

FINANCIAL INSTITUTIONS INC

Form 10-Q

May 08, 2009

Table of Contents

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

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2009

or

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

(State or other jurisdiction of incorporation or organization)

16-0816610

(I.R.S. Employer Identification No.)

220 LIBERTY STREET, WARSAW, NEW YORK

(Address of principal executive offices)

14569

(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 No

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 No

Indicate by check mark whether the registrant 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

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller company)

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

The registrant had 10,805,319 shares of Common Stock, \$0.01 par value, outstanding as of April 30, 2009.

FINANCIAL INSTITUTIONS, INC.
Form 10-Q
For the Quarterly Period Ended March 31, 2009
TABLE OF CONTENTS

	PAGE
<u>PART I. FINANCIAL INFORMATION</u>	
<u>ITEM 1. Financial Statements</u>	
<u>Consolidated Statements of Financial Condition (Unaudited) at March 31, 2009 and December 31, 2008</u>	3
<u>Consolidated Statements of Income (Unaudited) Three months ended March 31, 2009 and 2008</u>	4
<u>Consolidated Statement of Changes in Shareholders' Equity (Unaudited) Three months ended March 31, 2009</u>	5
<u>Consolidated Statements of Cash Flows (Unaudited) Three months ended March 31, 2009 and 2008</u>	6
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	7
<u>ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
<u>ITEM 3. Quantitative and Qualitative Disclosures about Market Risk</u>	29
<u>ITEM 4. Controls and Procedures</u>	29
<u>PART II. OTHER INFORMATION</u>	
<u>ITEM 1. Legal Proceedings</u>	30
<u>ITEM 1A. Risk Factors</u>	30
<u>ITEM 6. Exhibits</u>	30
<u>Signatures</u>	32
<u>Exhibit 12</u>	
<u>Exhibit 31.1</u>	
<u>Exhibit 31.2</u>	
<u>Exhibit 32</u>	

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Consolidated Statements of Financial Condition (Unaudited)**

<i>(Dollars in thousands, except share and per share data)</i>	March 31, 2009	December 31, 2008
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	\$ 48,073	\$ 34,528
Federal funds sold and interest-bearing deposits in other banks	74,616	20,659
Total cash and cash equivalents	122,689	55,187
Securities available for sale, at fair value	553,710	547,506
Securities held to maturity, at amortized cost (fair value of \$61,737 and \$59,147, respectively)	60,675	58,532
Loans held for sale	2,290	1,013
Loans	1,157,944	1,121,079
Less: Allowance for loan losses	19,657	18,749
Loans, net	1,138,287	1,102,330
Company owned life insurance	23,959	23,692
Premises and equipment, net	36,112	36,712
Goodwill	37,369	37,369
Other assets	55,338	54,578
Total assets	\$ 2,030,429	\$ 1,916,919

LIABILITIES AND SHAREHOLDERS EQUITY

Deposits:		
Noninterest-bearing demand	\$ 279,284	\$ 292,586
Interest-bearing demand	392,353	344,616
Savings and money market	396,644	348,594
Certificates of deposit	668,999	647,467
Total deposits	1,737,280	1,633,263
Short-term borrowings	31,884	23,465
Long-term borrowings	46,877	47,355
Other liabilities	22,712	22,536
Total liabilities	1,838,753	1,726,619

Shareholders equity:

Edgar Filing: FINANCIAL INSTITUTIONS INC - Form 10-Q

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 \$37,515; net of \$1,933 and \$2,016 discount, respectively	35,582	35,499
Series B-1 8.48% Preferred Stock, \$100 par value, 200,000 shares authorized, 174,223 shares issued	17,422	17,422
Total preferred equity	53,157	53,074
Common stock, \$0.01 par value, 50,000,000 shares authorized, 11,348,122 shares issued	113	113
Additional paid-in capital	26,472	26,397
Retained earnings	125,922	124,952
Accumulated other comprehensive loss	(3,868)	(4,013)
Treasury stock, at cost 542,803 and 550,103 shares, respectively	(10,120)	(10,223)
Total shareholders equity	191,676	190,300
Total liabilities and shareholders equity	\$ 2,030,429	\$ 1,916,919

See accompanying notes to the consolidated financial statements.

Table of Contents

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

<i>(Dollars in thousands, except per share amounts)</i>	Three months ended March 31,	
	2009	2008
Interest income:		
Interest and fees on loans	\$ 17,059	\$ 16,728
Interest and dividends on investment securities	6,007	8,234
Other interest income	27	310
Total interest income	23,093	25,272
Interest expense:		
Deposits	5,015	9,236
Short-term borrowings	38	152
Long-term borrowings	713	799
Total interest expense	5,766	10,187
Net interest income	17,327	15,085
Provision for loan losses	1,906	716
Net interest income after provision for loan losses	15,421	14,369
Noninterest income:		
Service charges on deposits	2,320	2,500
ATM and debit card	811	752
Broker-dealer fees and commissions	269	459
Loan servicing	257	186
Company owned life insurance	260	19
Net gain on sale of loans held for sale	170	164
Net gain on sale of other assets	158	37
Net gain on investment securities	54	173
Impairment charges on investment securities	(50)	
Other	442	454
Total noninterest income	4,691	4,744
Noninterest expense:		
Salaries and employee benefits	8,731	8,436
Occupancy and equipment	2,876	2,580
Professional services	849	557
FDIC assessments	680	45
Computer and data processing	617	581
Supplies and postage	465	441

Edgar Filing: FINANCIAL INSTITUTIONS INC - Form 10-Q

Advertising and promotions	174	150
Other	1,686	1,483
Total noninterest expense	16,078	14,273
Income before income taxes	4,034	4,840
Income tax expense	1,067	1,061
Net income	\$ 2,967	\$ 3,779
Preferred stock dividends, net of amortization	918	371
Net income available to common shareholders	\$ 2,049	\$ 3,408
Earnings per common share (Note 2):		
Basic	\$ 0.19	\$ 0.31
Diluted	\$ 0.19	\$ 0.31

See accompanying notes to the consolidated financial statements.

Table of Contents

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
Consolidated Statement of Changes in Shareholders' Equity (Unaudited)

<i>(Dollars in thousands, except per share data)</i>	Preferred Equity	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Shareholders' Equity
Balance at January 1, 2009	\$ 53,074	\$ 113	\$ 26,397	\$ 124,952	\$ (4,013)	\$ (10,223)	\$ 190,300
Comprehensive income:							
Net income				2,967			2,967
Other comprehensive income, net of tax					145		145
Total comprehensive income							3,112
Issuance costs of Series A Preferred Stock			(68)				(68)
Share-based compensation plans:							
Share-based compensation			246	1			247
Restricted stock awards issued, net			(103)			103	
Accrued undeclared cumulative dividend on Series A Preferred Stock, net of amortization	83			(277)			(194)
Cash dividends declared:							
Series A 3% Preferred-\$0.75 per share				(1)			(1)
Series A Preferred-\$36.11 per share				(271)			(271)
Series B-1 8.48% Preferred-\$2.12 per share				(369)			(369)
Common-\$0.10 per share				(1,080)			(1,080)
Balance at March 31, 2009	\$ 53,157	\$ 113	\$ 26,472	\$ 125,922	\$ (3,868)	\$ (10,120)	\$ 191,676

See accompanying notes to the consolidated financial statements.

Table of Contents

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

<i>(Dollars in thousands)</i>	Three months ended	
	March 31,	
	2009	2008
Cash flows from operating activities:		
Net income	\$ 2,967	\$ 3,779
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,025	988
Net amortization of premiums and discounts on investment securities	252	120
Provision for loan losses	1,906	716
Amortization of unvested stock-based compensation	247	325
Deferred income tax expense	3,810	89
Proceeds from sale of loans held for sale	27,951	11,644
Originations of loans held for sale	(29,058)	(11,673)
Increase in company owned life insurance	(260)	(19)
Net gain on investment securities	(54)	(173)
Impairment charge on investment securities	50	
Net gain on sale of loans held for sale	(170)	(164)
Net gain on sale and disposal of other assets	(158)	(37)
Increase in other assets	(4,568)	(270)
Increase (decrease) in other liabilities	331	(1,715)
Net cash provided by operating activities	4,271	3,610
Cash flows from investing activities:		
Purchase of investment securities:		
Available for sale	(101,293)	(121,256)
Held to maturity	(5,801)	(5,973)
Proceeds from principal payments, maturities and calls on investment securities:		
Available for sale	84,309	97,240
Held to maturity	3,309	7,485
Proceeds from sale of securities available for sale	10,375	33,436
Net loan originations	(38,242)	(9,075)
Purchase of company owned life insurance	(7)	(40)
Proceeds from sales of other assets	767	250
Purchase of premises and equipment	(355)	(368)
Net cash (used in) provided by investing activities	(46,938)	1,699
Cash flows from financing activities:		
Net increase in deposits	104,017	52,001
Net increase in short-term borrowings	8,419	2,192
Repayment of long-term borrowings	(478)	(67)
Purchase of common stock		(1,304)
Issuance costs of preferred stock	(68)	

Edgar Filing: FINANCIAL INSTITUTIONS INC - Form 10-Q

Cash dividends paid to preferred shareholders	(641)	(371)
Cash dividends paid to common shareholders	(1,080)	(1,434)
Net cash provided by financing activities	110,169	51,017
Net increase in cash and cash equivalents	67,502	56,326
Cash and cash equivalents, beginning of period	55,187	46,673
Cash and cash equivalents, end of period	\$ 122,689	\$ 102,999
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 5,645	\$ 10,228
Cash paid for income taxes		170
Supplemental disclosure of noncash investing and financing activities:		
Real estate and other assets acquired in settlement of loans	\$ 379	\$ 118
Accrued and declared unpaid dividends	1,691	1,912
Decrease in net unsettled security transactions	571	61

See accompanying notes to the consolidated financial statements.

Table of Contents**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, 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 FISIT 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 in this Quarterly Report on Form 10-Q include the accounts of the Company and its subsidiaries. The Trust is not included in the consolidated financial statements of the Company. All significant intercompany accounts and transactions have been eliminated in consolidation. The accounting and reporting policies conform to general practices within the banking industry and to U.S. generally accepted accounting principles. Prior years consolidated financial statements are re-classified whenever necessary to conform to the current year presentation.

These financial statements have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in conformity with U.S. generally accepted accounting principles 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, stockholders equity and cash flows for the periods indicated, and contain adequate disclosure to make the information presented not misleading. These consolidated financial statements should be read in conjunction with the Company's latest 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 U.S. generally accepted accounting principles 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 valuation of goodwill and deferred tax assets, and the valuation and other than temporary impairment considerations related to the securities portfolio.

Recently Adopted Accounting Pronouncements

Earnings Per Share. On January 1, 2009, the Company adopted the provisions of Financial Accounting Standards Board (FASB) Staff Position (FSP) on Emerging Issues Task Force (EITF) Issue 03-6, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP EITF 03-6-1). FSP EITF 03-6-1 states that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per common share (EPS) pursuant to the two-class method. FSP EITF 03-6-1 was effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. The adoption of FSP EITF 03-6-1 did not have a material impact on the Company's EPS calculations.

Fair Value Measurements. On January 1, 2008, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157), for the Company's financial assets and financial liabilities. In accordance with the provisions of FSP 157-2, *Effective Date of FASB Statement No. 157*, the Company deferred the effective date of SFAS 157 for the Company's nonfinancial assets and nonfinancial liabilities, except for those items recognized or disclosed at fair value on an annual or more frequently recurring basis, until

January 1, 2009. The adoption of the fair value measurement provisions of SFAS 157 for the Company's nonfinancial assets and nonfinancial liabilities had no impact on the Company's statements of income and condition.

Derivative Financial Instruments. On January 1, 2009, the Company adopted the provisions of SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* — an amendment of FASB Statement No. 133 (SFAS 161). The statement amended the disclosure requirements for derivative financial instruments and hedging activities. Expanded qualitative disclosures required under SFAS 161 include: (1) how and why an entity uses derivative financial instruments; (2) how derivative financial instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and related interpretations; and (3) how derivative financial instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS 161 also requires several added quantitative disclosures in financial statements. As SFAS 161 amended only the disclosure requirements for derivative financial instruments and hedged items, the adoption had no impact on the Company's statements of income and condition.

Table of Contents**FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Unaudited)****(1.) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)****Recently Issued Accounting Pronouncements not Yet Adopted**

In April 2009, the FASB finalized four FSPs intended to provide additional application guidance and enhance disclosures regarding fair value measurements and impairments of securities.

These FSPs changed the method for determining if OTTI exists and the amount of OTTI to be recorded through an entity's income statement. The changes brought about by the FSPs provide greater clarity and reflect a more accurate representation of the credit and noncredit components of an OTTI event. The four FSPs are as follows:

FSP 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*, clarifies the application of FAS 157, *Fair Value Measurements*, in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active.

FSP 157-4, *Determining Fair Value When the Volume and Level of Activity for the Assets or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, provides guidelines for making fair value measurements more consistent with the principles presented in SFAS 157, *Fair Value Measurements*.

FSP 115-2 and FSP 124-2, *Recognition and Presentation of Other-than-temporary impairments*, provides additional guidance designed to create greater clarity and consistency in accounting for and presenting impairment losses on securities.

FSP 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, enhances consistency in financial reporting by increasing the frequency of fair value disclosures.

These staff positions are effective for financial statements issued for periods ending after June 15, 2009, with early application possible for the first quarter of 2009. The Company elected not to adopt any of the above positions early. The Company has not completed its evaluation of the impact of these standards on its statements of income and condition.

(2.) EARNINGS PER COMMON SHARE

The Company's restricted stock awards pay nonforfeitable common stock dividends and meet the criteria of a participating security pursuant to FSP EITF 03-6-1. Accordingly, EPS is calculated using the two-class method, under which earnings are allocated to both common shares and participating securities. This FSP requires retrospective application, thus basic and diluted earnings per share presented for the three months ended March 31, 2008 were calculated in accordance with this FSP. Neither basic nor diluted earnings per share for the three months ended March 31, 2008 changed from the adoption of this FSP.

The computation of basis and diluted EPS is presented in the following table (in thousands, except per share amounts).

	Three months ended	
	March 31,	
	2009	2008
Net income	\$ 2,967	\$ 3,779
Less: Preferred stock dividends and amortization of discount	918	371
Net income available to common shareholders	2,049	3,408
Less: Earnings allocated to participating securities	10	12
Earnings allocated to common shares outstanding	\$ 2,039	\$ 3,396
Weighted average common shares used to calculate basic EPS	10,716	10,938
Add: Effect of common stock equivalents	31	37

Weighted average common shares used to calculate diluted EPS	10,747	10,975
--	--------	--------