

THE FIRST OF LONG ISLAND CORPORATION
2023 FOURTH QUARTER EARNINGS CALL

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Replay available at: <https://www.cstproxy.com/fnbli/earnings/2023/q4>

Operator [00:00:01]

Welcome to The First of Long Island Corporation's Fourth Quarter 2023 Earnings Conference Call. On the call today are Chris Becker, President and Chief Executive Officer and Janet Verneuille, Senior Executive Vice President and 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/q4>.

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 September 30, 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 [00:01:37]

Thank you. Good afternoon and welcome to The First of Long Island Corporation's earnings call for fourth quarter and year-end of 2023.

I am proud to say key aspects of our transformation strategy which began in 2020 are largely in the rearview. The Bank has a fresh look, top notch technology, innovative partnerships, a more efficient branch network, bankers focused on commercial relationship growth, a proven history of strong asset quality all of which is underpinned by

a strong capital position with leverage and tangible capital ratios of 10.1% and 9.0%, respectively. Combined with optimism about short-term rates moving lower, especially for a Bank that remains generally liability-sensitive, we enter 2024 with a bright outlook for the future.

As reported in our first quarter 2023 earnings call, we proactively completed two balance sheet repositioning transactions that converted approximately \$450 million of fixed rate assets to floating rates to lessen our liability sensitivity. These two transactions were generating over \$2 million in quarterly pre-tax earnings as we entered 2024. It was the right move in early 2023. As we considered similar transactions throughout the remainder of the year, the benefit of rates staying flat or moving up did not outweigh the risk of rates moving down. We will consider additional strategies for 2024, but based on the current sentiment for rates, we believe we struck an appropriate balance so our net interest margin can begin to bounce back nicely as short-term rates come down.

The technology upgrades announced in the summer of 2022 are built, tested, and planned to “Go Live” in February 2024. Upgrades to our technology include Fiserv’s DNA core processing system, business online banking, business mobile app, branch platform and teller systems, biometric identification and paper-eliminating efficiencies. I cannot thank our team enough for their outstanding work and dedication to this project. We believe our new best-in-class systems will enhance customer experience and provide our bankers with the tools needed to service our clients and generate new relationship-based business.

The transition to a more commercially focused institution that began in 2020 continued to make progress in 2023 thanks to the hard work of our commercial lending teams and their branch partners. A key component of this objective is growing our commercial and industrial loan and owner-occupied mortgage business. This combined relationship-based portfolio has increased 12% per year on average since 2020 and our total commercial loan portfolio has grown a half a billion dollars over the same period.

Other moves such as consolidating our back-office operations into a new administrative headquarters, selling vacated buildings, closing branches and adjusting branch hours are all starting to pay dividends. Refreshing our brand and building a social media presence are getting the bank noticed. We believe the Bank is now a much better company with a solid footing both physically and digitally. Our team is 25% smaller than it was just four years ago, but much more adept at meeting today’s challenges.

Janet Verneuille will now take you through financial highlights of the full year and fourth quarter. Janet.

Janet Verneuille [00:05:44]

Thanks, Chris. Good afternoon, everyone.

Net income for 2023 totaled \$26.2 million and fully diluted earnings per share were \$1.16. The Company's return on average assets was 0.62% and its return on average equity was 7.14%. Our performance for 2023 did not match up to the record net income and fully diluted earnings per share performance the Company produced in 2022 of \$46.9 million and \$2.04, respectively. In 2022, ROA was 1.11% and ROE was 12.13%.

The overwhelming reason for the decline in earnings was the drop in the net interest margin to 2.16% in 2023 from 2.89% in 2022. The pace of decline in the net interest margin has slowed significantly throughout 2023, with the quarterly margin declining 57 basis points in the first half of the year compared to 17 basis points in the second half of the year. The Bank's non-interest income, excluding net losses on sales of securities, pension credits and other one-time items, was relatively flat when comparing 2023 and 2022.

The Bank's non-interest expense for 2023 of \$64 million decreased \$3 million from \$67 million in 2022. Salaries and employee benefits declined by \$3.7 million mostly due to lower incentive and stock-based compensation expense as the Bank fell short of its performance metrics this year. An increase of over \$700,000 in FDIC insurance expense due to higher assessment rates partially offset the savings in incentive compensation.

The Bank's effective tax rate was 11% for 2023 down from 19.4% in 2022. The decline in the effective tax rate was 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.

Net income for the fourth quarter of 2023 totaled \$6.1 million, down \$741,000 from the linked quarter. The decrease was mostly due to lower net interest income of \$1.5 million resulting from alternative higher priced funding that replaced seasonal deposit outflows. Additionally, the provision for credit losses increased \$1.1 million, as \$1.6 million in net charge-offs were partially offset by net improvements in various qualitative and quantitative factors in our ACL model. These items were partially offset by lower salaries and employee benefits expense and lower income tax expense for the same reasons mentioned previously for the full year of 2023.

The Bank's net interest margin was 2.00% in the fourth quarter compared to 2.13% in the linked quarter. The 13-basis point decrease in the net interest margin in the fourth quarter was largely due to seasonal outflow of lower cost non-maturity deposits being replaced by higher wholesale funding costs.

The Bank's quarterly non-interest income was \$2.4 million which is consistent with prior guidance and prior quarters.

The Bank's non-interest expense decreased \$1.4 million to \$14.8 million compared to the linked quarter. The decline is mostly attributable to lower incentive and stock-based compensation expense, the same reason as for the full year.

Net income for the fourth quarter of 2023 was down \$3.8 million compared to the fourth quarter of 2022. The decrease was mainly attributable to the reasons cited with respect to the year over year or linked quarter changes including a \$7.8 million decline in net interest income, an increase in the provision for credit losses of \$818,000, a decline in salaries and employee benefits expense of \$2.7 million, and a decline in income tax expense of \$1.7 million.

The yield curve has been inverted for approximately 18 months, one of the longest periods in history and continues to make it difficult for Banks to utilize their excess capital to leverage the balance sheet. As far as the Balance Sheet is concerned...

On the asset side, the Bank continues to deploy approximately \$80 to \$90 million in quarterly cash flows from our securities and loan portfolios into new assets at current market rates. The Bank has approximately \$860 million or 21% of interest earning assets maturing or repricing within one year but remains liability sensitive.

On the liability side of the balance sheet, pricing pressure continued through year end. Although the Bank priced competitively to maintain deposit balances, total deposits on a linked quarter declined 4.85% to \$3.3 billion mostly due to seasonally lower municipal and tax escrow deposits. The deposits were replaced by overnight borrowings and FHLB advances. The Bank's total wholesale funding, including brokered deposits, was \$648.7 million or 15% of total assets on December 31, 2023, and had a weighted average cost of funds of 4.66% and average maturity of 6 months. In addition, the Bank has \$352 million in retail time deposits that mature in 2024 with an average cost of funds of 4.20%.

As this funding matures in the coming quarters, we anticipate some final additional upward cost pressure. However, management believes additional interest expense from liability repricing will be largely offset by additional income as asset cashflows reprice higher leading to margin stabilization. Once the Federal Reserve begins to lower short-terms rates we believe margin expansion should follow shortly thereafter.

Liquidity indicators remain ample. We maintained \$1.1 billion in collateralized borrowing lines with the Federal Home Loan Bank of New York and the Federal Reserve Bank. We also had \$386 million in unencumbered cash and securities. In total we had approximately \$1.5

billion of available liquidity at the end of the quarter, which is well in excess of our uninsured and uncollateralized deposits.

The Bank did not repurchase any shares during 2023. We still have approximately \$15 million authorized under the most recent Board approved stock repurchase plan and given our strong capital levels will likely resume the buyback program in 2024.

Chris will talk a little bit now about 2024. Chris

Chris Becker [00:12:28]

Thanks, Janet. In preparing today's remarks, I reviewed our fourth quarter 2022 earnings call, which included forward-looking challenges for 2023. I specifically cited:

- The Federal Reserve's increases in interest rates have not been at this pace in over 40-years putting downward pressure on the Bank's net interest margin. We projected a lower margin.
- I mentioned the political and regulatory message of removing so called "junk fees" is limiting the Bank's ability to charge for the fundamental services we provide. We projected noninterest income of \$2.5 million per quarter in 2023.
- I stated that regulatory oversight continues to pile on operational costs no matter an institutions size, but management efforts to create efficiencies through branch and back-office consolidations have kept expense growth in check. We projected noninterest expenses between \$16.5 and \$17 million per quarter in 2023.

As we all know now, the Federal Reserve increased rates four more times during 2023 putting more pressure on our net interest margin than anticipated. Backing out of our net loss on sales of securities we were spot on with our 2023 projected noninterest income averaging close to \$2.5 million per quarter. And while thousands of more pages of regulatory guidance were issued, our noninterest expenses came in lower than projected principally due to lower incentive compensation expense. Other than incentive compensation, noninterest expenses were in line with 2023 projections.

Let's consider these same three areas as we enter 2024.

- First, our net interest margin. Our 2024 projections include the Federal Reserve beginning to lower rates during the second half of the year. As Janet reported, our net interest margin in the fourth quarter of 2023 was 2.00%. We currently believe there will be downward pressure during the first quarter of 2024 with a leveling out during the second quarter of the year. During the third and fourth quarters of 2024, we are projecting the net interest margin to begin to recover as short-term rates

begin to come down. Our current thinking is consistent with my comments during our third quarter earnings call that the margin should bottom out over the next two quarters, referring to the fourth quarter of 2023 and the first quarter of 2024.

- Next our noninterest income. During 2023, we fine-tuned our business checking account analysis program and adjusted service charges on consumer checking accounts to encourage more debit card and eStatement usage. These changes should produce some additional fee income in 2024 and as such we are projecting noninterest income to average \$2.6 million per quarter in 2024.
- Lastly, our noninterest expenses. Even though we are investing in new technology, our continued success with our branch optimization plan, back-office consolidations, selling vacated buildings and eliminating our residential mortgage group, among other initiatives, have reduced our run rate of noninterest expenses. We are projecting noninterest expenses to average 6.25 million per quarter in 2024, or \$250,000 to \$500,000 lower than 2023 guidance. Please note that our noninterest income and noninterest expense guidance are averages and quarterly variances are likely.

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

Operator [00:16:46]

Thank you. Our first question for today comes from Chris O'Connell from KBW. Chris, please proceed with your question.

Chris O'Connell

Yeah, just on the last item on the guide, you said 6.25. That seems low.

Chris Becker

16.25. Yes. Sorry.

Chris O'Connell

Okay. Great. That's helpful. And does the compensation line, is that kind of reset back to normal immediately for the for the first quarter?

Chris Becker

Yeah. It will reset back to normal for the first quarter. But, we do have some efficiencies

going in there as from some of the branch consolidations and back office consolidations, our computer upgrades and such. And just from the work we've done throughout the year on staffing in the branches. So, realize an entire year's benefit of that in 2024.

Chris O'Connell

Great. And then on the margin, it sounds like, maybe down a little bit in the first quarter, but the pace of that should probably slow. Based on the funding costs kind of having a little bit less pressure into the first quarter. And some of the deposits may be coming back in on seasonality.

Chris Becker

Yes. If you look at the fourth quarter with some of the deposit outflows, which were the bulk of that, was some municipal deposit outflows. And in November and December each year, we pay out from our escrow accounts, the real estate tax bills. So that number alone was 35 million. And with those outflows, as Janet mentioned, that money going into overnight borrowings, that's more expensive. That obviously pushed down the fourth quarter margin a little bit. So far, we've already brought 35 million back in this first quarter. So, that will also help relieve some of that pressure as that money flows back in.

Chris O'Connell

Great. And regarding the second half of the year, with fed cuts, maybe you guys could provide a little bit of color as to how you see the margin reacting. Depending on the level or the pace of fed cuts and how much upward mobility it has.

Janet Verneuille

Okay, so for every 25 basis points that the fed cuts, over time, we're predicting that the marginal improved 4 to 5 basis points. Again, this is over time, it depends obviously on many factors. But that's where we're projecting it to increase.

Chris O'Connell

Great. And last one for me. What's a good go forward tax rate for 2024?

Janet Verneuille

So, we're looking at between 12 and 13% for the next year. Some of the benefits of the REIT are capping out. So, it's going up slightly.

Chris O'Connell

Great. Thanks for taking my questions.

Chris Becker

Thank you. Chris.

Operator [00:20:26]

Our next question comes from Alex Twerdahl of Piper Sandler. Alex, please proceed with your question.

Alex Twerdahl

Hey. Good afternoon.

Chris Becker

Hey. Good afternoon. Alex.

Janet Verneuille

Hi, Alex.

Alex Twerdahl

Hey, I guess we'll start with sort of the outlook for the loan portfolio. Obviously, you guys have plenty of capital. Liquidity, obviously not as much. And maybe that's a little more strained, but as you kind of set yourself up for potential rate cuts and maybe some easing liquidity, there's funding costs. Do you think we could see a little bit more loan growth in 2024?

Chris Becker

We do think there will be some growth in 2024. We don't think it's going to be as robust as we would all like. But we do think that there'll be some lower single digit loan growth during this year. Last year loans were pretty flat throughout the year to down. And hopefully with some rate relief. And really, you've already seen some of that because you've seen five- and ten-year rates come off of their highs. So, that does also provide some rate relief as the loan rates are pricing off. More of that end of the curve. So, we're, anticipating to see some additional volume, the pipeline at the end of the year was not overly robust, about 100 million, at year end. But there are certainly some more conversations going on and some more activity. So, encouraged that that pipeline is going to grow.

Alex Twerdahl

Got it. And I think in the past you've given us sort of the average yield on the pipeline. Are you able to provide that?

Chris Becker

The pipelines are always difficult, right? Because it's floating, kind of, with the rates moving every day. But I can tell you that the loan closings that we had in the fourth quarter, the yield was right around 7%. So, it should be pretty much in line with that. Shouldn't stray too much from that.

Alex Twerdahl

Great. And I just wanted to ask you how you guys are thinking about the dividend going forward.

Janet Verneuille

Well, we look at the dividend, obviously every quarter. We analyze it. And right now, we're expecting that we'll continue to pay the dividend going forward.

Alex Twerdahl

Yeah, at the current level, because I know you guys have a pretty extensive history of increasing the dividend annually, and it's something that probably has given you a lot of, I don't want to say people have relied on it, but it's a nice streak. Is that a consideration? Or is it really that you've got to take one quarter at a time and look at it from a payout ratio standpoint and from a capital standpoint.

Chris Becker

You know, we appreciate that streak. I think our shareholders appreciate that streak, or our board of directors appreciates that streak. And again, in an environment like this, you look at it, quarter by quarter. But obviously our board declared the fourth quarter dividend, to keep it going. We just paid that out in early January. And so, at this point, they've committed to continuing to pay the quarterly dividend. But last year we did not have an increase. We usually do one increase a year. Last year we did keep the quarterly dividend flat at the \$0.21 a share.

Alex Twerdahl

Okay. And then I guess, Janet, I think you said in your prepared remarks that buybacks will be back on the table in the near term. Can you just give us a sense for what would trigger buybacks or capital levels that you'd feel comfortable with, things like that?

Janet Verneuille

The capital ratio is at 10%. So, we're going to analyze that each quarter. Take a look at it. And if there's room for buybacks, like we said, we didn't do any last year, we'll definitely. Based on where we project earnings to go for the year, we do have to watch that, we would consider buying back. But I don't think we have a number at this point. I'm sorry.

Chris Becker

I think we've talked before that as a national bank, we do watch our, dividend ability to dividend money up to the holding company based on the prior two years retained earnings in the current year. So, we do monitor that also. So, that's also something that could be a little bit of a governor on how much money we dividend up to the holding company. So, that's why it's kind of a quarter, by quarter item that we have to consider.

Alex Twerdahl

Understood. And then I just wanted to ask about the pickup at NPLs this quarter. If you can give us a little bit more color on something that is relatively uncharacteristic for you guys.

Chris Becker

Yes, absolutely. So unfortunately, when we seem to have any LPL's, it seems to come up. So, we actually have a grand total of about \$1 million in non-accruals. There was one CNI relationship that we took a \$1.4 million charge off of in the fourth quarter. It was a business that generally had longer terms, fixed rate contracts and that created some losses due to pandemic price increases and delays and such. And we take proactive steps to resolve that and do it quickly. But we charge that as a partial charge off. There's still about a \$600,000 balance on that loan which we have fully reserved for. But that 600,000 is part of that. And then we have one small residential mortgage just a little over 300,000 that's in that's part of an estate. So, we're not concerned about that. And then there's an even smaller, less than \$100,000, SBA small business line, SBA guaranteed small business line. That is in that list. So, the grand total is three loans in there, all below \$1 million. And in the total, it is \$1 million.

Alex Twerdahl

Really appreciate you taking my questions. Thanks.

Chris Becker

All right. Thank you. Alex.

Operator [00:27:06]

This concluded our question-and-answer session. I will now turn the floor back to Chris Becker for closing comments.

Chris Becker

Thank you for your attention and participation on the call today. I want to reassure our loyal shareholders that the Board of Directors and Management Team are focused on returning to, and improving on, our historical performance metrics. We look forward to talking to you at the end of the first quarter. Have a good rest of the day.