THE FIRST OF LONG ISLAND CORPORATION

2023 SECOND QUARTER EARNINGS CALL

JULY 28, 2023 – 2:00 p.m.

Replay available at: https://www.cstproxy.com/fnbli/earnings/2023/q2

Operator [00:01]

Welcome to The First of Long Island Corporation's Second 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/q2.

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, as supplemented by our 10-Q for the quarter ended March 31, 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 [01:40]
Thank you. Good afternoon and welcome to The First of Long Island Corporation's earnings call for the second quarter of 2023.

As the volatility of the first quarter settled down, I am pleased to report that total assets, total loans, and total deposits all increased when comparing the end of the second quarter to the end of the first quarter in 2023. Most important, our deposit franchise has remained strong. Deposit levels were only $12 million below year-end 2022, which has allowed us to avoid adding more costly borrowings and brokered deposits. Regulators have generally frowned on continually funding loan growth through brokered channels. Our business model has allowed us to avoid that formula, which we believe speaks to the strength of our franchise.

While some customers have moved money to higher yielding options such as short-term Treasuries, our banking teams have been able to replace that funding with new relationship-based deposits.

We remain focused on our key strategic initiatives of improving our Balance Sheet mix, optimizing our branch network, and enhancing our technology as we manage for long-term success.

With that in mind, in the second quarter we added a deposit gathering team to our Rockville Centre market and celebrated the relocation of three legacy branches. Our branch optimization plan has resulted in the closing of 14 branches since 2020 and the relocation of four others. After a decade of rapid branch expansion, the current management team is getting the right number of branches, in the right locations, with the right people.

In October we plan to rollout upgrades to our business online banking including a new business mobile app. And, our branches and back office will also see significant efficiencies from new systems.

Our loan pipeline was $135 million at the end of the second quarter, an increase from $96 million reported last quarter that reflects new commercial opportunities from the recent disruption in the market. Our pipeline could be higher, but we have passed on several CRE deals that did not offer an acceptable spread over the cost of new borrowings at over 5%. Our lending focus is meeting the needs of our current relationships and pursuing new commercial relationships with deposits attached. Our earnings release refers to originating loans of $76 million with a weighted average rate at just under 6% during the second quarter. Please note that is the outstanding amount at quarter end. Given the fact the certain originations are lines that were not fully drawn at quarter end, the all in number is higher. Total originations for the quarter were $101 million with a gross weighted average rate of 6.32%.

As expected from First National Bank LI, credit quality continues to be excellent with nonaccruals again at zero at the end of second quarter.

Jay McConie will now discuss our financial results for the quarter. Jay.

Jay McConie [05:21]

Thank you, Chris. Good afternoon, everyone.

As discussed last quarter, the Bank completed two balance sheet repositioning transactions in March of 2023. The purpose of the two transactions was to help reduce the Bank’s liability sensitive position to raising rates.

To briefly recap, the first transaction was a $300 million interest rate swap that converted fixed rate residential mortgage loans to floating rate for a period of 3 years. The Bank pays a fixed rate of 3.82% and receives a floating rate based on the SOFR overnight rate. This transaction provided an additional $765,000 of interest income and helped increase our margin by seven basis points in Q2-2023.

In the second transaction, the Bank sold $149 million in fixed rate municipal securities earning a tax equivalent yield of approximately 3.32% and purchased $135 million of floating rate SBA securities with a projected yield of approximately 5.38% over the life of the bonds. This transaction increased securities income by approximately $900,000 in the second quarter when compared to the first quarter of 2023. In total, these two transactions improved interest income by $1.7 million in the second quarter of 2023.

These two transactions also increased the amount of securities and loans that reprice within one year to $832 million or 20% of total assets on June 30, 2023. We also anticipate approximately $90 million in quarterly cash inflows from both the securities and mortgage loans portfolios will be reinvested into new assets at current market rates over the next twelve months. The quarterly cash inflows represent approximately 8% of total assets on an annualized basis.

The Bank purchased approximately $36 million in securities with an average yield of 5.23% during the second quarter. Management will continue to add various government agency securities with higher yields and some rate lock protection over the next several quarters.

These pro-active steps taken by management have slowed the pace of decline in the net interest margin from 40 basis points in the first quarter of 2023 to 17 basis points in the second quarter. While at a slower pace, margin decline will likely continue through the second half of 2023 and potentially into early 2024 unless the Federal Reserve Bank reduces short-term rates and the yield curve begins to steepen again.

On the funding side of the balance sheet, total deposits have remained very stable at approximately $3.4 billion in 2023, but the mix of deposits has changed with approximately $100 million moving from noninterest bearing demand deposits to interest bearing deposits as customers seek higher rates. This shift increased the average cost of funding on interest-bearing deposits by 112 basis points to 2.17%% when comparing the second quarter of 2023 to the fourth quarter of 2022.

The Bank's cumulative deposit beta on non-maturity deposits was approximately 34% through June 30, 2023, which is close to our historical average in a raising rate environment. However, since both the pace and size of the increases has not been seen in over forty years, our deposit betas could be higher in this rising rate cycle, especially given that the Federal Reserve has indicated that there could be additional rate hikes in 2023 and that rates could remain elevated well into 2024.

The Bank's total wholesale funding, including brokered deposits, was $559 million or 13% of total assets on June 30th and had a weighted average cost of funds of 4.49% and an average maturity of 9 months. In addition, the Bank has $330 million in retail time deposits that mature over the next 18 months with an average cost of funds of 3.67%. As this funding matures, it could result in some additional upward cost pressure in each of these categories.

The Bank's uninsured and uncollateralized deposits were 38% of total deposits on June 30th the same percentage as on March 31, 2023.

The Bank continues to have ample liquidity. We maintain $1.4 billion in collateralized borrowing lines with the Federal Home Loan Bank of New York and the Federal Reserve Bank. We also have $173 million in unencumbered cash and securities. In total we have approximately $1.6 billion of available liquidity, which is well in excess of our uninsured and uncollateralized deposits.

The Bank had net income of $6.9 million and earnings per share of $0.31 for the second quarter of 2023 compared to $12.5 million or $0.54 per share for the same period in 2022. The Bank's return on assets and equity were 0.66% and 7.44%, respectively. The decline in net interest income continues to be caused by the Federal Reserve Bank's aggressive monetary policy which has increased short-term rates by 550 basis points and caused further inversion of the yield curve. The spread between the three-month and 10-year U.S bond is currently inverted by approximately 140 basis points. The Bank's interest expense increased $13.1 million when compared to the second quarter of 2023 to the same quarter last year and was only partially offset by a $5.2 million increase in interest income.

The Bank's quarterly non-interest income was $2.7 million which was consistent with expectations. The current run rate should continue throughout 2023.

The Bank's non-interest expense was $16.5 million during the second quarter, flat when compared to both the linked and prior year quarter. We expect non-interest expense to remain near the current level for the remainder of 2023. Management is very mindful of expense control given the current environment and is making every effort to keep the run rate steady or decreasing as we move forward.

The Bank's efficiency ratio was 64.3% for the six months ended June 30, 2023, up from 49.4% in the prior year. The increase is mostly attributable to a decline in net interest income. The Bank's ratio of non-interest expense to average total assets remained fairly flat at 1.57% and 1.52% for the six months ended June 30, 2023 and 2022, respectively.

Our capital position remains strong with a leverage ratio of 10.11% on June 30, 2023, and increase of 17 basis points from 9.94% on March 31, 2023.

The Bank did not repurchase any shares during the second quarter of 2023. We still have approximately $15 million authorized under the most recent Board approved stock repurchase plan. The Bank declared its quarterly cash dividend of $0.21 cents to shareholders on June 29, 2023. The Board and management continue to evaluate dividends and repurchases to provide the best opportunity to maximize shareholder value.

The Bank's effective tax rate decreased to 13.8% in the second quarter of 2023 from 19.81% in the second 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 and Bank Owned Life Insurance. We anticipate our tax rate for 2023 to be between 11% to13.0%. With that I turn it back to our operator for questions.

Operator [12:33]

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

Alex Twerdahl

Good afternoon, guys.

Jay McConie

Hi, Alex.

Chris Becker

Hi, Alex.

Alex Twerdahl

I think, Jay, last quarter you were able to give us the NIM by month and the exit NIM for the quarter. And I was wondering if you had that handy. And really what I'm trying to figure out is the sort of the trajectory of the decline this quarter and whether or not there is maybe some more stabilization to come later this year.

Jay McConie

Yeah, on a monthly basis, April was 219, May was 223 and June was 210. May being a little bit higher because of the extra day you get a little bit higher margin on 31 days.

Alex Twerdahl

Okay. I guess as I think about trying to figure out the NIM is going to be for the next couple quarters or it could shake out just in terms of the deposit rates that you're paying. I mean, are the exit rates from the quarter similar to what's the average rate for the quarter or are they much higher? And I guess for the two categories that you guys break out in the average balance sheet?

Jay McConie

The average balance sheet. A little bit higher. I mean, I look at it this way, Alex, we're very happy with the pace of increase on non-maturity deposits. Funding has slowed significantly this quarter. You know, it was 40 basis points of NIM contraction in Q1, 17 basis this quarter. And the monthly pace on non-maturity deposits was probably about, I'd say on average 17 basis points in Q1. And for July we're down to about 7 basis points. So we've definitely seen a non-maturity deposits a very significant slowdown in the rate of increase which we're happy with. But we're just cautious about providing guidance because obviously we just had the rate increase yesterday. You know, they're saying higher for longer. And, you know, we just don't know if there's going to be additional rate hikes at the end of this cycle. You know, it seems it was a good inflation print today, but it just seems to be a 50/50 chance. And markets are assuming we're near the end and the FED is really trying to push that. There's still some work to be done to tackle inflation.

Alex Twerdahl

Understood. And then maybe, Chris, you can give us just a little bit more on sort of the outlook for loan growth. It looks like the pipeline actually did increase a decent amount into the end of the quarter relative at least to the end of March. I guess first, what you're seeing for the demand out there, if anything's changed in the market. Obviously, there's a big player that's gone away. How that's impacted you. And then just sort of the complexion, I guess, of the pipeline would be the third part of the question. Just a little surprised to see that overall yield, I guess, of the pipeline looked like it came down a little bit. I'm wondering if that's just a function of mix shift in there.

Chris Becker
So, as I said, the pipeline's up a little bit and that's from some additional opportunities that have come from the disruption in the market. So, we're pleased to see that. And when you look at our pipeline, you know, it's closer to, what we close in the upcoming quarter and that kind of, you know, tracks historically. And if you look at last quarter's pipeline when we gave a $96 Million pipeline and our actual closings for the month were $101 million. I know that's, as I said, a little higher than what's in the release. What's in the release is how much was funded. But we have lines of credit that were unfunded. And again, those lines that are unfunded generally carry a higher rate than some of the mortgages that were funded. So, that's why that rate is a little bit higher. So, you know, around 6% as far as outstandings is because that's all your mortgages are fully outstanding. But lines that might be at prime or prime plus that aren't fully drawn are not fully outstanding. So, there is a little discrepancy there.

But looking at our whole year originations the weighted average gross rate on those is north of six and a half, it's about 6.61%. So, we're not disappointed with where those numbers are coming in. And as the lines are drawn, that will certainly help improve our yield because those are the higher rate items. So overall the pipeline looks good. It's mainly relationship-based business not doing as much CRE right now, as we said. And so I would kind of look at that pipeline as a pretty good proxy of where we think closings would be in the third quarter. Obviously, things come in during the quarter, they get closed during the quarter that weren't there at quarter end. And obviously other things can fall out. But I think that would be a pretty good proxy where the closings would be a little bit higher in the third quarter than the second quarter.

Alex Twerdahl
Okay, so I guess all in all...

Jay McConie
Alex, this is Jay. We're definitely seeing, though, that rates for loans are starting to go up. You know, the inversion was kind of keeping competition for CRE loans and loans to spreads a little bit lower and the rates you're getting. And that's definitely starting to change as we go into the second half of the year with funding costs. I

think just the industry in itself is realizing that spreads have to go higher and you need to be paid for the risk that you're getting.

Alex Twerdahl
Got it. Would it be fair to say, based on the pipeline today, that assuming similar pay off amortization activities you saw in the second quarter, that the overall portfolio can chug higher at a mid-single digit annualized pace in the back half of the year?

Chris Becker
We think that we can see some growth in the second half of the year. I don't know if it would be as high as mid-single digits. I would think that would probably be the top of it. But we're certainly optimistic to see some continued growth in the second half of the year as we saw a little bit of growth in the second quarter.

Jay McConie
Alex, that's a little bit too. We have a couple of demand lines and stuff for some of our larger customers. And depending where those footings kind of come out, they can fluctuate up 15 to 20 million, you know, 25 million. And if they're outstanding and up, then loan footing is obviously up at a higher yield. And if they're paid off, then a little bit lower. So that kind of drives a little bit too. That's hard to predict for our customers.

Chris Becker
Yes. So, our line usage, as we've said in previous quarters, obviously it was way down in the pandemic, it came back a little bit. But line usage is lower than historically it's been. And we believe that's a reflection of the rates and some companies may be just avoiding doing certain things, making certain purchases, maybe keeping inventory levels a little bit lower and trying not to use the line as much because of the current level of interest rates.

Alex Twerdahl
Got it. That's helpful. All right. I appreciate you taking my questions.

Jay McConie
Thanks, Alex.

Operator: [20:31]

Thank you. This concluded 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. We are halfway through a challenging 2023 due to the interest rate environment and shocks to the banking system from recent bank failures. We believe these events have highlighted the strengths of our organization, a strong deposit franchise, strong asset quality, ample liquidity, and a pro-active management team that continues to transition the Bank for long-term success. We look forward to talking to you next quarter. Have a good rest of the day.