treasurer & CFO

So that's -- excuse me, I'm having trouble speaking this morning. So that is pretty close. The $4 million onetime compensation expense item that we took in the fourth quarter of this year should largely offset the seasonal expenses that we see in the first quarter of 2022. And then we have -- yes, we are expecting higher-than-normal growth in the expenses and the high -- and more in the high single digits as we continue to invest in the company.

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

Okay. And so just to put it all together, if I'm reading it right, I think the first quarter kind of shakes out to somewhere, plus or minus, a bit in the $41 million range. And then usually, you guys have -- I think typically in the past, you said about a $3.5 million drop down in the second quarter off the seasonality or maybe it's, I guess, $4 million to $4 million to $5 million now.

Susan K. Cullen
Senior EVP, Treasurer & CFO

Right. It depends on what the stock does, where that -- they'll be between $3.5 million and $4 million or $4.5 million. So it's somewhere in that range.

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

Got it. Okay. Perfect.

John R. Buran
President, CEO & Director

And then 80% of that drops off in the second quarter of 2022, roughly.

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

Yes. So about the $3.5 million or so, $3.5 million to $4 million kind of drops off.

Susan K. Cullen
Senior EVP, Treasurer & CFO

Yes.

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

Okay, great. Perfect.

Susan K. Cullen
Senior EVP, Treasurer & CFO

Yes.

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

And usually, it's seasonally flattish, plus or minus.

Susan K. Cullen
Senior EVP, Treasurer & CFO

Right, on a core basis -- right. Correct.

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

Thereafter, got you. Okay. Great. And then I was hoping to just get some color around Slides 11 and 12. As far as, I guess, on Slide 11, this chart on the left, what would the line look like be for a third line that's not using the forward curve on kind of NII? Just trying to get a frame of maybe like what 125 basis point Fed hike does to either NIM or NII or kind of how that looks.

Susan K. Cullen
Senior EVP, Treasurer & CFO

So well, obviously, what it would look like would also depend on what assumptions we put in there. As we said, this slide was built on lagging deposit costs. So we would continue to lag deposit costs, I would not expect the 25 basis points to have much of an effect on our net interest income because the deposit betas. We've lagged those deposit betas as we said, and it would depend on what the shape of the yield curve did if it was just the low end that rose or if the high -- if the back end rose as well.

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

Okay. Got it. So it seems like -- then, I guess, based on Slide 12, the pressure to the margin NII really comes after 2 or 3 hikes here?

Susan K. Cullen
Senior EVP, Treasurer & CFO

Yes.

John R. Buran
President, CEO & Director

Yes. Yes, just remember, Chris, on that slide, on Slide 12, we're not assuming any loan growth in that structure. Obviously, if this loan growth, the net interest income, of course, improves.

Susan K. Cullen
Senior EVP, Treasurer & CFO

That's on both slides, Chris. Both slides assume a static balance sheet.

Operator

[Operator Instructions] There appear to be no further questions at this time. I will turn the conference back over to John Buran for any closing remarks.

John R. Buran
President, CEO & Director

Well, thank you very much for your attention. With the economy improving and some opportunities associated with merger disruption, we're looking forward to a very, very strong 2022. Although I think we do have a question that just popped up. Do we want to take that one from D.A. Davidson?

Operator

The question is from Manuel Navas of D.A. Davidson.

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

Can you talk -- can you add any more color on those 9 new hires? I'm curious where they're coming from and what business lines you're adding them to?

John R. Buran
President, CEO & Director

I think we want to keep that confidential, so as not to tip our hands going forward. But obviously, we've got some lenders there. We've got some branch staff. We have new business development people. So it's a pretty good mix.

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

Are you expand -- would those add any new products to your product set? Or are they kind of fall...

John R. Buran
President, CEO & Director

No, I think that we're really talking about people who already do the type of business that were after the multifamily and small business market.

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

Okay. I have a quick follow-up on both Slides 11 and 12. Are they just kind of an expanded of your 10-Q disclosure? Because just kind of wondering the percent difference between year 1 and year 2, for example, on Slide 12. Would that match up with your roughly 3% disclosure in 3Q declining NII?

Susan K. Cullen
Senior EVP, Treasurer & CFO

They are expanded disclosures based on the 10-Q that was filed in November.

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

Okay. And what betas are you using in year 1 versus year 2? You do say you lag them. Can you disclose?

Susan K. Cullen
Senior EVP, Treasurer & CFO

Yes. No, we don't disclose what we're using as our betas, but they are based on what we have seen as historical runoff. So they're based on what we have seen.

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

Okay. And is the historical your historical? Are you taking some of the passage of the whole...

Susan K. Cullen
Senior EVP, Treasurer & CFO

Yes. We use our historical because we've been around long enough to be through -- tend to have gone through many rate cycles.

John R. Buran
President, CEO & Director

And at least what we're seeing is -- what we're projecting is beta is going to rise in year 2 versus year 1.

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

Right, right. Okay. That was helpful. One last question. On capital return, you're disclosing that payout ratio. Does that mean you're starting to think about capital return in terms of a payout ratio?

Susan K. Cullen
Senior EVP, Treasurer & CFO

Well, we've always had a payout ratio. What we're just trying to point out with that 56% is based on our earnings, the dividends we paid and the effects of the repurchases that we returned 56% to the shareholder. We paid a dividend every year and have never decreased our dividend since we went public in 1995.

John R. Buran
President, CEO & Director

It looks like we have no other questions. Once again, thank you very, very much for your attention, and we look forward to updating you in the future about our continued strong results. Thank you.

Susan K. Cullen
Senior EVP, Treasurer & CFO

Thank you.

Operator
The teleconference is now concluded. Thank you for attending today's presentation, and you may disconnect your lines.