FINANCIAL INSTITUTIONS INC
Form 10-Q
November 06, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2012

or

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

For the transition period from to

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 x 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 x No ¨

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	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller company)	Smaller reporting company	¨

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

The registrant had 13,787,889 shares of Common Stock, $0.01 par value, outstanding as of October 31, 2012.

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FINANCIAL INSTITUTIONS, INC.

Form 10-Q

For the Quarterly Period Ended September 30, 2012

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Financial Condition

(Dollars in thousands, except share and per share data)	September 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	$ 76,951	$ 57,489
Federal funds sold and interest-bearing deposits in other banks	94	94
Total cash and cash equivalents	77,045	57,583
Securities available for sale, at fair value	748,618	627,518
Securities held to maturity, at amortized cost (fair value of $20,118 and $23,964, respectively)	19,564	23,297
Loans held for sale	1,411	2,410
Loans (net of allowance for loan losses of $24,301 and $23,260, respectively)	1,634,684	1,461,516
Company owned life insurance	46,890	45,556
Premises and equipment, net	36,653	33,085
Goodwill and other intangible assets, net	50,924	37,369
Other assets	37,530	48,019
Total assets	$ 2,653,319	$ 2,336,353
LIABILITIES AND SHAREHOLDERS EQUITY		
Deposits:		
Noninterest-bearing demand	$ 490,706	$ 393,421
Interest-bearing demand	472,023	362,555
Savings and money market	673,883	474,947
Time deposits	695,107	700,676
Total deposits	2,331,719	1,931,599
Short-term borrowings	38,282	150,698
Other liabilities	31,476	16,862
Total liabilities	2,401,477	2,099,159
Shareholders equity:		
Series A 3% preferred stock, $100 par value; 1,533 shares authorized, 1,499 and 1,500 shares issued, respectively	150	150
Series B-1 8.48% preferred stock, $100 par value, 200,000 shares authorized, 173,210 and 173,235 shares issued, respectively	17,321	17,323
Total preferred equity	17,471	17,473
Common stock, $0.01 par value, 50,000,000 shares authorized and 14,161,597 shares issued	142	142
Additional paid-in capital	67,562	67,247
Retained earnings	168,474	158,079
Accumulated other comprehensive income	5,161	945

Treasury stock, at cost 376,308 and 358,481 shares, respectively	(6,968)	(6,692)
Total shareholders equity	251,842	237,194
Total liabilities and shareholders equity	$ 2,653,319	$ 2,336,353

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Income (Unaudited)

(In thousands, except per share amounts)	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Interest income:				
Interest and fees on loans	$ 21,048	$ 19,180	$ 60,096	$ 57,286
Interest and dividends on investment securities	4,251	4,594	12,384	13,957
Total interest income	25,299	23,774	72,480	71,243
Interest expense:				
Deposits	2,029	2,728	6,596	8,859
Short-term borrowings	171	172	456	354
Long-term borrowings		256		1,321
Total interest expense	2,200	3,156	7,052	10,534
Net interest income	23,099	20,618	65,428	60,709
Provision for loan losses	1,764	3,480	4,608	5,618
Net interest income after provision for loan losses	21,335	17,138	60,820	55,091
Noninterest income:				
Service charges on deposits	2,292	2,257	6,101	6,605
ATM and debit card	1,219	1,117	3,368	3,256
Broker-dealer fees and commissions	609	541	1,630	1,329
Company owned life insurance	433	422	1,300	967
Net gain on sale of loans held for sale	323	318	981	659
Net gain on disposal of investment securities	596	2,340	2,164	2,347
Loan servicing	142	64	645	662
Impairment charges on investment securities			(91)	
Net (loss) gain on disposal of other assets	(114)	7	(79)	44
Other	853	970	2,475	2,289
Total noninterest income	6,353	8,036	18,494	18,158
Noninterest expense:				
Salaries and employee benefits	12,438	9,113	30,565	26,384
Occupancy and equipment	2,915	2,722	8,400	8,209
Professional services	1,452	570	3,243	1,823
Computer and data processing	976	603	2,462	1,854
Supplies and postage	899	461	1,930	1,337
FDIC assessments	356	437	957	1,212
Advertising and promotions	261	477	499	895
Loss on extinguishment of debt		1,083		1,083
Other	2,321	1,546	5,800	4,718
Total noninterest expense	21,618	17,012	53,856	47,515
Income before income taxes	6,070	8,162	25,458	25,734

Income tax expense	1,805	2,664	8,341	8,697
Net income	$ 4,265	$ 5,498	$ 17,117	$ 17,037
Preferred stock dividends	368	368	1,105	1,508
Accretion of discount on Series A preferred stock				1,305
Net income available to common shareholders	$ 3,897	$ 5,130	$ 16,012	$ 14,224
Earnings per common share (Note 4):				
Basic	$ 0.28	$ 0.38	$ 1.17	$ 1.10
Diluted	$ 0.28	$ 0.37	$ 1.16	$ 1.09
Cash dividends declared per common share	$ 0.14	$ 0.12	$ 0.41	$ 0.34
Weighted average common shares outstanding:				
Basic	13,703	13,635	13,692	12,876
Diluted	13,759	13,704	13,748	12,968

See accompanying notes to the consolidated financial statements.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Unaudited)

(Dollars in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net income	$ 4,265	$ 5,498	$ 17,117	$ 17,037
Other comprehensive income:				
Unrealized gains on securities:				
Change in net unrealized securities gains arising during period	5,053	7,733	8,048	23,654
Deferred tax expense	(2,002)	(3,063)	(3,188)	(9,371)
Reclassification adjustment for gains included in income before income taxes	(596)	(2,340)	(2,073)	(2,347)
Related tax expense	236	927	821	930
Change in net unrealized gains on securities, net of tax	2,691	3,257	3,608	12,866
Change in pension and post-retirement obligations:				
Change in net actuarial gain\loss	336	146	1,007	436
Related tax expense	(133)	(58)	(399)	(173)
Change in pension and post-retirement obligations, net of tax	203	88	608	263
Other comprehensive income	2,894	3,345	4,216	13,129
Comprehensive income	$ 7,159	$ 8,843	$ 21,333	$ 30,166

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Shareholders Equity (Unaudited)

Nine months ended September 30, 2012 and 2011

(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, 2011	**$ 53,785**	**$ 113**	**$ 26,029**	**$ 144,599**	**$ (4,722)**	**$ (7,660)**	**$ 212,144**
Comprehensive income:							
Net income				17,037			17,037
Other comprehensive income, net of tax					13,129		13,129
Total comprehensive income							30,166
Purchases of common stock for treasury						(205)	(205)
Issuance of common stock		29	43,098				43,127
Repurchase of warrant issued to U.S. Treasury			(2,080)				(2,080)
Redemption of Series A preferred stock	(37,515)		68				(37,447)
Repurchase of Series B-1 8.48% preferred stock	(96)						(96)
Share-based compensation plans:							
Share-based compensation			863				863
Stock options exercised			(28)			119	91
Restricted stock awards issued, net			(991)			991	
Excess tax benefit on share-based compensation			64				64
Directors retainer			(12)			110	98
Accretion of discount on Series A preferred stock	1,305			(1,305)			
Cash dividends declared:							
Series A 3% Preferred-$2.25 per share				(4)			(4)
Series A Preferred-$53.24 per share				(399)			(399)
Series B-1 8.48% Preferred-$6.36 per share				(1,105)			(1,105)
Common-$0.34 per share				(4,362)			(4,362)
Balance at September 30, 2011	**$ 17,479**	**$ 142**	**$ 67,011**	**$ 154,461**	**$ 8,407**	**$ (6,645)**	**$ 240,855**
Balance at January 1, 2012	**$ 17,473**	**$ 142**	**$ 67,247**	**$ 158,079**	**$ 945**	**$ (6,692)**	**$ 237,194**
Comprehensive income:							
Net income				17,117			17,117
Other comprehensive income, net of tax					4,216		4,216
Total comprehensive income							21,333
Purchases of common stock for treasury						(554)	(554)
Repurchase of Series B-1 8.48% preferred stock	(2)						(2)
Share-based compensation plans:							
Share-based compensation			373				373
Stock options exercised			(5)			31	26
Restricted stock awards issued, net			(140)			140	
Excess tax benefit on share-based compensation			97				97

Directors retainer			(10)			107	97
Cash dividends declared:							
Series A 3% Preferred-$2.25 per share				(3)			(3)
Series B-1 8.48% Preferred-$6.36 per share				(1,102)			(1,102)
Common-$0.41 per share				(5,617)			(5,617)
Balance at September 30, 2012	**$ 17,471**	**$ 142**	**$ 67,562**	**$ 168,474**	**$ 5,161**	**$ (6,968)**	**$ 251,842**

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, 2012**	**2011**
Cash flows from operating activities:		
Net income	$ 17,117	$ 17,037
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,761	2,580
Net amortization of premiums on securities	3,958	4,227
Provision for loan losses	4,608	5,618
Share-based compensation	373	863
Deferred income tax expense	3,684	2,122
Proceeds from sale of loans held for sale	42,847	20,464
Originations of loans held for sale	(40,867)	(19,070)
Increase in company owned life insurance	(1,300)	(967)
Net gain on sale of loans held for sale	(981)	(659)
Net gain on disposal of investment securities	(2,164)	(2,347)
Impairment charges on investment securities	91	
Net loss (gain) on sale and disposal of other assets	79	(44)
Loss on extinguishment of debt		1,083
Decrease in other assets	4,745	353
Increase (decrease) in other liabilities	3,419	(216)
Net cash provided by operating activities	38,370	31,044
Cash flows from investing activities:		
Purchases of investment securities:		
Available for sale	(245,020)	(130,587)
Held to maturity	(10,803)	(12,018)
Proceeds from principal payments, maturities and calls on investment securities:		
Available for sale	136,912	126,908
Held to maturity	14,479	18,304
Proceeds from sales of securities available for sale	2,303	10,077
Net loan originations	(102,391)	(105,514)
Loans sold or participated to others		13,033
Purchases of company owned life insurance	(34)	(18,034)
Proceeds from sales of other assets	549	509
Purchases of premises and equipment	(4,554)	(3,056)
Net cash received in branch acquisition	195,778	
Net cash used in investing activities	(12,781)	(100,378)
Cash flows from financing activities:		
Net increase in deposits	113,301	100,781
Net (decrease) increase in short-term borrowings	(112,416)	25,965
Repayments of long-term borrowings		(26,767)
Proceeds from issuance of common stock, net of issuance costs		43,127
Repurchase of preferred stock	(2)	(37,543)
Purchase of common stock for treasury	(554)	(205)
Repurchase of warrant issued to U.S. Treasury		(2,080)
Proceeds from stock options exercised	26	91
Excess tax benefit on share-based compensation	97	64

Cash dividends paid to preferred shareholders	(1,105)	(1,750)
Cash dividends paid to common shareholders	(5,474)	(3,806)
Net cash (used in) provided by financing activities	(6,127)	97,877
Net increase in cash and cash equivalents	19,462	28,543
Cash and cash equivalents, beginning of period	57,583	39,058
Cash and cash equivalents, end of period	$ 77,045	$ 67,601

See accompanying notes to the consolidated financial statements.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

(1.) BASIS OF PRESENTATION AND 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 has also expanded its indirect lending network to include relationships with franchised automobile dealers in the Capital District of New York and Northern Pennsylvania. Financial Institutions, Inc. owns all of the capital stock of Five Star Bank, a New York State chartered bank, and Five Star Investment Services, Inc., a financial services subsidiary offering noninsured investment products and investment advisory services. 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 Financial Institutions, Inc. 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 for a fair presentation of the consolidated statements of financial condition, income, comprehensive 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 2011 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.

Subsequent Events

The Company has evaluated events and transactions for potential recognition or disclosure through the day the financial statements were issued.

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.

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.* The provisions of ASU No. 2011-04 provide a consistent definition of fair value and common requirements for the measurement of and disclosure about fair value between U.S. GAAP and International Financial Reporting Standards (IFRS). The changes to U.S. GAAP as a result of ASU No. 2011-04 are as follows: (1) the concepts of highest and best use and valuation premise are only relevant when measuring the fair value of nonfinancial assets (that is, it does not apply to financial assets or any liabilities); (2) extends the prohibition on applying a blockage factor in valuing financial instruments with quoted prices in active markets; (3) creates an exception to the basic fair value measurement principles for an entity that holds a group of financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk that are managed on the basis of the entity s net exposure to either of those risks by allowing the entity, if certain criteria are met, to measure the fair value of the net asset or liability position in a manner consistent with how market participants would price the net risk position; (4) aligns the fair value measurement of instruments classified within an entity s shareholders equity with the guidance for liabilities; and (5) enhances disclosure requirements for Level 3 fair value measurements to disclose quantitative information about unobservable inputs and assumptions used, to describe the valuation processes used by the entity, and to qualitatively describe the sensitivity of fair value measurements to changes in unobservable inputs and the interrelationships between those inputs. In addition, entities must report the level in the fair value hierarchy of items that are not measured at fair value in the statement of condition but whose fair value must be disclosed. The Company adopted the provisions of ASU No. 2011-04 effective

January 1, 2012. The fair value measurement provisions of ASU No. 2011-04 had no material impact on the Company s consolidated financial statements. See Note 11 to the consolidated financial statements for the enhanced disclosures required by ASU No. 2011-04.

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

(1.) BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income.* The provisions of ASU No. 2011-05 allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both options, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. Under either method, entities are required to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. ASU No. 2011-05 also eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders equity but does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. ASU No. 2011-05 was effective for the Company s interim reporting period beginning on or after January 1, 2012, with retrospective application required. In December 2011, the FASB issued ASU No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05.* The provisions of ASU No. 2011-12 defer indefinitely the requirement for entities to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented. ASU No. 2011-12, which shares the same effective date as ASU No. 2011-05, does not defer the requirement for entities to present components of comprehensive income in either a single continuous statement of comprehensive income or in two separate but consecutive statements. The Company adopted the provisions of ASU No. 2011-05 and ASU No. 2011-12 which resulted in a new statement of comprehensive income beginning with the interim period ended March 31, 2012. The adoption of ASU No. 2011-05 and ASU No. 2011-12 had no material impact on the Company s statements of income and financial condition.

In September 2011, the FASB issued ASU No. 2011-08 *Testing Goodwill for Impairment.* The provisions of ASU 2011-08 permit an entity the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity believes, as a result of its qualitative assessment, that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further impairment testing is required. ASU No. 2011-08 includes examples of events and circumstances that may indicate that a reporting unit s fair value is less than its carrying amount. The provisions of ASU No. 2011-08 are effective for annual and interim goodwill impairment tests performed beginning in 2012. The adoption of ASU No. 2011-08 did not have a material impact on the Company s consolidated financial statements.

In July 2012, the FASB issued ASU No. 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment.* The provisions of ASU No. 2012-02 permit an entity to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform a quantitative impairment test, as is currently required by GAAP. ASU No. 2012-02 is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company does not have any indefinite-lived intangible assets other than goodwill, therefore the adoption of ASU No. 2012-02 is expected to have no material impact on the Company s consolidated financial statements.

(2.) SUPPLEMENTAL 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,	
	2012	**2011**
Cash payments:		

Interest	$ 8,046	$ 12,425
Income taxes	3,787	5,191
Noncash investing and financing activities:		
Real estate and other assets acquired in settlement of loans	$ 250	$ 237
Accrued and declared unpaid dividends	2,287	2,008
Increase in net unsettled security transactions	11,148	1,341
Accretion of preferred stock discount		1,305
Net transfer of loans to held for sale		13,576
Assets acquired and liabilities assumed in branch acquisition:		
Loans and other non-cash assets, excluding goodwill and core deposit intangible asset	77,912	
Deposits and other liabilities	287,331	

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

(3.) BRANCH ACQUISITIONS

On January 19, 2012, the Bank entered into agreements with First Niagara Bank, National Association (First Niagara) to acquire four retail bank branches in Medina, Brockport, Batavia and Waterloo, New York (the First Niagara Branches) and four retail bank branches previously owned by HSBC Bank USA, National Association (HSBC) in Elmira, Elmira Heights, Horseheads and Albion, New York (the HSBC Branches). First Niagara assigned its rights to the HSBC branches in connection with its acquisition of HSBC s Upstate New York banking franchise. Under the terms of the agreements, the Bank assumed all related deposits and purchased the related branch premises and certain performing loans. The transaction to acquire the First Niagara Branches was completed on June 22, 2012 and the transaction to acquire the HSBC Branches was completed on August 17, 2012. The combined assets acquired and deposits assumed in the two transactions were recorded at their estimated fair values as follows:

Cash	$ 195,778
Loans	75,635
Bank premises and equipment	1,938
Goodwill	11,599
Core deposit intangible asset	2,042
Other assets	339
Total assets acquired	$ 287,331
Deposits assumed	$ 286,819
Other liabilities	512
Total liabilities assumed	$ 287,331

The transactions were accounted for using the acquisition method of accounting and accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at their estimated fair values on the acquisition dates. Fair values are preliminary and in certain cases are subject to refinement for up to one year after the closing date of the acquisition as additional information relative to fair values becomes available.

The operating results of the acquired branches included in the Company s consolidated statement of income for the nine months ended September 30, 2012 reflect only amounts from the acquisition dates through September 30, 2012, the end of the third quarter. The operating results of the acquired branches prior to the acquisition dates were not material for purposes of supplemental disclosure under the FASB guidance on business combinations.

The Company acquired the loan portfolios at a fair value discount of $824 thousand. The discount represents expected credit losses, net of market interest rate adjustments. The discount on loans receivable will be amortized to interest income over the estimated remaining life of the acquired loans using the level yield method. The core deposit intangible asset will be amortized on an accelerated basis over a period of approximately nine and a half years. The time deposit premium of $335 thousand will be accreted over the estimated remaining life of the related deposits as a reduction of interest expense.

Preliminary goodwill of $11.6 million is calculated as the purchase premium after adjusting for the fair value of net assets acquired and represents the value expected from the synergies created and the economies of scale expected from combining the operations of the acquired branches with those of the Bank. All goodwill and core deposit intangible assets arising from this acquisition are expected to be deductible for tax purposes.

The following table provides a reconciliation of goodwill and other intangible assets, net:

	Goodwill	Other intangible assets, net	Total
Balance, December 31, 2011	$ 37,369	$	$ 37,369
Addition: Branch acquisitions	11,599	2,042	13,641
Less: Amortization of core deposit intangible assets		(86)	(86)
Balance, September 30, 2012	$ 48,968	$ 1,956	$ 50,924

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

(4.) EARNINGS PER COMMON SHARE (EPS)

The following table presents a reconciliation of the earnings and shares used in calculating basic and diluted EPS (in thousands, except per share amounts).

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net income available to common shareholders	$ 3,897	$ 5,130	$ 16,012	$ 14,224
Less: Earnings allocated to participating securities		9	3	29
Net income available to common shareholders for EPS	$ 3,897	$ 5,121	$ 16,009	$ 14,195
Weighted average common shares outstanding:				
Total shares issued	14,162	14,162	14,162	13,409
Unvested restricted stock awards	(99)	(171)	(116)	(164)
Treasury shares	(360)	(356)	(354)	(369)
Total basic weighted average common shares outstanding	13,703	13,635	13,692	12,876
Incremental shares from assumed:				
Exercise of stock options	4		4	3
Vesting of restricted stock awards	52	69	52	59
Exercise of warrant				30
Total diluted weighted average common shares outstanding	13,759	13,704	13,748	12,968
Basic earnings per common share	$ 0.28	$ 0.38	$ 1.17	$ 1.10
Diluted earnings per common share	$ 0.28	$ 0.37	$ 1.16	$ 1.09

For each of the periods presented, average shares subject to the following instruments were excluded from the computation of diluted EPS because the effect would be antidilutive:

Stock options	295	394	309	372
Restricted stock awards			1	5
	295	394	310	377

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

(5.) INVESTMENT SECURITIES

The amortized cost and fair value of investment securities are summarized below (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
September 30, 2012				
Securities available for sale:				
U.S. Government agencies and government sponsored enterprises	$ 96,281	$ 3,943	$ 3	$ 100,221
State and political subdivisions	177,480	7,214	7	184,687
Mortgage-backed securities:				
Federal National Mortgage Association	123,346	4,731		128,077
Federal Home Loan Mortgage Corporation	51,586	1,869		53,455
Government National Mortgage Association	60,341	4,019		64,360
Collateralized mortgage obligations:				
Federal National Mortgage Association	60,336	1,463	2	61,797
Federal Home Loan Mortgage Corporation	70,456	1,814		72,270
Government National Mortgage Association	80,085	1,916	1	82,000
Privately issued	103	698		801
Total collateralized mortgage obligations	210,980	5,891	3	216,868
Total mortgage-backed securities	446,253	16,510	3	462,760
Asset-backed securities	157	793		950
Total available for sale securities	$ 720,171	$ 28,460	$ 13	$ 748,618
Securities held to maturity:				
State and political subdivisions	$ 19,564	$ 554	$	$ 20,118
December 31, 2011				
Securities available for sale:				
U.S. Government agencies and government sponsored enterprises	$ 94,947	$ 2,770	$ 5	$ 97,712
State and political subdivisions	119,099	5,336	11	124,424
Mortgage-backed securities:				
Federal National Mortgage Association	98,679	2,944		101,623
Federal Home Loan Mortgage Corporation	63,838	1,017		64,855
Government National Mortgage Association	73,226	3,376		76,602
Collateralized mortgage obligations:				
Federal National Mortgage Association	28,339	581	7	28,913
Federal Home Loan Mortgage Corporation	22,318	675	1	22,992
Government National Mortgage Association	103,975	2,654	18	106,611
Privately issued	327	1,762		2,089
Total collateralized mortgage obligations	154,959	5,672	26	160,605
Total mortgage-backed securities	390,702	13,009	26	403,685

Asset-backed securities	297	1,400		1,697
Total available for sale securities	$ 605,045	$ 22,515	$ 42	$ 627,518
Securities held to maturity:				
State and political subdivisions	$ 23,297	$ 667	$	$ 23,964

Sales and calls of securities available for sale were as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2012	**2011**	**2012**	**2011**
Proceeds from sales	$ 633	$ 15,552	$ 2,303	$ 24,452
Gross realized gains	596	2,340	2,164	2,344
Gross realized losses				

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FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

(5.) INVESTMENT SECURITIES (Continued)

The scheduled maturities of securities available for sale and securities held to maturity at September 30, 2012 are shown below (in thousands). Actual expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

	Amortized Cost	Fair Value
Debt securities available for sale:		
Due in one year or less	$ 29,303	$ 29,629
Due from one to five years	73,220	76,262
Due after five years through ten years	263,593	274,455
Due after ten years	354,055	368,272
	$ 720,171	$ 748,618
Debt securities held to maturity:		
Due in one year or less	$ 14,273	$ 14,346
Due from one to five years	4,372	4,660
Due after five years through ten years	829	990
Due after ten years	90	122
	$ 19,564	$ 20,118

There were no unrealized losses in held to maturity securities at September 30, 2012 or December 31, 2011. Unrealized losses on investment securities available for sale and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows (in thousands):

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<u>September 30, 2012</u>						
U.S. Government agencies and government sponsored enterprises	$	$	$ 4,359	$ 3	$ 4,359	$ 3
State and political subdivisions	625	7			625	7
Mortgage-backed securities:						
Collateralized mortgage obligations:						
Federal National Mortgage Association			1,277	2	1,277	2
Government National Mortgage Association	3,457	1			3,457	1