FINANCIAL INSTITUTIONS INC
Form 10-Q
November 02, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2010
or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Commission File Number: 000-26481

(Exact name of registrant as specified in its charter)

NEW YORK	**16-0816610**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
220 LIBERTY STREET, WARSAW, NEW YORK	**14569**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(585) 786-1100**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the regsitrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

The registrant had 10,931,456 shares of Common Stock, $0.01 par value, outstanding as of October 28, 2010.

FINANCIAL INSTITUTIONS, INC.
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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Consolidated Statements of Financial Condition (Unaudited)

(Dollars in thousands, except share and per share data)	September 30, 2010	December 31, 2009
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	$ 73,354	$ 42,874
Federal funds sold and interest-bearing deposits in other banks	94	85
Total cash and cash equivalents	73,448	42,959
Securities available for sale, at fair value	687,955	580,501
Securities held to maturity, at amortized cost (fair value of $32,555 and $40,629, respectively)	31,669	39,573
Loans	1,326,381	1,264,427
Less: Allowance for loan losses	19,732	20,741
Loans, net	1,306,649	1,243,686
Company owned life insurance	25,722	24,867
Premises and equipment, net	33,516	34,783
Goodwill	37,369	37,369
Other assets	53,203	58,651
Total assets	$ 2,249,531	$ 2,062,389
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits:		
Noninterest-bearing demand	$ 345,257	$ 324,303
Interest-bearing demand	398,682	363,698
Savings and money market	439,615	368,603
Certificates of deposit	762,843	686,351
Total deposits	1,946,397	1,742,955
Short-term borrowings	39,968	59,543
Long-term borrowings	26,768	46,847
Other liabilities	20,209	14,750
Total liabilities	2,033,342	1,864,095
Shareholders equity:		
Series A 3% Preferred Stock, $100 par value, 1,533 shares authorized and issued	153	153
Series A Preferred Stock, $100 par value, 7,503 shares authorized and issued, aggregate liquidation preference of $37,515; net of $1,398 and $1,672 discount, respectively	36,117	35,843
	17,422	17,422

Series B-1 8.48% Preferred Stock, $100 par value, 200,000 shares authorized, 174,223 shares issued				
Total preferred equity		53,692		53,418
Common stock, $0.01 par value, 50,000,000 shares authorized, 11,348,122 shares issued		113		113
Additional paid-in capital		25,837		26,940
Retained earnings		141,518		131,371
Accumulated other comprehensive income (loss)		2,802		(3,702)
Treasury stock, at cost 416,666 and 527,854 shares, respectively		(7,773)		(9,846)
Total shareholders equity		216,189		198,294
Total liabilities and shareholders equity	$	2,249,531	$	2,062,389

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Consolidated Statements of Income (Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
(Dollars in thousands, except per share amounts)	**2010**	**2009**	**2010**	**2009**
Interest income:				
Interest and fees on loans	$ 19,069	$ 18,712	$ 56,401	$ 53,618
Interest and dividends on investment securities	5,117	4,965	15,801	16,401
Other interest income		20	10	73
Total interest income	24,186	23,697	72,212	70,092
Interest expense:				
Deposits	3,739	4,826	11,253	14,729
Short-term borrowings	107	77	270	171
Long-term borrowings	547	716	1,968	2,142
Total interest expense	4,393	5,619	13,491	17,042
Net interest income	19,793	18,078	58,721	53,050
Provision for loan losses	2,184	2,620	4,707	6,614
Net interest income after provision for loan losses	17,609	15,458	54,014	46,436
Noninterest income:				
Service charges on deposits	2,528	2,643	7,260	7,480
ATM and debit card	1,046	920	3,034	2,639
Broker-dealer fees and commissions	263	238	1,002	741
Company owned life insurance	271	271	822	806
Loan servicing	267	304	687	1,031
Net gain on sale of loans held for sale	197	129	374	545
Net gain on investment securities	70	1,721	139	2,928
Impairment charges on investment securities		(2,318)	(526)	(4,101)
Net (loss) gain on other assets	(188)	19	(186)	177
Other	677	479	1,574	1,366
Total noninterest income	5,131	4,406	14,180	13,612
Noninterest expense:				
Salaries and employee benefits	8,131	8,253	24,422	25,421
Occupancy and equipment	2,736	2,730	8,177	8,289
FDIC assessments	629	753	1,865	3,026
Computer and data processing	552	578	1,738	1,757
Professional services	534	532	1,618	1,972
Supplies and postage	442	473	1,318	1,414

Advertising and promotions	338	227	877	650
Other	1,574	1,596	4,529	5,131
Total noninterest expense	14,936	15,142	44,544	47,660
Income before income taxes	7,804	4,722	23,650	12,388
Income tax expense	2,141	1,313	7,461	3,384
Net income	$ 5,663	$ 3,409	$ 16,189	$ 9,004
Preferred stock dividends, net of amortization	932	927	2,792	2,770
Net income applicable to common shareholders	$ 4,731	$ 2,482	$ 13,397	$ 6,234
Earnings per common share (Note 2):				
Basic	$ 0.44	$ 0.23	$ 1.24	$ 0.58
Diluted	$ 0.43	$ 0.23	$ 1.23	$ 0.57

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Consolidated Statement of Changes in Shareholders Equity (Unaudited)
Nine months ended September 30, 2010

(Dollars in thousands, except per share data)	Preferred Equity	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Shareholders Equity
Balance at January 1, 2010	**$ 53,418**	**$ 113**	**$ 26,940**	**$ 131,371**	**$ (3,702)**	**$ (9,846)**	**$ 198,294**
Comprehensive income:							
Net income				16,189			16,189
Other comprehensive income, net of tax					6,504		6,504
Total comprehensive income							22,693
Purchase of treasury stock						(69)	(69)
Share-based compensation plans:							
Share-based compensation expense			807				807
Stock options exercised			(52)			187	135
Restricted stock awards issued, net			(1,843)			1,843	
Directors retainer			(15)			112	97
Accrued undeclared cumulative dividend on Series A Preferred Stock, net of amortization	274			(274)			
Cash dividends declared:							
Series A 3% Preferred-$2.25 per share				(3)			(3)
Series A Preferred-$187.50 per share				(1,407)			(1,407)
Series B-1 8.48% Preferred-$6.36 per share				(1,108)			(1,108)
Common-$0.30 per share				(3,250)			(3,250)
Balance at September 30, 2010	**$ 53,692**	**$ 113**	**$ 25,837**	**$ 141,518**	**$ 2,802**	**$ (7,773)**	**$ 216,189**

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows (Unaudited)

(Dollars in thousands)	Nine months ended September 30, 2010	Nine months ended September 30, 2009
Cash flows from operating activities:		
Net income	$ 16,189	$ 9,004
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,672	3,067
Net amortization of premiums and discounts on investment securities	1,671	1,792
Provision for loan losses	4,707	6,614
Share-based compensation expense	807	690
Deferred income tax expense	1,179	5,562
Proceeds from sale of loans held for sale	26,245	76,704
Originations of loans held for sale	(28,994)	(76,178)
Increase in company owned life insurance	(822)	(806)
Net gain on investment securities	(139)	(2,928)
Impairment charge on investment securities	526	4,101
Net gain on sale of loans held for sale	(374)	(545)
Net (loss) gain on other assets	186	(177)
Decrease (increase) in other assets	389	(5,095)
Increase in other liabilities	1,398	1,562
Net cash provided by operating activities	25,640	23,367
Cash flows from investing activities:		
Purchase of investment securities:		
Available for sale	(346,773)	(451,137)
Held to maturity	(16,747)	(22,350)
Proceeds from principal payments, maturities and calls on investment securities:		
Available for sale	163,962	243,439
Held to maturity	24,210	36,512
Proceeds from sale of securities available for sale	88,090	127,142
Net loan originations	(64,683)	(159,750)
Purchase of company owned life insurance	(33)	(34)
Proceeds from sales of other assets	509	1,577
Purchase of premises and equipment	(1,774)	(1,439)
Net cash used in investing activities	(153,239)	(226,040)
Cash flows from financing activities:		
Net increase in deposits	203,442	163,915
Net (decrease) increase in short-term borrowings	(19,575)	49,800
Repayment of long-term borrowings	(20,079)	(507)
Purchase of common shares	(69)	
Issuance of preferred and common shares		(68)
Stock options exercised	135	15
Cash dividends paid to preferred shareholders	(2,518)	(2,320)

Cash dividends paid to common shareholders	(3,248)	(3,243)
Net cash provided by financing activities	158,088	207,592
Net increase in cash and cash equivalents	30,489	4,919
Cash and cash equivalents, beginning of period	42,959	55,187
Cash and cash equivalents, end of period	$ 73,448	$ 60,106

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

(1.) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Financial Institutions, Inc., a financial holding company organized under the laws of New York State (New York or NYS), and its subsidiaries provide deposit, lending and other financial services to individuals and businesses in Central and Western New York. The Company owns all of the capital stock of Five Star Bank, a New York State chartered bank, and Five Star Investment Services, Inc., a broker-dealer subsidiary offering noninsured investment products. The Company also owns 100% of FISI Statutory Trust I (the Trust), which was formed in February 2001 for the purpose of issuing trust preferred securities. References to the Company mean the consolidated reporting entities and references to the Bank mean Five Star Bank.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The accounting and reporting policies conform to U.S. generally accepted accounting principles (GAAP). Certain information and footnote disclosures normally included in financial statements prepared in conformity with GAAP have been condensed or omitted pursuant to such rules and regulations. However, in the opinion of management, the accompanying consolidated financial statements reflect all adjustments of a normal and recurring nature necessary to present fairly the consolidated balance sheet, statements of income, shareholders equity and cash flows for the periods indicated, and contain adequate disclosure to make the information presented not misleading. Prior years consolidated financial statements are re-classified whenever necessary to conform to the current year s presentation. These consolidated financial statements should be read in conjunction with the Company s 2009 Annual Report on Form 10-K. The results of operations for any interim periods are not necessarily indicative of the results which may be expected for the entire year.

Use of Estimates

The preparation of these financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Material estimates relate to the determination of the allowance for loan losses, assumptions used in the defined benefit pension plan accounting, the carrying value of goodwill and deferred tax assets, and the valuation and other than temporary impairment considerations related to the securities portfolio.

Cash Flow Information

Supplemental cash flow information addressing certain cash payments and noncash investing and financing activities was as follows (in thousands):

	Nine months ended September 30, 2010	2009
Cash payments (receipts):		
Interest	$ 13,826	$ 15,338
Income taxes	7,020	(1,312)
Noncash investing and financing activities:		
Real estate and other assets acquired in settlement of loans	$ 136	$ 903
Accrued and declared unpaid dividends	1,694	1,692
Increase in net unsettled security transactions	4,059	16,795
Loans securitized		15,983

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

(1.) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements

FASB ASC 810 Consolidation (ASC 810) was amended to change how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity s purpose and design and a company s ability to direct the activities of the entity that most significantly impact the entity s economic performance. The new authoritative accounting guidance requires additional disclosures about the reporting entity s involvement with variable-interest entities and any significant changes in risk exposure due to that involvement as well as its affect on the entity s financial statements. The new authoritative accounting guidance under ASC 810 was adopted effective January 1, 2010 and did not have a significant impact on the Company s consolidated financial statements.

FASB ASC 860 Transfers and Servicing (ASC 860) was amended to enhance reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. The new authoritative accounting guidance eliminates the concept of a qualifying special-purpose entity and changes the requirements for derecognizing financial assets. The new authoritative accounting guidance also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. The new authoritative accounting guidance under ASC 860 was adopted effective January 1, 2010 and did not have a significant impact on the Company s consolidated financial statements.

FASB ASC 820 Fair Value Measurements and Disclosures (ASC 820) was amended to require some new disclosures and clarify some existing disclosure requirements about fair value measurement. It requires separate presentation of significant transfers into and out of Levels 1 and 2 of the fair value hierarchy and disclosure of the reasons for such transfers. It will also require the presentation of purchases, sales, issuances and settlements within Level 3 on a gross basis rather than a net basis. The amendments also clarify that disclosures should be disaggregated by class of asset or liability and that disclosures about inputs and valuation techniques should be provided for both recurring and non-recurring fair value measurements. These new disclosure requirements were adopted by the Company during the current year, with the exception of the requirement concerning gross presentation of Level 3 activity, which is effective for fiscal years beginning after December 15, 2010. With respect to the portions of this amendment that were adopted during the current period, the adoption of this standard did not have a significant impact on the Company s consolidated financial statements. The Company believes that the adoption of the remaining portion of this amendment will not have a significant impact on the Company s consolidated financial statements.

FASB ASC 310 Receivables (ASC 310) was amended to require an entity to provide a greater level of disaggregated information about the credit quality of its financing receivables and its allowance for credit losses. The requirements are intended to enhance transparency regarding credit losses and the credit quality of loan and lease receivables. Under this statement, allowance for credit losses and fair value are to be disclosed by portfolio segment, while credit quality information, impaired financing receivables and nonaccrual status are to be presented by class of financing receivable. Disclosure of the nature and extent, the financial impact and segment information of troubled debt restructurings will also be required. These new disclosure requirements are effective for interim and annual reporting periods after December 15, 2010. The Company believes that the adoption of the standard will not have a significant impact on the Company s consolidated financial statements.

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