S&P Global
Market Intelligence

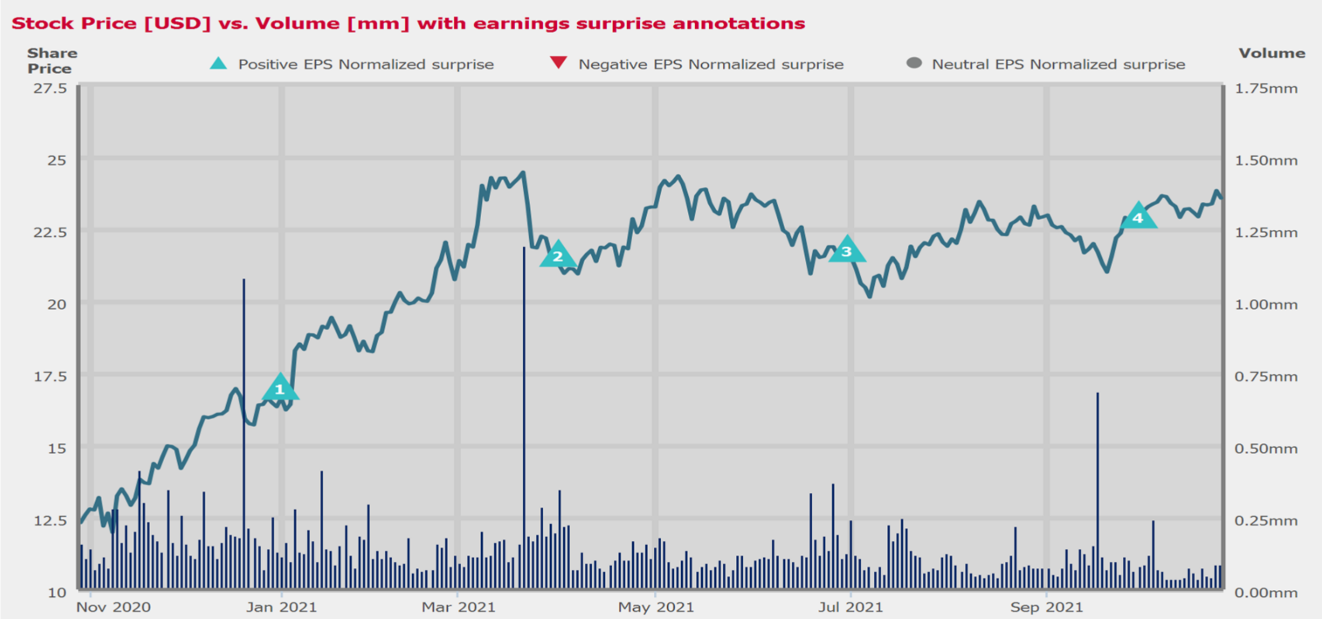
Flushing Financial Corporation NasdaqGS:FFIC FQ3 2021 Earnings Call Transcripts

Wednesday, October 27, 2021 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2021-			-FQ4 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.64	0.88	35.38	0.62	2.55	NA
Revenue (mm)	63.87	66.64	4.34	64.20	256.39	NA

Currency: USD
Consensus as of Oct-04-2021 9:08 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2020	0.42	0.58	1 38.10 %
FQ1 2021	0.47	0.54	2 14.89 %
FQ2 2021	0.64	0.73	3 14.06 %
FQ3 2021	0.64	0.88	4 35.38 %

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Call Participants

EXECUTIVES

Francis W. Korzekwinski
Senior EVP & Chief of Real Estate Lending

John R. Buran
President, CEO & Director

Susan K. Cullen
Senior EVP, Treasurer & CFO

ANALYSTS

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

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Presentation

Operator

Welcome to the Flushing Financial Corporation's Third 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 Frank Korzekwinski, Senior Executive Vice President and Chief of Real Estate Lending.

[Operator Instructions] Please note, this event is being recorded. 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 you.

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 the U.S. GAAP. For information about these non-GAAP measures and for reconciliation to GAAP, please refer to the earnings release and/or the presentation.

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

John R. Buran
President, CEO & Director

Thank you, operator. Good morning, everyone, and thank you for joining us for our third quarter 2021 earnings call. On today's call, I'll discuss third quarter highlights and ongoing strategic objectives before turning the call over to our CFO, Susan Cullen, to provide greater detail on our financial performance. Following our prepared remarks, we will address your questions along with our Chief Real Estate Lending Officer, Frank Korzekwinski.

So the execution of our strategy resulted in record third quarter results. We had our second consecutive quarter of record core EPS and our sixth consecutive quarter of record net interest income and record loan pipeline. Our GAAP and core return on average assets, return on average equity, net interest margin, efficiency ratio, profitability metrics improved year-over-year even without the benefit of reduced provisioning. We continue to focus on our strategic objectives, and we're performing well against them.

Our first objective was to ensure appropriately risk-adjusted returns for loans while optimizing the cost of funds. Our GAAP NIM increased 20 basis points, and core NIM rose 13 basis points during the quarter. Our cost of funds declined another 4 basis points. Loan yields expanded 10 basis points quarter-over-quarter and 8 basis points year-over-year. And our noninterest-bearing deposits improved to 15% of average deposits.

The second objective is to maintain strong historical loan growth. Excluding PPP, loans were flat quarter-over-quarter due to normal summer delays, but activity picked up significantly in September. Business activity for the quarter was strong, however, as we had record loan pipeline to end the quarter. As a result, we're expecting positive loan growth excluding PPP in the fourth quarter and into 2022.

Our third objective is to enhance core earnings power by improving scalability and efficiency. In this regard, we've been realizing the benefits of the Empire merger, spreading fixed costs over a wider asset base. Digital banking efforts have continued to gain traction with our customers. We're also expanding future technology opportunities that I'll get into later. Our efficiency ratio improved to 52%, and there's a significant organic growth opportunity over the next 12 to 18 months.

The fourth strategic objective is to manage asset quality with consistent and disciplined underwriting. For the quarter, net recoveries were 4 basis points. We have low levels of NPAs and a high level of reserve coverage. Our average loan to value in our real estate portfolio is less than 38%. We'll remind you that real estate represents greater than 87% of our loans. Historically, we've had a low level of credit risk in our portfolio, and of course, this remains.

On Slide 4, we note that October 30 will mark the 1-year anniversary of the closing of Empire Bancorp transaction. At the time of the announcement, we expect that the transaction would achieve several goals, and we've met them all. We achieved a 20% EPS accretion. Tangible common equity now exceeds 8%, and tangible book value per share increased 5% year-over-year. Our cost of deposits improved 28 basis points year-over-year. Our average noninterest-bearing deposits increased 58%. The loan-to-deposit ratio improved to 102%, and we achieved our 50% cost savings target. And Suffolk County, where we've begun to develop more business, remains a focus for us.

Bottom line, we achieved our targets, and Empire has been a very successful transaction for us. So we approached the end of 2021 a stronger, more resilient company with a much improved outlook.

Slide 5, we recognize the impact technology is having on the industry, and we are prepared for additional changes. We upgraded our digital banking platform just before the pandemic started and continue to see significant gains 18 months later. We had a 39% increase in monthly mobile active users and a 51% 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 us an early look at emerging technologies, and we're very excited about the offerings we've seen so far.

As you may recall, we partnered with a fintech, Numerated, to help in our PPP program. This integration was smooth, and the customer experience was very much improved. We gained efficiencies using this platform. Now we're looking to expand this relationship into other lending opportunities to provide an enhanced level of service to our customers. We recognize the impact of technology and what it's having on the industry, and we expect to be prepared for additional changes as time goes on.

On Slide 6, our most significant opportunity for the next 12 to 18 months is the eight announced or recently closed mergers that involve a participant in our market. Out of the $328 billion of deposits on Long Island, $60 billion or 18% involved one of these merger participants. We're already starting to see some benefits by adding both people and business. Most of the transactions have not closed yet. As a result of this opportunity for growth, our focus will be organic.

We'll turn now to Slide 7. In addition to the merger opportunity, there are other drivers of future growth. We have a record loan pipeline that serves as a baseline for growth. New York is recovering to more normal activity, and our important Asian market is seeing increased activity. We see similarities between coming out of the Great Recession and the opening in this pandemic. Coming out of the Great Recession, you'll recall loan growth accelerated at a high pace. From 2010 to 2015, multifamily loans increased at a double-digit rate. Commercial real estate were high single digits, and commercial business was in the low 20% growth rate. So we see a positive outlook for loan growth, excluding PPP, for the fourth quarter and into 2022.

I'll now turn it over to Susan to provide more details on how we executed versus our strategic objectives.

Susan K. Cullen
Senior EVP, Treasurer & CFO

Thank you, John. I'll begin on Slide 8. Average noninterest-bearing and total deposits increased 58% and 28%, respectively, year-over-year. Average core deposits comprised 84% of average deposits, an improvement from 78% in the third 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 5 basis points quarter-over-quarter and 28 basis points over the past 12 months.

Branch business activity continues to normalize as third quarter checking account openings exceeded pre-pandemic levels in the third quarter of 2019. The company closed the Mineola branch and is due to open a new branch in the Elmhurst area.

Slide 9 outlines the net interest income and margin trends. GAAP net interest margin was 3.34% and improved 20 basis points during the quarter. Net interest income was a record for the sixth consecutive quarter despite the decline in average loans. Core net interest income, which removes the impact of net gains from fair value adjustments and purchase accounting accretion, was also a record, with core net interest margin increasing 13 basis points to 3.27% in the third quarter. Excluding 19-basis-point impact of net prepayment penalty, net gains from fair value adjustments and purchase accounting accretion in the third quarter, the net interest margin was 3.15% compared to 10 basis points of adjustments in the second quarter and a net interest margin of 3.04%.

On this basis, the net interest margin expanded 11 basis points primarily due to the decrease in the cost of deposits and a shift in the balance sheet funding. For modeling purposes, we encourage you to start with the base net interest margin of 3.15%, which includes 2 basis points of positive PPP impact, and then add in your own assumptions for the items previously mentioned.

As a reminder, we have $592 million of effective swaps with a cost of 195 basis points that currently are a drag on the net interest margin, with the majority maturing by the end of 2023. These swaps will largely be replaced with $405 million of forward swaps with a cost of 77 basis points. The repricing of the swaps, absent any other interest rate changes, should provide a benefit to the net interest margin in the future.

Slide 10 outlines loan portfolio and yields. Loans excluding PPP were flat quarter-over-quarter As John mentioned previously, the company experienced normal summer and third-party delays, and then activity increased in September. The record loan pipeline of $531 million reflects a positive outlook for loan growth. The loan pipeline has increased activity in both commercial real estate and commercial business and is reflective of the current loan portfolio. The weighted average rate on loan closings increased 13 basis points quarter-over-quarter. Additionally, the steepening of the yield curve should help rates on loan originations to move higher over time.

PPP loans declined 34% to $131 million during the quarter as the SBA continues to forgive loans. The company recognized approximately $1 million of accelerated PPP fees.

Slide 11 provides a snapshot of our disciplined underwriting. The company's credit quality has held up well through the pandemic and has mirrored our historical performance. Our underwriting is conservative, and we are not a price leader.

New York continues to make progress in return to normal economic activity. However, the unemployment rate in New York City is 7.6% compared to 3.5% to 4% prepandemic and down from the peak of the 17% in May 2020.

The company released reserves in the third quarter due to the improved economic outlook. Future loan loss provisions are expected to be driven by loan growth, mix and economic factors. The company had 4 basis points of net recoveries in the third quarter and just 6 basis points of net charge-offs for the 9-month period. The average loan to value on the real estate portfolio remains at less than 38%.

Slide 12 continues to outline the company's solid credit metrics, with a low level of nonperforming assets and a strong level of reserve coverage. Forbearance has continued to decline with only $40 million of loans on full P&I deferral of the remaining $162 million. Over 57% of the total forbearance are due to resume making full payments by the end of the year. Overall, we remain very comfortable with our credit risk profile and continue to expect a minimal loss content.

Slide 13 shows our strong capital ratios. Tangible common equity ratio improved 24 basis points during the third quarter to just over our target of 8% and comparable to the year-ago levels, which did not include Empire. Tangible book value per share increased to $21.13 even as we repurchased 286,000 shares at an average price of $22.42.

The company returned 51% of earnings to shareholders this quarter through a combination of dividends and share repurchases. 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 approximate 3.7% dividend yield and the opportunity for future growth.

Before I turn the call back to John, let me remind you some items that could impact the fourth quarter. Core net interest margin will be impacted by the timing and level of overall loan growth and deployment of liquidity. Reported net interest margin contained elevated levels of purchase accounting accretion, net prepayment penalty and positive fair value mark on hedges, all of which totaled 19 basis points compared to 10 basis points in the prior quarter, and averaged mid-single digits in prior quarters in 2020 and 2019. Purchase accounting accretion is expected to be less than $1 million per quarter. Assuming no change in the pandemic response, we expect loan growth to improve, excluding the PPP loans, in the fourth quarter and into 2022. The starting point for fourth quarter operating expenses is $35 million before adding a normal growth rate. Our effective tax rate for the full year 2021 should approximate 26.5%.

I'll now turn it back over to John.

John R. Buran
President, CEO & Director

Thank you, Susan.

Slide 14 shows our outlook. We expect to benefit from all of the merger activity in our market. Over $60 billion of deposits on Long Island involve a merger participant. We've already gained staff and customers and are looking to add more in the future. Additionally, a major acquirer has already changed its posture on holding CRE loans.

We also expect positive loan growth, excluding PPP, in fourth quarter and into 2022. Our loan pipelines are at record levels, and the local economy continues to normalize. Core net interest income growth is expected to be driven more by volume than rate. We expect positive loan growth into 2022. We continue to manage our funding costs, and loan yields have been stable.

We've reached the 8% tangible common equity target within 1 year of the Empire deal closing. We have the flexibility to return capital to shareholders, and our capital priorities have not changed. We'll first look to profitably grow the balance sheet, then return dividends to shareholders and then opportunistically repurchase shares. We look to maintain the TCE ratio above 8%.

I'll remind everyone that we operate with a low-risk business model with conservative average LTVs, low credit risk. And our stock has an approximate 3.7% dividend yield. We've been exceeding our profitability targets. ROAA and ROAE have been above through-the-cycle targets, both on a reported basis and without the benefit of credit losses.
Operator, I'll turn it over to you to open up the lines for questions.

Question and Answer

Operator

[Operator Instructions] And our first question today comes from Mark Fitzgibbon with Piper Sandler.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

First question I had, do you think that we're -- the reserve releases are behind given how strong your loan pipeline is today?

Susan K. Cullen
Senior EVP, Treasurer & CFO

I think if the loan portfolio grows, the reserve releases may cease because the reserve release will be predicated upon the loan mix current originations and the economic factors. So if we grow the portfolio, my expectation would be that the reserve releases would stop.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Okay. And then, Susan, I heard what you had mentioned about expenses, but are there any other major expense initiatives coming down the pipe, whether technology or otherwise?

Susan K. Cullen
Senior EVP, Treasurer & CFO

No, not at this time. But as a reminder, as everybody is doing their modeling, we do have the first quarter. And I can't believe we're talking about first quarter 2022 already, but we do have the first quarter seasonal expenses that will come into play.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Okay. Great. And then on the merger charges related to Empire, I think they were $2.1 million this quarter. Is there any more of those outstanding? Or are those all behind at this point?

Susan K. Cullen
Senior EVP, Treasurer & CFO

I think they're mostly behind us. This was primarily related to some fixed asset impairment charges and closing the branch.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Okay. And then I guess I was wondering, of the $40 million of loans on deferral that are not making interest payments right now, would you expect a lot of those to migrate to nonaccrual when the deferrals expire later this year?

Susan K. Cullen
Senior EVP, Treasurer & CFO

No. I would expect them to migrate to performing loans when they migrate at the end of this year.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Okay, and then one last one actually. Of the $531 million loan pipeline, I guess I was curious, roughly what would be your guess on how much is coming from other players that are in the midst of mergers?

Susan K. Cullen

Senior EVP, Treasurer & CFO

I'll turn that over to Frank, Mark, and let him answer that.

Francis W. Korzekwinski
Senior EVP & Chief of Real Estate Lending

The volume has been fairly active. I can't say with any accuracy as to how much is coming from individual institutions, but I can say that we're growing new customers as well. Obviously, the deals that we're doing are in market, so they would naturally come from replacing debt that's already existing. We continue to see an enhanced experience with our existing borrowers. Many of our relationships are growing and expanding. And I think that is likely a result of other borrowers not being as comfortable going to an institution that may be going through a merger scenario. Generally speaking, when two institutions come together, there is a delay in understanding how loans are originated, processes change, requirements change. So we are definitely picking up business in the market from borrowers and relationships that we have not seen in the past.

Operator

[Operator Instructions] The next question comes from Chris O'Connell with KBW.

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

I was hoping you guys just talk about the loan growth expectations. It seems like they're strong coming into the fourth quarter. Was there anything in the third quarter that just caused like some delays in closings? Because the pipeline was pretty robust coming into this quarter. Did things just get pushed out a bit coming into the fourth quarter here?

John R. Buran
President, CEO & Director

So we've seen a few larger loans roll into this -- into the third quarter. In addition, the delays that we were -- that we have been having with respect to ancillary services being available continued into -- in through August. And we did see a pickup in September.

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

Got it. Great. And could you just talk a little bit about the mix of what you guys are -- what the pipeline mix currently? And maybe what yields each of those categories are coming on at?

John R. Buran
President, CEO & Director

So it looks like about half of it is coming out of our business banking operations. Some of which as a subset is commercial properties because we've got a lot of customers who are taking advantage of the rate environment and have been buying additions or renovations on their plan. And most of it is reflective of the current portfolio that we have.

So I think not very, very much different in terms of the yield expectations. You'll notice that over the last 4 quarters or so despite a very, very low rate environment, we've been able to retain much of our yield. And we expect that to continue with some minor adjustments going forward.

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

Got it. Great. And then just following up on Mark's question on the provisioning and the reserve, just with the Empire transaction having closed, where is the day 1 CECL, I guess, all in, if you could remind us of that?

Susan K. Cullen
Senior EVP, Treasurer & CFO

It's $1.8 million, I believe.

Christopher Thomas O'Connell

Keefe, Bruyette, & Woods, Inc., Research Division

Sorry, on the like the reserve to loans ratio?

Susan K. Cullen
Senior EVP, Treasurer & CFO

I don't remember that off the top of my head, Chris. It was about 38, 39 basis points, somewhere like that at 12/31/2020.

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

Okay. Got it.

Susan K. Cullen
Senior EVP, Treasurer & CFO

2019, excuse me, because we adopted it in 2020. I get my years messed up.

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

Got it. No problem. Okay. Great. And then one minor one, it just looked like the cash yield on the interest-earning deposits have been kind of holding pretty consistently. It just came up a bit this quarter. Was there any strategies being like implemented or anything?

Susan K. Cullen
Senior EVP, Treasurer & CFO

No, that is primarily Fed-dependent. Our excess reserves are sitting in the Fed. So whatever the Fed is paying is what we're seeing.

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

Okay. Got it. Great. And then lastly just on the overall margin, I know you guys don't give any specific guidance. But it seemed like last quarter, you were indicating more towards near-term kind of margin pressures. And from what I'm seeing I guess in the slide deck, it seems like the asset side is holding in relatively stable and that there's a little bit more on the liabilities side to go in terms of downward movement. Is it kind of safe to say that it's more of an upward bias at this point?

Susan K. Cullen
Senior EVP, Treasurer & CFO

I would still say it's a relatively flattish bias at this point, Chris. Because we do have just a little bit more, I think, that we can squeeze out on the liabilities side of the balance sheet. We were able to hold our asset yields.

And as John said, the pipeline is pretty consistent. But as we've talked about in the past, about 20% of our portfolio reprices in any given year. And although they have floors, there's some susceptibility to not continue with those yields.

Operator

At this time, there are no more questions in the queue. I'd like to turn the conference back over to John Buran for any closing remarks.

John R. Buran
President, CEO & Director

Yes. Thank you very much. Well, thank you all for your attention. And once again, we look forward to wrapping up a very, very strong year. This certainly has been a good one for us. And we hope you all stay safe and sound over the next quarter or so 'til we speak again. Bye now.

Susan K. Cullen
Senior EVP, Treasurer & CFO

Thank you.

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