THE FIRST OF LONG ISLAND CORPORATION
2023 FIRST QUARTER EARNINGS CALL

APRIL 28, 2023 – 2:00 p.m.

Replay available at: https://www.cstproxy.com/fnbli/earnings/2023/q1

Operator [00:00:02]

Welcome to The First of Long Island Corporation's First Quarter 2023 Earnings Conference Call. On the call today are Chris Becker, President and Chief Executive Officer and Jay McConie, Chief Financial Officer.

Today's call is being recorded. A copy of the earnings release is available on the Corporation's website at FNBLI.com and on the earnings call webpage at https://www.cstproxy.com/fnbli/earnings/2023/q1.

Before we begin, the Company would like to remind everyone that this call may contain certain statements that constitute 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. Investors should also refer to our 2022 10-K filed on March 9, 2023, for a list of risk factors that could cause actual results to differ materially from those indicated or implied by such statements.

I would now like to turn the call over to Chris Becker.

Chris Becker [00:01:33]

Thank you. Good afternoon and welcome to The First of Long Island Corporation's earnings call for the first quarter of 2023.

As mentioned in my remarks at our recent Annual Meeting of Stockholders, 2023 is proving to be most challenging. After a decade of short-term rates near zero, and 5 and 10 year Treasury yields averaging 1.64% and 2.16%, respectively, the Fed has driven short-term rates up to 5% over the past 12 months while the 5 and 10 year Treasury yields are in the mid 3's. The margins of community and small regional banks generally do not respond well to a 475 basis point rate shocks and big yield curve inversions. Add concerns over recent bank failures and the cost of interest-bearing liabilities is escalating rapidly and margin compression is generally beyond analyst expectations.

With that backdrop, I am pleased to report that our customers have remained loyal and we had ample liquidity at March 31, 2023.

Throughout the turmoil of the first quarter, we are proud that total deposits have held steady, ranging from $3.4 to $3.5 billion during the quarter and averaged $3.47 billion. All numbers are in line with total deposits at year-end 2022, with only a $66 million reduction. Checking deposits still represent 35% of total deposits and we were able to maintain our deposit levels without any increase in brokered deposits and minimal increases in CDs.

When we look at deposit beta internally, we focus on cumulative non-maturity interest-bearing deposit betas. That is the cumulative change in savings, now and money market deposits compared to the cumulative change in Fed funds. Historically in rising rates, these deposit betas have been plus or minus 35%. Through the end of the first quarter these deposit betas in the current rate cycle are approximately 28%. One interpretation could be we are nearing the end of repricing deposits higher. However, our historical tracking of deposit betas does not include a near 500 basis point rate increase over 12-months with four consecutive 75 basis point moves. As a result, we cannot be totally confident that our historical betas will hold in this current rate cycle. Based on the current pace of deposit rate increases, deposits betas could easily exceed 40%.

The Bank’s uninsured and uncollateralized deposits were 38% of total deposits at March 31, 2023. Our uninsured and uncollateralized deposit levels have been consistent and trending lower over the past couple of years. Many peers that operate in our market have similar ratios of uninsured and uncollateralized deposits, mainly from working with businesses that need amounts greater than $250,000 in their accounts to operate and meet payroll. We believe there is a clear distinction between being a relationship oriented commercial bank like ours, with business customers needing a few million dollars to operate their business, verses a bank that takes in large concentrations of private equity funds earmarked for startups.

Our monthly net interest margin continues to be impacted by the current environment. Recent monthly margins have been:

2.66% in December.

2.45% in January.
2.25% in February.
And, 2.34% in March.
February's numbers are always lower due to the short month.

With the Fed still talking about the possibility of higher rates and/or short-term rates remaining high for an extended period, our cost of funds should continue to outpace any increases in the average yield on earning assets through the remainder of 2023. Although, Jay will take you through some specifics that could slow the pace of decrease in the net interest income throughout the remainder of the year.

Our loan pipeline was $96 million at March 31, 2023. Loan demand was weaker during the first quarter and our focus this year is skewed toward commercial relationship lending and related deposits. Borrowing at 5+% to put on commercial or residential mortgages at 5.50% to 6.00% is not overly enticing to us. Especially on the residential side when they will just refinance immediately after rates fall. The reduction in C&I loans during the quarter was related to lower line utilization as customers have reacted to higher interest rates in the way they operate their business. New opportunities have increased with the recent disruption in the market.

As expected from First of Long Island, credit quality continues to be excellent with nonaccruals again at zero on March 31, 2023.

Jay McConie will now take you through the first quarter results. Jay.

Jay McConie [00:08:06]

Thank you, Chris. While the Bank remains liability sensitive at March 31, 2023, management proactively completed two balance sheet repositioning transactions during the first quarter to help us reduce our sensitivity to rising interest rates.

In March, the Bank entered into an interest rate swap to convert $300 million of fixed rate residential mortgage loans to floating rate for a period of 3 years. The Bank will pay a fixed rate of 3.82% and receive a floating rate based on the

SOFR overnight rate. This transaction was immediately accretive to annual interest income by approximately $2.9 million if rates remain unchanged.

The Bank also sold $149 million in fixed rate municipal securities earning a tax equivalent yield of 3.32% and purchased $135 million of floating rate SBA securities projected to yield 5.38% at the time of purchase. As noted, the Bank recognized a $3.5 million pre-tax loss and expects the earned back to be 1.2 years. This transaction was also immediately accretive to annual interest income by approximately $2.8 million. The first quarter results do not reflect a full quarter's benefit of these transactions since they were executed close to the end of the quarter. These transactions presently help increase interest income and will slow the pace of decline in net interest income and margin. Reversing the decline in net interest income and margin will take time for asset repricing to catch up to liability repricing or until the Federal Reserve Bank reduces short-term rates. The interest rate swap and securities repositioning transactions result in loans and securities repricing within one year nearly doubling during the quarter to $813 million or 21% of total securities and loans at March 31, 2023.

The Bank securities portfolio was $655 million and comprised 16% of total assets at the end of the quarter. The portfolio has a duration of approximately 3.6 years. Approximately 36% of the investment portfolio is comprised of floating rate assets. The Bank had $135 million in SBA floating rate securities with a current yield, as of the end of the month, of 5.77% that reprice quarterly off the prime rate and represent 21% of the investment portfolio. The Bank also has $116 million in floating rate corporate bonds with a current yield of approximately 3.84% that reprice quarterly off the ten-year swap rate.

The Bank's government agency fixed rate mortgage-backed securities portfolio, including CMOs, was $260 million and comprised 40% of the investment portfolio. This portfolio had a current yield of approximately 1.85%. The Bank expects approximately $50 million of cash inflows from the investment securities portfolio in 2023 and will look to reinvest them in higher yielding agency mortgage securities that provide some lock out protection when rates eventually decline. The remaining 24% of the portfolio is invested in tax exempt municipal bonds that currently yield 3.84%.

Our $3.3 billion loan portfolio is comprised of $1.9 billion in commercial real estate loans, $1.2 billion in residential mortgages and $197 million in commercial and industrial loans. Approximately $560 million or 18% will reprice by March

31, 2024, of which $300 million is related to the interest rate swap transaction previously discussed and $115 million in loans that reprice on a monthly basis such as home equity and C&I loans. We expect approximately $75 million of cash flow from the loan portfolio per quarter. The Bank expects an additional $178 million or 6% of the loan portfolio will reprice from approximately 3.97% to 6.62% from March 31, 2024 to March 31, 2025 based on current market rates.

The Bank has $383 million in outstanding Federal Home Loan Bank advances with a weighted average cost of 4.31% and average maturity of 1.3 years at the end of the quarter. The Bank has one remaining advance that will mature in 2023. It is for $50 million with a current cost of funds of 2.62% that will mature on June 1, 2023. Federal Home Loan Bank advances decreased $28 million during the quarter.

The Bank had brokered time deposits that totaled $176 million or 5% of total deposits on March 31. That number is the same as year-end 2022. The brokered time deposits have a weighted average cost of 3.12% and the average maturity of approximately six months. $85 million or 48% will mature in the second quarter of 2023 with an average cost of funds of 2.61%. The current reinvestment rate for both the Federal Home Loan Bank advance and brokered time deposit market is currently between 5% to 5.25%.

We expect that a significant portion of our current wholesale borrowings, meaning the Federal Home Loan Bank advances and brokered time deposits will reprice to current market rates by the end of Q2-2023.

With regard to liquidity, the Bank maintains over $1.5 billion in available collateralized borrowing lines with the Federal Home Loan Bank and Federal Reserve Bank. In addition, the Bank had over $143 million in cash and unencumbered securities available to be pledged. This liquidity exceeds the $1.3 billion in uninsured and uncollateralized deposits that Bank held at March 31.

The Bank had net income of $6.5 million and earnings per share of $0.29 for the first quarter of 2023 compared to $12.1 million or $0.52 per share for the same period in 2022. The Bank's return on assets and equity were 0.62% and 7.09%, respectively. The key drivers that caused net income to decline were a decrease in net interest income of $4.4 million and the loss on the sale of securities of $3.5 million. These two items were partially offset by a decline in income tax expense of $2.5 million and a decrease in the provision for credit losses of $1.5 million.

The decline in net interest income of $4.4 million was due to the Federal Reserve Bank increasing short-term rates by over 475 basis points and the inversion of the yield curve. The spread between the three-month and 10-year U.S bond is currently inverted by over 150 basis points, a level not seen in over 40 years. The pace and magnitude of these rates increases has caused the cost of our deposits and wholesale funding to increase at a faster pace than the yields on our interest earning assets. The Bank's interest expense increased $9.4 million when compared to the prior year quarter and was only partially offset by a $5.0 million increase in interest income. Our cost of interest-bearing liabilities increased to 1.96% in the current quarter an increase of 142 basis points while our yield on interest earning assets increased 35 basis points.

The Bank's quarterly non-interest income, excluding the loss on the sale of securities, was $2.5 million. This result was consistent with expectations and this run rate should continue throughout 2023.

Also consistent with expectations, the Bank's non-interest expense was $16.5 million during the first quarter an increase of $802,000 from the first quarter of last year. The increase was primarily due to an increase in rent expense relating to the Bank's corporate headquarters facility and higher FDIC insurance expense attributable to higher assessment rates. We expect non-interest expense to be $16.5 million to $17.0 million per quarter for the remainder of 2023. Management is very mindful of expenses during the current environment and will make every effort to keep the run rate towards the lower end of this range in 2023.

Our capital position remains strong with a leverage ratio of 9.94% at March 31, 2023 and an increase of 11 points from 9.83% at December 31, 2022. Accumulated other comprehensive lose, net of tax, improved by $3.8 million, or 5.9%, since year-end 2022.

The Bank did not repurchase any shares during the first quarter of 2023 and future repurchases will be decided based on maximizing shareholder value. We still have approximately $15 million authorized under the most recent Board approved stock repurchase plan.

The Bank's effective tax rate declined to 9.1% in the first quarter of 2023 from 20.6% when compared to the first quarter of 2022. The decline in the effective tax rate is mainly due to an increase in the percentage of pre-tax income derived from the Bank's real estate investment trust, municipal securities portfolio and Bank Owned Life Insurance. We anticipate our tax rate for 2023 to be between 10% to12.0%

With that I turn it back to our operator for questions.

Operator [00:17:03]

Thank you. Our first question for today comes from Alex Twerdahl of Piper Sandler. Alex, please proceed with your question.

Alex Twerdahl

Hey, good afternoon, guys.

Jay McConie

Hi, Alex.

Chris Becker

Good afternoon, Alex.

Alex Twerdahl

Hey, first off, Chris and your prepared remarks. You commented about some opportunities that might be presenting themselves. I was hoping you could expand on that comment just a little bit more.

Chris Becker

I don't have quantifiable numbers on the loan side. I mean, we've brought in approximately $15 million in new deposits from Signature Bank and First Republic specifically. We've been tracking them and we have opportunities on the credit side, lines of credits, term loans and such that they're looking for a new bank. So, but I don't have total numbers on that.

Alex Twerdahl

Okay. And when you say looking for a new bank, you're talking customers, loan officers? All of the above?

Chris Becker

We are talking to both people and customers.

Alex Twerdahl

Okay. And then, Jay, you went through a lot of very helpful statistics on the repricing of assets and liabilities over the next 12 months. You went a little bit fast. I'm certainly gonna look back at the transcript for all the details, but kind of boiling it down to the NIM, is it safe to assume the starting point is really that 234 from March plus about, I think it was 14 basis points from the de-leveraging and the swap transactions are really closer to 250 and then it sounded like pressure was gonna continue as those liabilities, especially the wholesale stuff continues to reprice during the quarter. So, when you think about the outlook from here, can you just help us boil it down to sort of what the near-term expectation of the NIM is in the second quarter?

Jay McConie

Yeah, I mean, I think you're right on the two transactions. I mean, like we said, it's about 5.7 million, so it's probably like 1.4 million a quarter if interest rates stay flat, right. For the swap and the SBA floaties, the rates go up, obviously it'd be a little bit more income there. And then I tried to provide you with the wholesale the federal home loan bank and the brokers because when you look at that, we feel that when those three priced, what I kind of talked about when you read the transcript, your wholesale for the most part will be pretty much repriced to market by the end of the second quarter with the full run rate reflected in Q3. Obviously if rates continue to go up, they could trend a little bit higher, but the big bulk of the increase stopped repricing from one to four and a half has kind of occurred and kind of got that behind us.

So, to your point, it then leaves the non-maturity deposits where we're kind of doing that on a customer-by-customer relationship and it's just when you have deposits that are in the 25 basis points to 1%, customers are coming in with demands per treasuries and money market mutual funds, you take it each time. We currently track our cost of funds on a daily basis and see kind of steady increase and we can project it out, but we're just not comfortable providing further guidance on that. So, we just feel that it's gonna take a little while for one, when does the fed pause, is May done? Or the PCE just came out with higher rates, so they're talking already maybe potentially June. So, do we have one or two?

And the other one is the yield curve. Not a lot of people talking about the inversion, but we have plenty of capital and one of the things we can do to help alleviate margin compression is leveraging up the balance sheet, but with an inverted yield curve, it makes it very, very difficult to do that because anything that you're borrowing against is at either the same rate or actually lower. So, we're gonna continue to kind of look each quarter at kind of things we did this quarter of a bunch of singles, kind of look at our investment portfolio each quarter, see if there's anything we can do small re-positionings to get those closer and closer to market rates and so forth. We still have the ability to do more flowing rate assets, but we think that we're kind of in the eighth and ninth inning so that if rates go down that that'll kind of help start to hurt. So, we we're trying to be a little bit more less liability sensitive and get a little closer to neutral. So, but I do agree with what you said, 234, you put those additive and then you kind of have to kind of back out where we're seeing with the wholesale and then again on the non-maturity it's just very hard to forecast where it's gonna end.

Chris Becker

And Alex, as I stated in my remarks, I mean, we do feel that our increase in the cost of funds is gonna continue to outpace the yield on earning assets which would lead to some further compression.

Jay McConie

We also know, Alex, loans are down a little bit, but we also realize our pipeline's $96 million. And we understand we want to see that pipeline from here going forward to the end of the year, kind of be more flat to hopefully slightly up. And we do realize the need that like I talked about the MBS's and the CMO's that are yielding 185, that we have to take that cash flow, get assets on in the 5%, 4.5%-5% range would lockout because we do think, whether it's six months or 18 months, that the yield curve will eventually steepen. And you know, because it always does and that the short end will come down and we need to also take advantage of getting some higher yielding assets on the books. And like Chris said, we're trying to focus more on commercial type business that have prepayment penalties and investments that have lockout versus residential because we know that the residential portfolio, once rates come down, don't just refinance literally right away from you. So, we're focused on the commercial business.

Alex Twerdahl

Yeah. Okay. That's all really helpful. Now, first of Long Island, historically has been very, very clean on credit and I don't want to say thrived cause you know, it's not necessarily the right word, but when other banks pull back, it's created opportunities for you guys. Would you say you're starting to see any other than the specific stuff you mentioned, Chris, from Signature and First Republic, any additional opportunities on the commercial real estate side or multi-family side of New York City? Certainly certain categories in the city have become a little bit more hot button subjects to investors are other banks starting to pull back that could create opportunities for you guys?

Chris Becker

We are seeing opportunities, but unfortunately because of the rates, sometimes the numbers don't work for us and sometimes they don't work for the borrower. So, because they might have to pay down their current outstanding bounds to refinance with us if they're if they're coming up on a reset with another institution. So, we're looking at a lot of opportunities but sticking to our underwriting criteria and staying true to who we are we're being very careful, so that is affecting obviously the pipeline. Because even though we're looking at them, they're not looking at them and making the pipeline are two different things for us.

Alex Twerdahl

Understood. Thank you for taking my questions.

Jay McConie

Thanks Alex.

Chris Becker

Thanks Alex.

]**Operator** [00:25:01]

Okay, our next question comes from Chris O'Connell at KBW. Chris, please proceed with your question.

Chris O'Connell

Hey, good afternoon. Hi.

Jay McConie

Hi Chris.

Chris O'Connell

There's bit of a follow up on the margin discussion. I understand the factors that are driving the pressure, given the timing of the transaction late in the quarter and the timing of some of the wholesale repricing. Do you expect that the margin impression will be greater in 2Q or in the third quarter, on a quarter over quarter basis?

Jay McConie

Like I said, I'm not taking the actual guidance on it, but we do think logically as our wholesale kind of repriced the market, and when I'm saying market, Chris, like we have stuff that's been repriced, let's call it 475, and then we have some stuff that might be on there at 185. So, I'm saying that by the end of Q2, everything has kind of repriced to quote it, the 4.75% to 5% range. So, in Q3 you'll have a full run rate of wholesale at that kind of higher cost, and you would think that then the only thing you have to really kind of focus on is non-maturity deposits and any DDA migration. And you would think that that should start to slow down because you start to have it in your run rate.

Two things that happen is the 4.75 to 5% current market six weeks from now, or is it five and five and quarter? You know, I think when we all started at the beginning of this year, we thought the Fed was gonna pause, then we got a couple of bad inflation reports and they've kind of continued to go and we're starting to see maybe this year's gonna be a hundred basis point increase by June 30th. And again, it comes to steepness of the yield curve the short end keeps going up by five and a quarter of the 10 year and a five-year stay locked in at that three and a half range. So, there are a lot of banks out there that are kind of trying to grow through this, putting on borrowings at 5% or five and a half in loans or, or securities are five and a half with the hopes that rates then kind of go back and steepen. And then we think that's a prudent strategy to a point. So, you have to kind of balance that growth with where the Fed and we've been taking it cautious the first two quarters so we can kind of get some guidance that the Fed has done and hopefully something with the steepness so, and that's why it's just very hard to provide any guidance. But high level, I would agree that it should slowly start to dissipate as the wholesale kind of gets locked in.

Chris O'Connell

Got it. I think in your prepared remarks, you said there's about $50 million of the securities cash flows for the remainder of 2023. Did you say that you were planning to reinvest those cash flows or do you plan to let those kind of roll off the balance sheet and help kind of keep the higher cost funding lower?

Jay McConie

Yeah, I think we're gonna try to invest those into assets. I mean, we tried to manage both. I think the first half and especially the first quarter was anywhere we could raise liquidity, keeping cash or pay down federal home loan banks to increase our lines. That was really clearly the focus. Hopefully after Q1, things have calmed down and as we can, I think it's kind of balancing that out, but definitely trying to get more assets on at higher rates, the second half for the, inevitable hopefully decline in interest rates. And then again, it's key that we try to put stuff on that as lockout that gives us maybe two to three year protection. So, it's not just funding costs getting cut, that's increasing margin. It's also the fact that we put on higher yielding assets that can kind of be locked in. So, kind of bouncing that. So, I would think you'd start to see a little bit more asset flat or, or slight growth.

Chris O'Connell

Yep. Got it. And as far as share purchases go, on a forward basis, I mean, you guys have pretty robust capital levels here. It sounds like balance street growth is gonna be fairly, flattish to slightly up. How are you guys thinking about kind of utilizing the buyback from here?

Chris Becker

So as you know, we didn't do anything in the first quarter as far as share repurchases and it's really gonna be based on opportunity to maximize shareholder value. We're not we’re not really given any guidance and if we're gonna have share repurchases or not in the second quarter we're gonna do what we think is best, for the company and quite frankly, that decision hasn't been made yet.

Chris O'Connell

Okay. Got it. And then as far as the expense run rate goes that's helpful guidance. Does the expense growth are things being delayed or put off and does that kind of normalize or increase as we go into 2024? Or do you guys still think there's opportunities to drive some efficiencies that haven't been, explored yet and keep growth fairly low as we go into next year?

Chris Becker

Well as you know, we've generally had a fairly low efficiency ratio and have always maintained expense control. We don't have high levels of staffing. As a matter of fact, with our branch optimization, we cut branch staffing levels. So, we're looking wherever we can to squeeze out some efficiency. I won't say we're putting off expenses but we're just being mindful, there are certain things you do at one level that possibly you could do it at a lower level for a year and go back to the normal level the following year. But I wouldn't say we're putting off, I mean, we're operating the bank for the long term, but obviously being mindful of managing expenses this year.

So, Jay gave the guidance. We think we could stay towards that lower end, that 16 and a half number and possibly do a little better than that in a particular quarter. So that some of that depends on staffing, if there's opportunities. There was questions by Alex earlier about are we looking at people, if there's opportunities to bring people in that are gonna generate deposits for us or good loan business, we'll take those opportunities as they come as we have in the past. So, some of those things are why you can't say exactly, it's gonna be here, it's gonna be there. Cause there's always moving pieces.

Chris O'Connell

Great. And last one for me, on the tax rate and some of the factors that are driving that considerably lower this year, can that range of the 10% to 12%, do you think that will hold as we go into next year? Or does some of those factors kind of pull back and, start to tick up a bit?

Jay McConie

Yeah**,** no, they'll slowly, as we get through this rate increase and hopefully it pauses and the yield curve steepens and you start to see kind of margin pickup, it will kind of revert back up to that 20%, it's just temporary. Alex, we have a REIT most of our loans are in the REIT. We do have loans on the banks books and obviously all the deposit costs on the bank's books. So basically what happens as interest expense goes up, there's less income on the bank, more on the REIT, and the dividend income from the REIT to the bank is tax deductible for New York State. So, because the bank only, you don't really recognize there's a consolidated is smaller, that benefit is a bigger percentage and that's why it's declined so much. So, as the banks kind of cost the funds goes down or assets reprice up, you'll see that pick up. But I think it would be, just based on where we're at, be kind of a gradual pickup and as we keep going and we work with our tax consult, mark them and do projections out, we always do a tax projection on a full year. And as we adjust it, we'll adjust our guidance for you. But I would stay with that 10% to 12% right now.

Chris O'Connell
Okay, great.

Jay McConie
Obviously, where the Fed goes.

Chris O'Connell
Yep. Got it. Thanks for all the detail and thanks for taking my questions.

Chris Becker
Okay, thank you, Chris.

Operator [00:34:18]
Thank you. This concludes our question-and-answer session. I'll turn the floor back to Chris Becker for some final closing comments.

Chris Becker
Thank you for your attention and participation on the call today. While 2023 performance metrics will not measure up to our historical averages, our deposit base has remained loyal, we have ample liquidity, our asset quality, always a hallmark of this company, remains strong, and the current management team is proactively making decisions to position the Bank for long-term success. We look forward to talking to you next quarter. Have a good rest of the day.