S&P Global
Market Intelligence

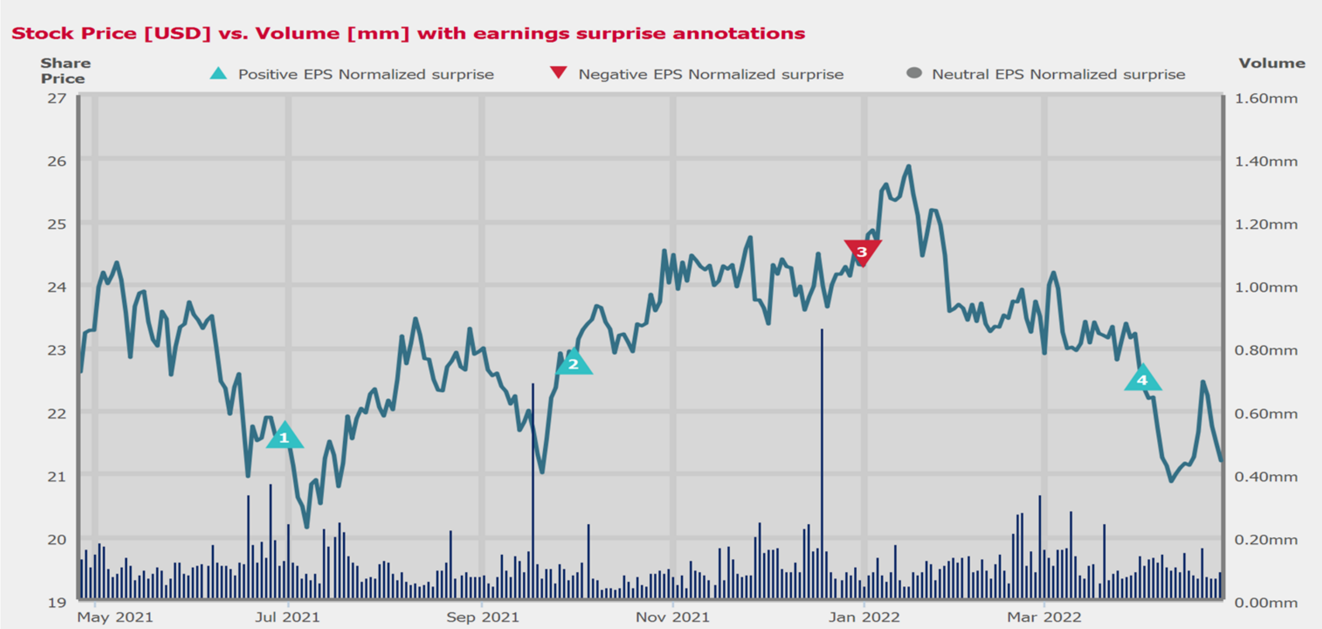
Flushing Financial Corporation NasdaqGS:FFIC FQ1 2022 Earnings Call Transcripts

Wednesday, April 27, 2022 1:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2022-			-FQ2 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.54	0.61	▲12.96	0.61	2.35	NA
Revenue (mm)	65.08	66.72	▲2.54	65.29	260.86	NA

Currency: USD
Consensus as of Apr-04-2022 9:46 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2021	0.64	0.73	▲(1) 14.06 %
FQ3 2021	0.64	0.88	▲(2) 35.38 %
FQ4 2021	0.68	0.67	▼(3) (1.47 %)
FQ1 2022	0.54	0.61	▲(4) 12.96 %

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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

SP1 -- welcome to Flushing Financial Corporation's First Quarter 2022 Earnings Conference Call. Hosting the call today are John Buran, President and Chief Executive Officer; and Susan Cullen, Senior Executive Vice President, Chief Financial Officer and Treasurer. Today's call is being recorded. [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 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 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 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.

John R. Buran
President, CEO & Director

Thank you, operator. Good morning, everyone, and thank you for joining us on our first quarter 2022 earnings call. On today's call, I'll discuss first quarter highlights and ongoing strategic objectives before turning the call over to Susan Cullen, Chief Financial Officer. Following our prepared remarks, we'll answer your questions.

On Slide 3, we're encouraged by some of the trends seen in the first quarter, but continue to monitor the various factors affecting the macroeconomy. The macro environment will impact us and the rest of the banking industry as the expectation of rising rates and improving local economy and in-market merger disruption all had an impact on our quarterly results. We remain focused on executing on our strategic objectives, and we're off to a good start in the first quarter.

We reported GAAP earnings per share of $0.58 and core EPS of $0.61. This translated to a return on assets of 91 basis points and a return on equity of 10.8%. Core return on assets was 94 basis points and core return on equity was 11.3%. These returns are within range of our stated through-the-cycle goals of 1% and 10%, respectively.

The cost of deposits declined to a record low of 21 basis points, and the core deposit mix continues to improve. Noninterest-bearing deposits were record at $1 billion for the quarter, increasing 13.5% (sic) [17%] year-over-year. Loan closings excluding PPP were up 65% year-over-year, but repayments remain elevated, challenging loan growth this quarter. However, our loan pipelines are at record levels and commercial business loan growth was significant during the quarter.

Asset quality is a hallmark of this company. Our credit metrics remain solid and the risk profile is conservative. We continue to invest in the future as we hired 30 people from institutions in our markets that were involved in a merger, and 12 of these people are revenue producers. Additionally, first quarter was impacted by seasonal expenses of $4.3 million that will not reoccur in the second quarter. Overall, I'm pleased with our execution on our strategic objectives and the returns we're generating for our shareholders.

Slide 4 outlines the merger disruption that is occurring in our markets. During the quarter, 1 more deal was announced and 5 deals closed year-to-date. We believe the biggest opportunity to expand our business and add more talent will occur over the next 6 to 12 months as integration of these deals progresses. Given this environment, we expect to remain focused on the organic growth opportunity.

On Slide 5, you can see the local economy continues to improve. While employment is not quite back to prepandemic levels in New York City MSA, it continues to see significant improvements, especially in Leisure and Hospitality. New York City MSA housing price index and median list price per square foot have risen and are above prepandemic levels.

The local markets are improving, and this is having a positive impact on our business volumes. The business and community activity within our markets continues to improve. For example, in the Asian markets we serve, we participated in 2 Lunar New Year parades, 3 galas and several events honoring women's achievements this quarter.

On Slide 6, you see the impact of the improving local economy, merger disruption and execution of our strategic objectives. The loan pipeline is at an all-time high, up 55% quarter-over-quarter. Commercial real estate is one of the big drivers. I want to stress that we continue to maintain our pricing discipline, and we're not a price leader. The loan pipeline includes, regarding refinances, only any incremental new money, which represents about 5% of the pipelines.

Business Banking is also seeing strength as its pipeline is up 46% year-over-year. Pull-through rates have recovered, reaching 77% this quarter compared to 68% last quarter and 56% in the same quarter last year. Unfortunately, this strong production has been impacted by loan repayments and satisfactions, which remain elevated in the first quarter, both with and without PPP. However, we expect loan repayments and satisfactions to slow in 2022 as interest rates increase.

We recognize the importance of technology as it improves the customer experience, enhances our product set and creates efficiencies. Slide 7 shows the continued growth of our digital platform. We continue to see high growth rates in monthly mobile active users, active online banking users and digital banking enrollment. We're pleased with the Zelle usage by our customers as this product continues to gain traction. We recently expanded our Numerated platform to digitally originate small dollar loans. These loans can close as quickly as 48 hours.

During the quarter, we originated over $4 million. While this amount is just over 1% of the quarter's originations, our marketing in the platform is in the very early stages. We continue to explore other fintech product offerings and partnerships.

I'll now turn it over to Susan Cullen to provide more detail on our key financial metrics. Susan?

Susan K. Cullen
Senior EVP, Treasurer & CFO

Thank you, John. I'll begin on Slide 8. Growing noninterest-bearing deposits is a priority for us. Average noninterest-bearing deposits increased 17% year-over-year to a record of over $1 billion and comprised nearly 16% of average deposits. Our teams are doing a great job of opening new checking accounts, which are up nearly 18% year-over-year. The growth in noninterest-bearing deposits is helping drive down the cost of deposits, which hit a record low of 21 basis points in the first quarter.

Slide 9 outlines the loan portfolio and yields. Loans excluding PPP were stable quarter-over-quarter. The loan pipeline of $664 million is a record and was up 77% year-over-year. The pipeline consists of only incremental new funds for refinancing and new money. With higher market rates, we expect to accelerate repayments to slow over time, and we remain optimistic that loan growth will improve in 2022.

Core loan yields, which include prepayment penalty income, were stable quarter-over-quarter and improved year-over-year. The difference between the yield on loan satisfaction net of PPP and loan originations continues to narrow.

Slide 10 outlines the net interest income and margin trends. The GAAP net interest margin was 3.36% and increased 7 basis points during the quarter. Net interest income increased 1% quarter-over-quarter to a record $64 million. Core net interest income, which removes the impact of net gains from fair value adjustments and purchase accounting accretion, increased 2% quarter-over-quarter as the core net interest margin expanded 10 basis points to 3.31%.

Excluding impact from net prepayment penalty income, net gains from fair value adjustments and the purchase accounting accretion, which totaled 14 basis points in the first quarter and 16 basis points in the prior quarter, the net interest margin increased 9 basis points quarter-over-quarter.

For modeling purposes, we encourage you to start with the base net interest margin of 3.22%, which includes 3 basis points of positive PPP impact and then add in your own assumptions for the previously mentioned adjustments.

Slide 11 takes a closer look at our funding profile. Overall, our funding mix has improved significantly from the prior rising rate cycle of 2015 to 2019. At September 30, 2015, or the last reporting period before the first rate hike of that cycle, higher cost in CDs and borrowings were 53% of funding, while noninterest-bearing deposits were 5%.

At year-end 2021 or the last reporting period before the Fed increased rates in March 2022, CDs and borrowings were reduced by more than 50% as a percentage of funding and noninterest-bearing deposits more than doubled. The gap between our cost of funds and average Fed funds has improved by approximately 50% between those periods.

The average balance of noninterest-bearing deposit accounts has increased by nearly 65% for business accounts and [238%] for personal accounts. We use very conservative deposit betas in our interest rate risk modeling ranging from 40% to 80% for non-maturity interest-bearing products. These betas are about 13 percentage points higher than what we experienced in the late -- in the last cycle.

Our ability to lag deposit rate increases will be a key factor in determining our net interest margin outlook. By lagging deposit rate increases to a similar pace to last cycle, our interest rate risk modeling for net interest income would improve by approximately 40% or 100 basis point gradual rise in rates over the next year.

The better we manage deposit costs, the more favorable the net interest income outlook. To provide additional perspective, a 50 basis point increase in short-term rates equates to an approximate $5 million annual increase in net interest income without any deposit rate adjustments.

In summary, we believe our funding profile has improved significantly and is better positioned to handle a rising rate environment.

Turning to Slide 12. We outlined some of the offsets we have on the asset side of the balance sheet. First, business banking loans, which are largely floating rate, have increased to 22% of the loan portfolio from 12% in the previous cycle. Second, we have $410 million of loan swaps that convert fixed rate loans to floating rate. Third, there are approximately $480 million of real estate loans that will reprice about 44 basis points higher based on the yield curve at the end of March. The actual benefit will depend on the level of rates and shape of the curve when the loans are priced.

Importantly, including hedges, approximately 30% or over $2 billion of loans will reprice higher within the next year. Overall, we are better prepared to handle higher interest rates this cycle compared to the last cycle.

Moving on to asset quality on Slide 13. We have a long history of strong credit quality, primarily due to our low-risk credit profile and conservative underwriting. Net charge-offs were only 6 basis points of average loans in the first quarter. The average loan to value on the real estate portfolio is less than 38% and only $21 million of loans or less than 1% of the loan portfolio has an LTV of 75% or more.

Slide 14 outlines some additional credit metrics. Nonperforming assets declined 6% linked quarter, and the loan to value on these assets is 37%. Criticized and classified loans were relatively stable in the first quarter. The allowance for credit losses to loans increased 1 basis points to 57 basis points during the quarter, and the mix of the reserves by loans depicted in the bottom right chart. Overall, we remain very comfortable with our credit risk profile and continue to expect minimal loss content.

Our capital position is depicted on Slide 15. Book value and tangible book value per share were flat quarter-over-quarter as net income was enough to absorb the increase in accumulated other comprehensive loss and capital return. Company increased its quarterly dividend to $0.22 per share in the first quarter and repurchased over $8 million of common stock to return 84% of the first quarter earnings to our shareholders.

The tangible common equity ratio remained over 8%. Our capital priorities are unchanged and are to, first, profitably grow the balance sheet; second, pay dividends to our shareholders; and third, opportunistically repurchase shares. We view the stock as attractively priced, given the low multiple tangible book value, the approximate 4% yield and a significant opportunity for future growth.

Before I turn it back to John, I want to provide some color on the outlook. Net interest income is a function of net interest margin and balance sheet growth. In addition to the key drivers for the net interest margin we previously discussed, first quarter results included elevated levels of purchase accounting accretion and net prepayment penalty income.

While loan growth has been impacted by high repayment rates, we expect repayments to slow during 2022. Noninterest expense includes over $4 million of seasonal expenses that should not recur in the second quarter. The core expense base is still expected to rise high single digit in 2022 and follow normal seasonal patterns. Lastly, the effective tax rate for the current year 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 16, we wrap up with our key messages. Our local economies are recovering, and we're capitalizing on the merger disruption. Our loan pipeline is at a record level. During 2022, we expect loan growth will improve.

From the beginning of the year through today, 5 of the mergers in our markets have closed. We've hired 12 revenue producers from the merger participants. We're investing in the business and our people. The company is better positioned for rising rates versus past cycles, with a record low cost of funds and improved funding mix and swaps with favorable repricing starting in the second quarter. Our ability to control deposit rates will be a key factor in determining the net interest income outlook.

We have a low-risk business model with a conservative loan-to-value ratio. We've traditionally had low credit risk in our portfolio, and the stock has an approximate 4% dividend yield that trades at a low price to tangible book value multiple. The company performed well versus it's through-the-cycle return on average assets and return on average equity goals in the first quarter, despite the elevated seasonal expenses.
Operator, I'll turn it over to you to open up the lines for questions.

Question and Answer

Operator

[Operator Instructions] Our first question will come from Mark Fitzgibbon with Piper Sandler.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

First, Susan, just to clarify, did you say that the expense number in the second quarter should be down about $4 million from the 1Q number? I just want to make sure I caught that.

Susan K. Cullen
Senior EVP, Treasurer & CFO

Yes. The $4 million is the seasonal expenses we have every first quarter.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Okay. Great. And then secondly, I wondered if you could kind of break down the $664 million pipeline for us, like in terms of complexion, the types of loans and maybe what the average rate on that looks like?

Susan K. Cullen
Senior EVP, Treasurer & CFO

The mix of the portfolio is very similar to our portfolio. There's not a material difference. And the rate is approaching 4%. Right now, it's approximately [$3.80] on the pipeline.

John R. Buran
President, CEO & Director

There's probably a little bit more C&I in there than the structure of the portfolio.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Okay. Great.

John R. Buran
President, CEO & Director

Similar to what we posted last quarter in terms of percentages.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Got you. And then I thought the stuff that you provided in the slides was really helpful about how the rate sensitivity is positioning has kind of changed since the last cycle. Are you suggesting that the balance sheet today is actually asset sensitive and that the core margin should go up as rates rise? Or are we closer to neutral?

John R. Buran
President, CEO & Director

No, I can't say we're asset sensitive, but we clearly are closer to neutral than we've ever been.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Okay. Great. And then Susan, I saw your comments about sort of the $5 million increase in NII. What gives you so much confidence that deposit rates won't start to move higher as we get some more Fed increases?

Susan K. Cullen

Senior EVP, Treasurer & CFO

The liquidity in the market will help tamper down the rate increases. That's the primary driver when we are very, very focused on the cost of our funds. Also the mix with the $1 billion of noninterest-bearing deposits, that will help tamp down the cost of funding going forward.

John R. Buran
President, CEO & Director

And then we restructured our incentives in the -- at the end of last year to emphasize noninterest-bearing DDA growth.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Okay. And then lastly, I guess I'm just curious how you balance growth versus buybacks given your stock is ow tangible book value now looks really attractive, right. How do you weigh the one versus the other?

Susan K. Cullen
Senior EVP, Treasurer & CFO

We agree, it's very attractively priced right now and a great deal for everybody to -- attractively priced, given the dividend yield and where we're trading. Mark, we haven't really changed our capital philosophy that we've been articulating for several years now. That if we can profitably grow the balance sheet, then that's where we're first going to deploy our capital.

Operator

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

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

I just want to follow up on the expense guidance trajectory. I understand there's some seasonal costs coming out. But you still have the same high single-digit growth for the full year. Does that mean that we should still see kind of flat to current levels of expenses for the rest of the next 3 quarters?

Susan K. Cullen
Senior EVP, Treasurer & CFO

No. We expect our -- if you start with our base that we had last year of core expenses of about $140 million, $145 million, we do expect there to be increases in the expenses as we invest in the company and the inflation, if it really starts to take hold in our employee expense base, which we haven't really seen yet. And we have some growth that we're anticipating that will also increase the expenses.

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

Okay. So a little bit better loan growth will add to variable costs a bit?

Susan K. Cullen
Senior EVP, Treasurer & CFO

Yes.

John R. Buran
President, CEO & Director

Yes. And we're still actively looking for additions to talent. And of course, that will provide us with additional expenses as the year goes on.

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

Were the new employees that were added, they were fully in the first quarter run rate? And can you add any more details about what business lines they're in?

John R. Buran
President, CEO & Director

Pretty much across the board, they're mostly business development individuals.

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

Okay. And as you get the growth eventually with higher rates, paydowns decline, can you kind of discuss the capabilities of your various deposit growth avenues, perhaps touch on commercial deposit gathering, your Asian-American market, Internet banking, the IntraFi network and broker deposits, the capabilities of all those to kind of fill in the gaps?

John R. Buran
President, CEO & Director

So we look at the funding. Obviously, we're -- we've made some changes in terms of our orientation and our focus on noninterest bearing, and we've been quite successful there. We expect that to continue and to be a major contributor. And then beyond that, we do have a very varied funding capability, and we make use of it as we see opportunities going forward.

So clearly, we have a fair amount of dry powder on the Internet side of the business. We did invest in improving our online banking capability last year, so we're starting to see some positive impact out of that. And we've -- as loan growth begins to come back, we also feel that we will get a very, very strong participation from our commercial real estate and our business banking. We've got about $30 billion -- $3 billion of liquidity kind of outside of any sort of deposit gathering.

So we've got a great deal of flexibility. And I think the situation with respect to existing liquidity in the market should tamp down any -- very, very significant competitive activity going forward. So I think we're in very good shape as it relates to our ability to gather funding, gather deposits and also maintain a reasonable level of increases in funding costs.

Operator

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

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

I was hoping to circle back to the expense guidance. I know you guys mentioned it should follow normal seasonal patterns, which is a pretty sharp drop in 2Q and typically flattish for the rest of the year. But based on the guide and the starting point here, I mean, is there going to be a fairly substantial increase in the second half of '22 relative to normal years?

Susan K. Cullen
Senior EVP, Treasurer & CFO

Yes, I would think so. If we get the personnel we're planning on hiring as we invest in the company, the expenses will be higher. I don't want to say inflation in this call -- will be higher in the second half of the year than they are in the first half.

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

Okay. Got it. Makes sense. Great. And then in terms of the color you gave around the pipeline and the gap on satisfaction is there. What -- how do you see, given the current trends and what you're seeing in the current pipeline, when do you think yields will converge with the portfolio yield in terms of core loans?

John R. Buran
President, CEO & Director

So when -- probably the first place to start when we talk about the portfolio yields is the natural tendency of -- let's talk about the real estate portfolio for a second. The natural tendency of that portfolio to increase in price as time goes on. So when we put these loans on, we peg them to certain refi rates. So we have somewhere around 25% of our real estate loans that will reprice over the course of this year.

And as rates increase, those prices will continue to move upward at a slow pace. And for example, we have loans that will reprice at close to 5%. Now we may not get 5% for those loans, but we will be able to get -- because of the risk of refying elsewhere, we will be able to get a better margin or a better yield than what the market will be looking at. Because it is expensive to go out and refi your commercial real estate loans in the market.

So we have this natural tendency of the portfolio, the real estate portfolio to rise. In addition, we've got a very significant proportion and a growing proportion of our loan portfolio that is floating rate due to our C&I capabilities and growth. So we expect to see -- we've already seen and we'll expect to see more upward pressure -- positive upward pressure on yields in that portfolio.

So those are the 2 major areas of continued growth in the yield on loans as our portfolio -- as the Fed continues to move. And then also, we have -- Susan also indicated we have a portion of the real estate portfolio that is -- that would normally be fixed that is now hedged. So that formerly fixed portion of the portfolio will also move. So it's over $400 million.

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

Great.

John R. Buran
President, CEO & Director

So we got a lot of capabilities that we've had -- that we have today that we didn't have a number of years ago during the last cycle, upward rate cycle.

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

Yes, definitely. And where specifically are you guys seeing multifamily origination yields coming on at now?

John R. Buran
President, CEO & Director

High 3s, mid- to high 3s based upon the size of the loan, the LTVs, et cetera. Smaller loans can go up into the 4 category.

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

Okay. Great. And then you guys made a comment on a percentage of the pipeline, something about new money. I kind of missed it there. I was wondering if you could go over it again, please?

Susan K. Cullen
Senior EVP, Treasurer & CFO

Sure. So the 95% of the pipeline is new money, new deals to the company. Of our pipeline, only 5% is incremental money on refinancing. Meaning if you have a $100,000 loan with us today and you want $150,000, only $50,000 is in the pipeline, not the full $150,000.

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

Okay. Great. Appreciate that. And then did you have the -- do you guys have the AOCI impact this quarter?

Susan K. Cullen
Senior EVP, Treasurer & CFO

We had some AOCI. We had the security impact offset by the derivatives were very positive to us. This quarter, the overall decline was about $8.5 million -- $9 million.

Christopher Thomas O'Connell

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

Okay. Great.

Susan K. Cullen
Senior EVP, Treasurer & CFO

All that had resulted in the tangible book value decreasing about 11 basis points with overall net effect -- I'm sorry, TCE.

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

Yes. Okay. Great. And then lastly, I was just wondering, obviously, still at low levels overall. I was curious if you could walk through the SBA charge-off?

Susan K. Cullen
Senior EVP, Treasurer & CFO

So the SBA charge-off is just some -- there are a few small immaterial items that came through. It's nothing indicative of deterioration in the portfolio.

Operator

Our next question is a follow-up from Manuel Navas with D.A. Davidson.

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

I just had one more. With the paydown, do you have any view on the first quarter paydowns. What was driving it or who was taking those loans? And then on the deposit side, have you seen any in April any kind of would you call like bad actors start to raise rates at all? I know you haven't, but just touch on those 2 kind of competition areas of question.

John R. Buran
President, CEO & Director

I think the paydowns have taken place associated for the most part with some, let's say, a little bit more aggressive pricing that we weren't willing to match. And then...

Susan K. Cullen
Senior EVP, Treasurer & CFO

Deposits. We've seen some one-offs but not anything wholesale in the market.

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

Okay. That's helpful. With the pricing on the loans that have refi-ed away, is it like insurance companies or other banks? I'm just trying to get a sense for that. I understand if you don't track it very carefully, but just wondering.

John R. Buran
President, CEO & Director

There's banks and insurance companies, but it's mostly banks. Mostly banks that are picking these up.

Operator

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. I want to thank you for your attention and participation on the call. And once again, I think we've -- we're very, very pleased with the quarter and look forward to continuing to update you on our progress toward improving the business. Have a good day, everyone.

Operator
This concludes today's teleconference. You may now disconnect your lines, and we thank you for your participation.