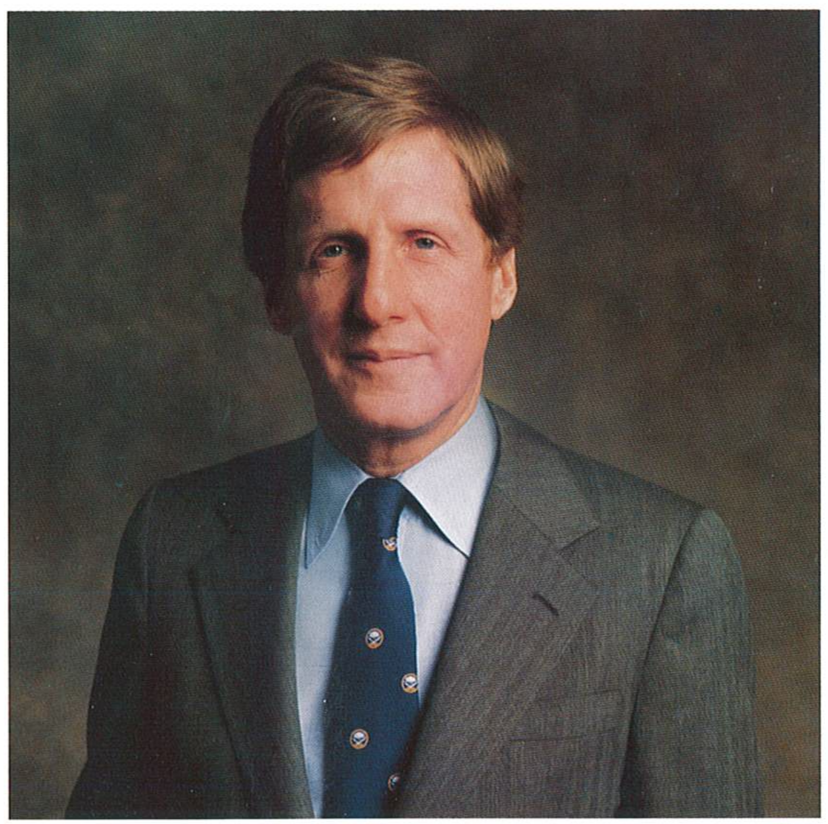

1983
1983 Annual Report
First Empire State Corporation

Message to Stockholders

Robert G. Wilmers
Chief Executive Officer
of First Empire State
Corporation and Manufacturers
and Traders Trust Company



In this, my first annual report to you, it would perhaps be more logical to deal with the future than with the past. It certainly would be more pleasant. While 1983 was a year of heavy loan losses and a decline in earnings, First Empire State Corporation moves into 1984 with decidedly improved prospects. Without minimizing the problems which remain, much less suggesting that new ones will not arise, it is possible to state that the company is heading in a positive direction and gaining momentum.

More on this point later in these comments; but first, since one of the functions of the annual report is to tell what has already transpired, some aspects of the year recently concluded. A more detailed discussion is in the financial review beginning on page 8.

You know, from press accounts and from the twelve-month interim report which you have received, that consolidated net income for the year was less than half that recorded in 1982—$5.3 million or $1.85 per share, compared with $11.8 million or $4.11 per share. The two ratios most commonly cited as key indicators of performance mirrored the decline in earnings. Net income as a percentage of average total assets fell to 0.27% in 1983 from 0.61% the year before. As a percentage of average stockholders' equity, it was 4.18%, compared with 9.81%.

The adverse factors in 1983's results were concentrated on the expense side. The provision for possible loan losses rose by nearly $4 million from 1982's level to $20.5 million. Other noninterest expenses increased by $11 million to $82 million. Income elements held up reasonably well. Net interest earnings on a taxable-equivalent basis, at $90.5 million, were down only $1.2 million despite the sharp drop in the general level of interest rates. Noninterest income was almost $4 million higher at $23 million.

As is evident from the foregoing brief scan of the broad aggregates, the rise in expenses outpaced revenue gains. In the case of the loan loss provision, the amount provided was essentially a matter of conservative banking practice—maintaining the allowance for possible loan losses at an adequate level after last year's high volume of charge-offs. Net charge-offs, totaling $20.5 million, included $5.4 million of loans to less-developed countries. While these losses were indeed unwelcome, as are all losses, we are fortunate in that our involvement in "third world" lending—the sector which is giving so much trouble to so many banks—has been small in relation to our total loans. After last year's charge-offs, it amounted to only $2.5 million still on our books, less than two-tenths of 1% of our total loans at the year-end.

The rise of 16% in other noninterest expenses was in part the result of a more conservative treatment of certain expenditures for building improvements, equipment and computer software. This accounted for approximately $1.7 million of last year's increase in noninterest costs. Another $1.8 million resulted from write-downs of the carrying value of real estate acquired in prior years through foreclosures on defaulted loans.

Salaries and employee benefits rose by $4 million, or 10%. Salary increments based on merit and length of service, along with higher costs for retirement and health insurance plans, accounted for most of the increase; but also contributing was our program of strengthening our subsidiaries by the aggressive recruitment of specially qualified managerial and technical personnel for key positions. To attract and hold men and women capable of bringing our enterprises into the front rank of professional competence and financial performance, we have had to raise our sights in matters of compensation policy. This is part of our commitment to upgrade the services we provide for our customers and the results we achieve for our stockholders.

We address that commitment with the advantage of a substantially improved financial position. Nonperforming assets, which totaled nearly $46 million at the end of 1982, were down to $23 million at the close of 1983. In the past they have been as high as $78.5 million; during the eight years for which data exist on the currently used basis, they have not until now been below $40 million. At the recent year-end they were equal to just 1.1% of total assets. A year earlier the percentage was 2.4%, and in the past it has been as high as 5%.

M&T Bank Vice Chairman Frank C. Harding (standing right) and Executive Vice Presidents Jeremy A.W.P. Wainwright, Robert E. Sadler, Jr. and James L. Hoffman

Also testifying to the improvement in asset quality is the reduction in the amount of the loan loss allowance allocated to specific loans or loan categories identified as involving potential loss. Allocations at the end of 1983 amounted to only $6.9 million, or 37% of the allowance. A year earlier they totaled $13.5 million, equal to 71%. It is interesting to note that the loans covered by allocations at the 1983 year-end included all $2.5 million of our remaining loans to less-developed countries.

Our principal subsidiary, Manufacturers and Traders Trust Company, has a strong capital base, ample to support further asset growth. It enjoys a high degree of liquidity: the average maturity of its investment portfolio at the recent year-end was 22 months, and the funds it had on deposit in the Eurodollar market were concentrated in the three-to-six-month maturity range. M&T Bank's total deposits increased 5% from 1982 to 1983 on a daily average basis and 8% from year-end to year-end. Our other banking subsidiary, The First National Bank of Highland, had an 11% increase in deposits during 1983.

A primary objective for both institutions is to build on their main strengths. Both are well-established in their markets, consumer as well as corporate, with intensive coverage of their areas through strategically located networks of banking offices. Within the past year, M&T Bank has made a successful thrust into home mortgage lending, a type of credit from which it had in effect withdrawn.

Mortgage lending is one of the pivots on which customer loyalty can be developed, and continuity of customer relationship takes on new importance in today's unprecedentedly diversified and competitive market for financial services.

M&T also is moving to increase its volume of consumer installment loans without incurring the slippage in credit standards which has accompanied some past efforts to expand this type of lending. Through an arrangement with a discount brokerage firm, the bank offers its customers low-cost execution of their securities transactions.

In the corporate market, M&T is responding to the financing needs of Western New York as the area moves its economy away from reliance on basic industry as the dominant element. The bank has worked with private companies and public agencies to develop financing plans for the conversion of buildings and machines to new uses, saving jobs that were threatened by plant closings and making possible the creation of new jobs.

As a preferred lender under the credit program of the Small Business Administration, the bank uses its system of branch offices to reach firms that are eligible for SBA loan guarantees, assist them in preparing loan applications, and establish solid banking relationships with good potential for future growth.

First National of Highland, centered on an area which is experiencing rapid industrial growth alongside a traditionally rich agriculture, is advantageously positioned to serve its expanding market. By working closely with M&T, it can make additional resources—both professional and financial—available to customers whose needs go beyond local banking.

Both subsidiary banks, as part of their business development efforts, conduct continuing research into the banking needs of companies in their regions. One current result of this fact-finding is an increased emphasis on asset-based lending. This type of financing is based on the security of a specific asset as well as the borrower's general creditworthiness. Its purpose may be to enable a company to add an expensive new machine, enlarge a plant, purchase an aircraft, acquire another firm, or carry out any of a number of other kinds of project involving tangible assets of predictably lasting value and marketability. Customarily this type of loan is of medium term, with repayment in scheduled installments. It requires thoughtful structuring by bankers who are knowledgeable about their customers' business as well as their own, and we are confident that we have a competitive edge in providing this.

M&T Bank's New York City office is active in international banking. While the bank, as already noted, has avoided major involvement in the kind of foreign lending that is causing widely publicized problems for many money-center banks, it does a substantial amount of short-term financing related to international trade. It also maintains a presence in world money markets, useful both to the bank's customers and to its own treasury operations.

M&T Bank's favorable experience in venture capital financing through its subsidiary, M&T Capital Corporation, has prompted an increase in the latter's permanent capital to $5 million through a transfer from its retained earnings. Under regulations governing small business investment companies, the increase raises to $1 million the amount that can be invested in a single enterprise. This will make a wider range of investment opportunities available to M&T Capital, an important consideration since the ratio of investments made to possibilities examined is extremely low under the selection criteria observed.

M&T Bank Senior Vice Presidents Clifford Jones Jr., Harry S. Tishelman and Albert E. Petersen; and Joseph V. Parlato, President of M&T Capital Corporation

As a venture capital investor, M&T Capital typically maintains close contact with the managements of portfolio companies and offers advice and assistance in areas where its expertise can be useful. In this it often works in cooperation with other investors. It has achieved impressive results. Realized capital gains, before income tax, totaled $3.1 million in 1983 and $1.3 million in 1982. At the end of 1983, M&T Capital's portfolio had unrealized capital gains of approximately $8.5 million. A gain of $948,000 was realized early in 1984 when a portfolio company was purchased for cash by a major corporation.

Seated—James L. Hoffman, President and Chief Executive Officer, First National of Highland; standing—Executive Vice Presdents Thomas F. Keefe and Anthony J. Koenig

A significant source of income for M&T is the issuance and servicing of credit cards. Fees from this source totaled $5.6 million last year—an increase of 22% after a 29% rise in 1982. The bank has developed this business by aggressive marketing combined with efficient handling of the voluminous detail it involves. An extensive upgrading of systems-development and data-processing resources, now under way, will further enhance M&T's position in this market while also serving the broader purpose of improving the bank's gathering and analysis of information vital to management decision-making.

Our subsidiary banks are firmly rooted in the communities they serve. They support civic causes with financial assistance and the personal participation of bank representatives. They sponsor cultural, recreational and athletic events. They work with local agencies and committees promoting economic development and neighborhood renewal.

All these forms of local involvement reflect a basic conviction: that a healthy social and economic environment in the communities where we are based is good for the business climate in which we function.

Last May, Claude F. Shuchter retired as chairman and chief executive officer of First Empire State Corporation, which he had led through the difficult period since 1976. He had served First Empire and M&T Bank with distinction in senior management positions starting in 1959. It is with keen awareness of his contribution that I follow him in office.

In July of last year, Andrew B. Craig III resigned as president of First Empire and of M&T to accept a position with another bank. In 26 years of valued service to M&T, he was a leader not only in banking but also in community affairs. He became president of M&T in 1974 and chief executive officer in March 1982. Upon his departure I assumed the duties of chief executive officer of the bank in addition to my duties as its chairman.

Seated—Robert G. Wilmers, Chairman and Chief Executive Officer of First Empire; standing—Dennis C. Smith, Vice President and Chief Financial Officer and Robert M. Edwards, Counsel and Secretary

In August 1983, James L. Hoffman was elected president and chief executive officer of The First National Bank of Highland. He continues to have senior management responsibilities in M&T Bank as an executive vice president.

Robert J. A. Irwin, Jr., who was elected a director of First Empire State Corporation at last year's annual meeting of stockholders and had earlier been elected a director of M&T Bank, has resigned both seats as the result of a Federal Reserve Board ruling that holding them conflicted with his long-held directorship in a mutual fund.

In the short time he served, Mr. Irwin made valuable contributions to the work of both boards of directors, and his departure is regretted.

Stewart T. Schantz, who has been a director of First Empire since 1972, has decided, because of the increased demands of his law practice, not to stand for reelection at the 1984 annual meeting. I am pleased that he has agreed to continue as a director of The First National Bank of Highland, which he also serves as legal counsel.

The transition which began last year with changes in management continues in our programs designed to improve services, deepen market penetration, control costs and achieve new levels of profitability. Transition involves continuity as well as change, and the cooperation of managers and staff members throughout the organization has made the process smooth and orderly. Many of them have taken on new and heavier responsibilities. Where it has been necessary to go outside the organization for people to fill key positions, those joining us have found a sincere welcome from associates ready to work together toward common goals.

With economic recovery continuing, this year should provide us with exciting opportunities. Coming out of 1983 and its unavoidable preoccupation with problems, all of us in the First Empire family are enthusiastically taking up the challenges offered by a more favorable 1984.

Robert G. Wilmers

Robert G. Wilmers
Chairman and
Chief Executive Officer

February 15, 1984

FIRST EMPIRE STATE CORPORATION

ANNUAL REPORT 1984

In an economic environment that was fundamentally favorable, but not without its challenging aspects, First Empire State Corporation earned net income in 1984 that was nearly 45% above the highest recorded in any previous year and more than three times the 1983 amount. At $17,083,000, consolidated net income was equal to $6.07 per share.

The performance of the national economy during the year confounded analysts and forecasters. After a first half that surprised just about everyone with its vigor, growth in the gross national product turned suddenly sluggish. Then, just as a pessimistic consensus was starting to form, economic activity rebounded. Meanwhile, inflation – as measured by rises in the key composites of consumer and producer prices – remained moderate. Interest rates rose during the first half of the year, steadied for a few months, and fell rather sharply in the final quarter.

Against this background, First Empire achieved increases over 1983 in deposits and loans, posted a modest gain in the spread between the cost of funds and the average yield on assets, enjoyed a reduction in loan losses and in the need to set aside funds against possible future losses, and held the rise in noninterest expense to less than 6%. As a result, we were able to:

—increase the quarterly dividend by 20%, from 25 to 30 cents per share, effective with the fourth-quarter distribution;

—add $9.2 million to stockholders' equity, bringing book value per share from $44.15 to $49.56; and

—reduce long-term debt by $9.3 million.

ROBERT G. WILMERS
Chairman and
Chief Executive Officer

Last year's results contrast vividly with those of 1983, when the need to make large loan loss provisions was a heavy drag on earnings. But the 1984 showing was not merely a turnaround from an "off" year. It carried the company's two key indices of profitability to levels not previously attained – or even approached, except in one year when an extraordinary tax credit from earlier losses accounted for nearly half of reported net income.

Net income in 1984, expressed as a rate of return on average total assets, was 0.79%; the best before that was 0.61%. Stated as return on average stockholders' equity, net income was 12.95%; the previous high, excluding the year of the special tax credit, was 9.86%.

Taxable-equivalent net interest income last year was $100.9 million, an increase of 12% over 1983's $90.1 million. All the major factors affecting this indicator of performance showed positive year-to-year changes. The average volume of earning assets, the average interest rate earned on them, the spread between that rate and the average rate paid on interest-bearing liabilities, and the average amount of earning assets financed with interest-free funds all were greater.

Besides increasing in total amount, earning assets exhibited a more advantageous mix. The growth came in loans and investment securities, both carrying higher average taxable-equivalent yields than money-market assets, which were reduced in amount.

Loans, after deduction of unearned discount, averaged $1,279 million, compared with $1,185 million in 1983. Loan volume benefited from intensified marketing efforts by Manufacturers and Traders Trust Company, our principal subsidiary, and by The First National Bank of Highland. Also contributing importantly was a gradual strengthening of the economy in the major market area served by M&T Bank.

JAMES L. HOFFMAN
President and Chief Executive Officer of The First National Bank of Highland

James L. Hoffman, a twenty-five year veteran of M&T Bank, is as enthusiastic as the newer members of the management team about the recent success of the company. His position as President and Chief Executive Officer of First National Bank of Highland and as a member of the Management Group of M&T Bank affords him a unique perspective. He provides an important element of continuity as he participates in the development of strategies, programs, and objectives of both M&T Bank and First National Bank of Highland. In addition he can take advantage of the expertise available at corporate headquarters in Buffalo and carry these concepts back to his management team in Highland. Thus the same philosophies and techniques that are at work in Western New York are being applied in the Hudson Valley, with equally positive results.

Its marketplace, one of the fastest growing in New York State, offers a great opportunity to the Highland bank, so a major effort has been launched to increase the bank's lending business. "We have staffed the bank with experienced professionals," Mr. Hoffman reveals. "We are much more active, much more aggressive, and we're attracting new customers."

Significant strides have been made. While loans at First National Bank of Highland increased only 6% during 1984, loan growth over the last seven months of 1984 was 12%. Mr. Hoffman sees two reasons for this progress. "We are developing a reputation as the leading commercial lender in the area," he explains. "Our rates are not always the lowest, but our people can put together the best financial package for the client. We can offer the combination of an SBA loan, a straight commercial loan, and a loan backed by an industrial development agency – all for the same customer."

In addition, the bank is utilizing the resources of its parent company to tremendous advantage. Mr. Hoffman puts it this way: "Though we have a relatively small balance sheet, we can provide our customers with all the services of a big bank."

The result is a changing perception of the Highland bank on the part of its marketplace, a perception that this organization has more to offer in terms of resources and expertise than its competition.

Besides a general firming in the demand for business credit, including small-business and industrial-development loans, an upturn in housing activity resulted in a rise in residential mortgage lending. Commercial construction also experienced a rebound, which produced financing opportunities for M&T not only in Western New York but also in the area served by its New York City office.

Holdings of investment securities averaged $361 million in 1984, up from $256 million the year before. A more aggressive stance in the management of the portfolios of M&T and First National contributed to an increase from 10.6% to 11.3% in the taxable-equivalent average yield on these assets. The change in strategy involved a greater emphasis on tax-exempt state and municipal securities and reduced holdings of U.S. Treasury obligations. It also included taking current losses on sales of lower-yielding securities in order to improve future earnings by buying higher-yielding paper in their place.

The effect of these moves became strikingly apparent in the most recent quarter. While the generalized downturn in market interest rates was pulling yields on other asset categories below third-quarter levels, our average taxable-equivalent yield on investment securities rose from 11.3% in the third quarter to 12% in the fourth. The solid deposit base of our banking subsidiaries provided most of the funds to support 1984's growth in earning assets. Total deposits averaged $154 million higher than in 1983. Time deposits and money-market savings accounts were the main factors in the rise. Short-term borrowings – chiefly Federal funds and repurchase agreements – were up $36 million on average.

Net interest margin, the ratio of taxable-equivalent net interest income to average total earning assets, was 5.09% last year. In 1983 it was 4.98%.

WILLIAM C. RAPPOLT
Executive Vice President and Treasurer of M&T Bank

As the most recent addition to M&T Bank's senior management team, William C. Rappolt approaches his position as Executive Vice President and Treasurer with "a healthy disrespect for bureaucracy. I have learned," he explains, "that when you want to get things done, there should be nothing sacrosanct about the way things were."

With that philosophy, Mr. Rappolt will be setting up new programs to direct the bank's operation in the money markets as well as to "manage its interest rate sensitivity." These challenges are similar to ones he faced as Senior Vice President at Fidelity Bank in Philadelphia, and ones he looks forward to here with both enthusiasm and optimism.

"There is no reason why this bank can't be at the top of the pyramid," he believes. "We have a strong deposit base. We've got a strong capital structure. We are making more money now, which means capital is improving. Our investment portfolio is strong, and therefore gives us a lot of flexibility. We have a good market position in Western New York. It's just a question of putting all those things together to make them work."

There are two key elements in making all those things work, and the first is M&T's focus on customer needs. In Mr. Rappolt's view, it's up to the bank to use its talents and resources to find profitable ways to address those needs. "People want to do business with a local bank," he says. "And we have to give them reason to do that. I think that's really our objective. We're going to give them better service than anybody else can. We'll be doing things a little more creatively."

And that, in turn, requires the right people in the right atmosphere...one that Mr. Rappolt nurtures very carefully. "If you have the right people, they'll come up with the right ideas," he points out. "We want people to be creative and encourage creativity by rewarding outstanding people. We recognize talent, and it works very well."

Income from noninterest sources, called other income in the income statement, increased in 1984 by $1.5 million, or 6.3%, in spite of a decline of $497,000 in profits realized on venture capital investments. Most of the rise came in fees received for services. Under accounting rules mandated as of 1983, gains or losses realized on sales of bank portfolio securities are included in other income. If the $2.1 million of such losses incurred in 1984 as part of portfolio strategy, and the $917,000 taken in 1983 for the same purpose, are excluded, the year-to-year growth in noninterest income would be $2.7 million, or 10.7%.

Cost control received close attention in 1984, and noninterest expense other than the provision for possible credit losses was held to an increase of $4.8 million, or 5.9%. Salaries and employee benefits were up by $5 million, or 11.4%. The other categories making up this composite were, in total, actually a shade below the 1983 level.

First Empire's annual report for 1983 detailed the company's major achievement in that year as the improved condition of the balance sheet. Nonperforming assets were halved, the percentage of the allowance for possible credit losses which was allocated to specific loans or loan categories was reduced substantially and the ratio of the allowance to the total of loans and leases net of unearned discount rose.

In 1984 the emphasis shifted to earnings, but with no diminution of regard for the integrity of the balance sheet. Nonperforming assets at the year-end were down from $23.0 millon a year earlier to $21.7 million. The allowance for possible credit losses amounted to $22.4 million, equal to 1.62% of total loans and leases less unearned discount.

ROBERT E. SADLER, JR.
Executive Vice President of M&T Bank

As a Senior Vice President in charge of the Commodity Finance Division of Chemical Bank in New York, Robert E. Sadler, Jr., felt his position – although a key one – confined him to a "fairly narrow sphere of influence." It was the opportunity to "have a direct influence over the whole range of deposit and lending services" that brought him to M&T as Executive Vice President in 1983.

And that influence has already had significant impact on the bank's organizational structure. To improve the quality of service to both retail and corporate customers, Mr. Sadler has combined the former Personal Bank and Corporate Bank units and has "streamlined procedures for credit approval," making the bank "more responsive to customer requests."

In making these changes, Mr. Sadler has enhanced what he terms "M&T's very strong market position in Western New York. We have a very loyal customer base," he says, "in both the consumer market and the corporate market. And we have a very strong branch system. Our delivery network is a good one."

But, in his view, it's people who are M&T's real strength. "We have very committed and enthusiastic people who feel they are an important part of the bank and want it to do well," he comments. In fact, he has found their attitude much different from that of employees at the large money center banks. "For people at M&T, it's more than a job. It's part of their life. And because the bank is such an integral part of the community, I think that leads to a much stronger commitment."

Underlying the progress made in these past two years is a process of regeneration that reaches into all aspects of the company's operations. The process, which continues, has been applied with deliberation rather than drama, but its workings have been visible both to the markets we serve and to the communities of which we are a part.

One focus of attention has been the coordination of marketing with asset-liability management. Because of its large stake in the consumer market, M&T Bank has seen profound change in the dynamics of its deposit structure as a result of the progressive deregulation of interest rates on savings accounts, the authorization of interest on checking accounts, and the liberalization of rules governing time deposits.

Attracting consumer deposits is essentially a marketing function, part of a whole range of personal banking services including installment loans, home mortgages, household checking accounts, and a steadily growing list of newer financial products such as discount brokerage and money-market investments. At the same time, deposit-gathering must be synchronized with a bank's ability to make sound and profitable use of those funds. To improve the articulation of these functions, M&T has placed responsibility for both corporate and consumer banking business under single direction and has unified funding activities and management of the investment portfolio in a newly formed treasury division.

JAMES L. VARDON
Executive Vice President
and Chief Financial Officer
of M&T Bank and
First Empire State Corporation

When James L. Vardon made the decision to become Executive Vice President and Chief Financial Officer of M&T Bank and First Empire State Corporation, he was attracted first and foremost by the "sense of shared purpose" he felt with other members of the bank's management team.

Just six months later, he has already helped to put M&T on the track to becoming a "top regional performer." The bank is "back in the lending business," he points out, and "the balance sheet is squeaky clean." Cost control has been tightened, and more new people are adding their talents and expertise to the staff.

In the coming year, "I think the most important thing to accomplish is to strengthen the financial discipline of the organization," he says, explaining his belief that "banking is a business like any other. Its success or failure is measured by the bottom line. The direction in which we are going is to hold all levels of management fully accountable for their contribution to that bottom line."

In the short time he has been in Buffalo, Mr. Vardon has enjoyed trading the "cultural wilderness" of places like Los Angeles, where he was Senior Vice President and Controller of Security Pacific National Bank – a large money center bank – and Miami, where he was Executive Vice President and Chief Financial Officer of the Southeast Banking Corporation, for a "community that knows its values."

"Buffalo has a considerable degree of confidence in its past, as well as in its future," he feels. And that confidence augurs well for M&T and for Western New York.

"It seems to me that what we're going to see over the next ten years is a rebuilding, a building of a new economic base for Buffalo," he predicts. And, for James Vardon, there is no question that M&T will play a significant role in that process. After all... "This is our head office. This is our focus. This is our community."

Restructuring, to be successful, demands the managerial and supervisory resources to translate concepts and plans into action. An important part of the past two years' work has been the staffing of key positions – through promotions from within where possible, by hiring from outside where necessary. Four executive vice presidents – profiles on some of whom are interleaved with this message – and seven senior vice presidents have been appointed, nine of them filling positions that were newly created or made much broader in scope. In January 1985, the management team was rounded out with the appointment of Harry R. Stainrook as executive vice president in charge of the Trust Division. Mr. Stainrook formerly held a similar position at First Pennsylvania Bank N.A.

An overhaul of compensation policies and procedures, aimed at a better correlation of achievement and reward, extends to all employee categories. A stock option plan for key executives was approved by stockholders at the 1984 annual meeting, and a performance-based bonus plan has been adopted for which officers of the rank of vice president or higher are eligible.

Individual jobs throughout the organization are being reviewed to insure that salary scales are consistent with the objective of attracting and retaining employees who will maintain the high standards of customer service we have set. Our comprehensive program of employee benefits also is being revised with the purpose of better tailoring our large expenditures in this area to employee needs and preferences.

In April 1984 the board of directors of First Empire authorized purchase by the company of 100,000 shares of its own common stock for use primarily in connection with the stock option plan. In September the board authorized purchase of an additional 150,000 shares for the same purpose. Recently, the company completed the purchase of these 250,000 shares at an average cost of $42.94 per share.

JEREMY A.W.P. WAINWRIGHT
Executive Vice President
of M&T Bank

Jeremy A.W.P. Wainwright, who heads the Operations Division as Executive Vice President, talks to a lot of M&T customers. And what they're telling him is good news...that the bank is providing good operational banking services as well as being a positive force in the community.

The perceptions of the marketplace are the result of a concentrated and continuing effort to improve the bank's products and services to its customers and to play an active part in the life of Western New York. "Key to our success are the managers of the bank – over 400 officers...professionals who know our customers and are involved in the communities that we serve." Their contribution is enhanced by the talented new additions to the management team, all of whom are dedicated to achieving superior performance in everything the bank does.

"Our good results in 1984 came mainly from three things," Mr. Wainwright explains. "First is the restructuring effort in 1983. Second is the improvement in our net interest earnings. That's very important. That's the fundamental strength of the bank. And third is that we established rather better control over our expenses. In fact, we've accomplished more in the past year than I would have thought we could do."

Mr. Wainwright came to Buffalo from Morgan Guaranty Trust in New York, and has not regretted it for an instant. He has found Western New York "a great place to live. It's very easy to get involved in the community." Besides, he adds, "once you see the resources and infrastructure that exist, the sporting possibilities, the cultural community, the art gallery – why would you *not* want to live here?"

Two new directors were elected to First Empire's board last year. L.J. Lambros, a private investor and formerly executive vice president of Amerada Hess Corporation, was elected on September 18. Roy M. Goodman, a member of the New York State Senate and a former finance administrator of the City of New York, was elected on November 20.

Later this year, Bruno A. Scrufari will reach the mandatory retirement age for directors of First Empire and M&T Bank. We shall miss his sage counsel and amiable presence on the holding company's board, to whose work he has been contributing since 1981, and on the bank's board, where his valued service began in 1973.

Jorge G. Pereira, who has been a director of First Empire and of M&T Bank since 1982, was elected a vice chairman of both companies on April 18.

Also during 1984, Patrick W.E. Hodgson, owner and president of London Machinery Co. Ltd. of Ontario, and R. Bruce Sampsell, president of Fisher-Price Toys, a division of The Quaker Oats Company, were elected to M&T's board; and Stephen E. Miron, vice president and general counsel of Miron Building Products, Kingston, N.Y., was elected a director of The First National Bank of Highland.

First Empire and M&T suffered the loss of a director who had given long years of service to both boards when James H. Righter died on June 9. He had been a director of the bank since 1949 and of First Empire since its formation in 1969. The contribution he so generously made out of his wisdom and experience is sorely missed.

Robert G. Wilmers

Robert G. Wilmers
Chairman and Chief Executive Officer

February 15, 1985

First Empire State Corporation

One M&T Plaza, Buffalo, New York 14240 716/842-5445

Officers

Chairman of the Board and Chief Executive Officer
ROBERT G. WILMERS

Vice President
DENNIS C. SMITH

Executive Vice President and Chief Financial Officer
JAMES L. VARDON

General Counsel and Secretary
RICHARD A. LAMMERT

Directors

• ROBERT G. WILMERS
Chairman of the Board

JORGE G. PEREIRA
Vice Chairman
Chairman and Chief Executive Officer
Patino Mining N.V.
Financial investments

• BRENT D. BAIRD
Limited Partner
Trubee, Collins & Co.
Stockbrokers

▪ HENRY H. COORDS
Retired President of
Fisher-Price Toys

ROY M. GOODMAN
New York State Senator

L.J. LAMBROS
Private investor

• ARTHUR H. MARSHALL
President
Marshall's News Company, Inc.
Distributor of magazines and newspapers

▪ BRUNO A. SCRUFARI
President
Scrufari Construction Co., Inc.

• RAYMOND D. STEVENS, JR.
Chairman of the Board and Chief Executive Officer
Pratt & Lambert, Inc.

• PETER TOWER
President and Treasurer
C.J. Tower & Sons of Buffalo, Inc.
Customhouse brokers

▪ SAMUEL F. WARD
President
Ward Beals & McCarthy, Inc.
Industrial distributors

Advisory Director
ROBERT J.A. IRWIN, JR.
President
Niagara Share Corporation

• Executive Committee
▪ Audit Committee

Quotation and Trading of Common Stock

The Company's common stock is traded in the national over-the-counter market. It is quoted, under the symbol FEMP, on the National Association of Securities Dealers' Automated Quotations System (NASDAQ). Quarterly information on the bid price of the stock is included in the table on page 16.

Availability of SEC Form 10-K

A copy of the Company's 1984 annual report to the Securities and Exchange Commission (Form 10-K) will be available in April 1985 at no charge.

Dividend Reinvestment Plan

A plan is available to stockholders whereby they may invest their dividends and voluntary cash payments in additional shares of the Company's stock.

Inquiries

Requests for information about the Dividend Reinvestment Plan and questions about stock certificates or dividend checks should be addressed to the Company's transfer agent, registrar and dividend disbursing agent:

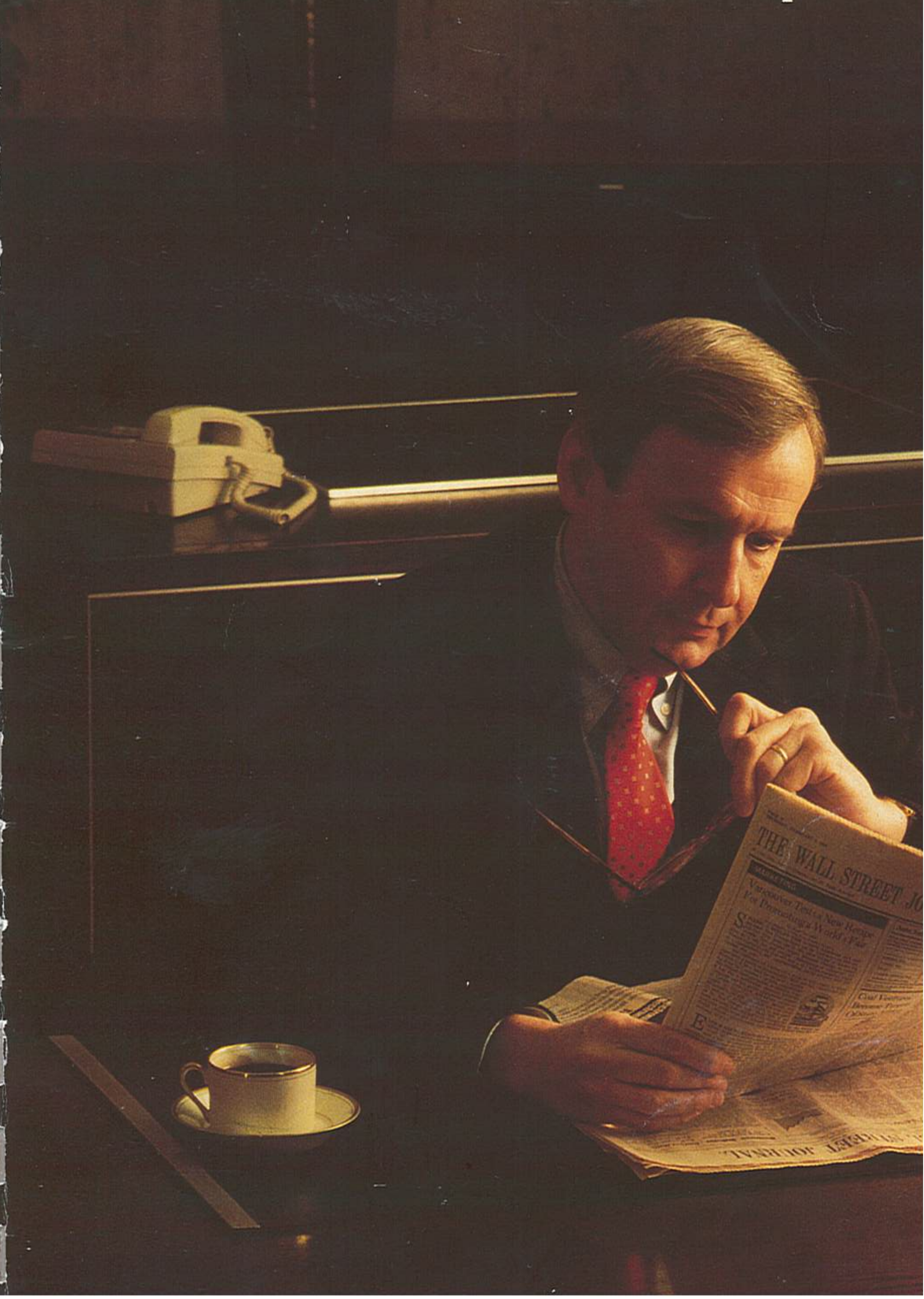
The First National Bank of Boston
Investor Relations Department
P.O. Box 644
Boston, MA 02102

Questions on other matters and requests for SEC Form 10-K may be directed to:

Dennis C. Smith, Vice President
First Empire State Corporation
One M&T Plaza
Buffalo, NY 14240

First Empire State Corpora

1985 Annual Report



Message to Stockholders

Continued growth in earnings, aided by a healthy expansion in business volume, made 1985 another year of progress for First Empire State Corporation. Consolidated net income was $22.2 million, 30% higher than the $17.1 million earned in 1984. Net income per share, at $8.25, was 36% above the prior year's $6.07.

The favorable results made possible an increase in the quarterly dividend rate from 30 to 35 cents per share, effective with the fourth-quarter distribution, and the addition of $13.4 million, or $7.24 per share, to stockholders' equity. Also impressive as an indicator of the robustness of the company's 1985 performance is the improvement in key ratios of profitability. Return on average total assets was 0.95%, and return on average stockholders' equity was 15.91%. The corresponding figures in 1984 were 0.79% and 12.95%.

Loan volume grew steadily through the year. The average total outstanding, less unearned discount, was $1,463 million. This was an increase of $184 million, or 14%, over the average in 1984. Attesting to the quality of the loan portfolio, net charge-offs were at an all-time low of $909,000, less than

Across Western New York, in the Hudson Valley and in Midtown Manhattan, sophisticated timed security devices count down through the final seconds. The vaults swing open, and doors unlock to welcome another business day to our network of 59 offices. Anthony Decillis, Branch Manager.

one-tenth of 1% of average total loans, and at the year-end nonperforming loans (those on which we are not accruing interest or are accruing at a reduced rate because of the borrowers' financial problems) were down to $18.9 million, or 1.18% of total loans.

We supported the increase in lending with gains in deposits, mainly savings and time accounts. Average total deposits rose some $220 million, or nearly 13%. This enabled us to reduce our short-term borrowings as a source of funds.

Translating loan and deposit growth into higher earnings in 1985's environment of declining interest rates required skill in the marshaling and deployment of financial resources by our subsidiary banks. Their success in meeting the challenge is confirmed by the increase achieved in the spread between the average interest rate paid on deposits and borrowings and the average rate earned on loans and investments. The spread widened from 3.71% in 1984 to an even 4% last year. Still more encouraging is the fact that the differential between average rates paid and earned was growing in the latter part of the year and reached 4.19% in the final quarter.

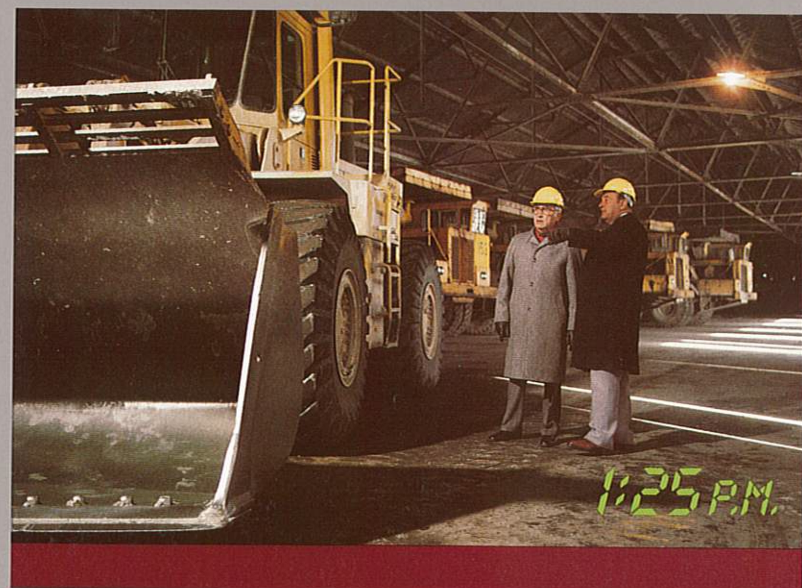
Volume exceeds $100 million throughout the branch system with 370 tellers processing 34,000 transactions a day. Lisa Frainier, Susan Sigler, Petrina Porter and Donna Sansone.

Asset growth and the improvement in spread – plus a rise of nearly $40 million in the average volume of demand deposits, on which interest is not paid – produced an increase of $10 million in taxable-equivalent net interest income. At $111 million, this key element in our profit picture was 10% above 1984's level. The ratio of net interest income to average total earning assets climbed to 5.20%, compared with 5.09% in 1984.

This record is the more notable because both Manufacturers and Traders Trust Company and The First National Bank of Highland draw a large share of their deposits from the consumer market, where the cost of money to banks tends to move down slower than do costs in the "wholesale" money markets.

Noninterest income last year totaled $33.7 million, compared with $25 million in 1984. The 1985 aggregate included $1.7 million of gains realized on sales of bank portfolio securities, while the 1984 total was reduced by the $2.1 million of losses incurred on such sales in that year. With these components excluded for purposes of comparison, noninterest income shows a lesser but still impressive year-to-year gain of $5 million, or 18%.

Among sources of noninterest income, trust department revenue was up 11%, or $481,000, to $4.7 million. While modest in relation to the potential we see for this activity, the increase was the best percentage rise for trust income since 1981 and the best ever in dollar amount.



Revenue from fees for deposit-related services grew 9% to $9.1 million. In fact, all major components of noninterest income showed increases from 1984 except gains realized on sales of investments by our venture capital subsidiary. These totaled $2.2 million in 1985, compared with $2.6 million the previous year.

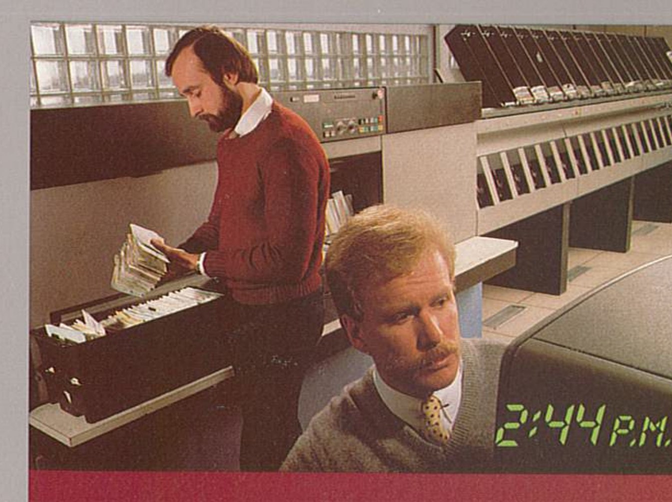
Slag recycling is just the beginning of plans to reclaim the darkened, former Bethlehem Steel facility, positive results of a 25 year relationship between a progressive bank and a progressive client, Buffalo Crushed Stone. Harry Tishelman, M&T Senior Vice President, with Richard Mirabelli of Buffalo Crushed Stone.

In response to last year's rise in loan volume, we set aside as a charge against earnings approximately the same provision for possible loan losses as in 1984 – $6 million, compared with $5.8 million. After the year's favorable charge-off experience, the allowance for possible losses amounted at December 31 to $27.4 million. This was equal to 1.71% of total loans at the year-end. A year earlier the ratio of allowance to loans was 1.62%.

Expenses other than interest and the loan loss provision rose 10% last year, to $95.3 million from $86.5 million the year before. Both in percentage and in dollar amount this was a greater increase in the expense aggregate than occurred between 1983 and 1984. The rise in payroll-related costs was slowed – to 8% last year from 11% the prior year – but equipment and net occupancy expense went up 16%. Contributing to that jump were outlays for needed improvements in data processing and other information systems, including the first stages of a $2.2 million installation in M&T Bank's trust and investment services division.

Read. Sort. Microfilm. High speed machines operating around the clock process more than 350,000 checks each day, up to 2000 per minute. Phillip Rowell and Lee Stadler.

The group of expense categories lumped in the statement of income as "other costs of operations" rose 14%. It includes a number of costs more or less directly related to business volume, such as fees for certain purchased services, as well as expenditures for our stepped-up programs of business development.



The results achieved by First Empire in the past two years have meaning beyond the

figures in which they are recorded. To investors, to the customers served by our subsidiaries, and to all of us in the company, they confirm that a fundamental change has occurred and that new institutional strengths are at work.

M&T Bank, our principal subsidiary, is well on the way to recapturing its former position in both corporate and consumer markets in Western New York. In new thrusts, M&T has established a leasing subsidiary and a private banking group. The latter, based in New York City, provides highly individualized financial services to clients with special banking needs.

The bank's treasury division has expanded its trading operations in fixed-income securities and foreign exchange. Later this year it will locate those activities in M&T's New York City office to gain the advantage of quicker access to market information and more efficient execution of transactions.

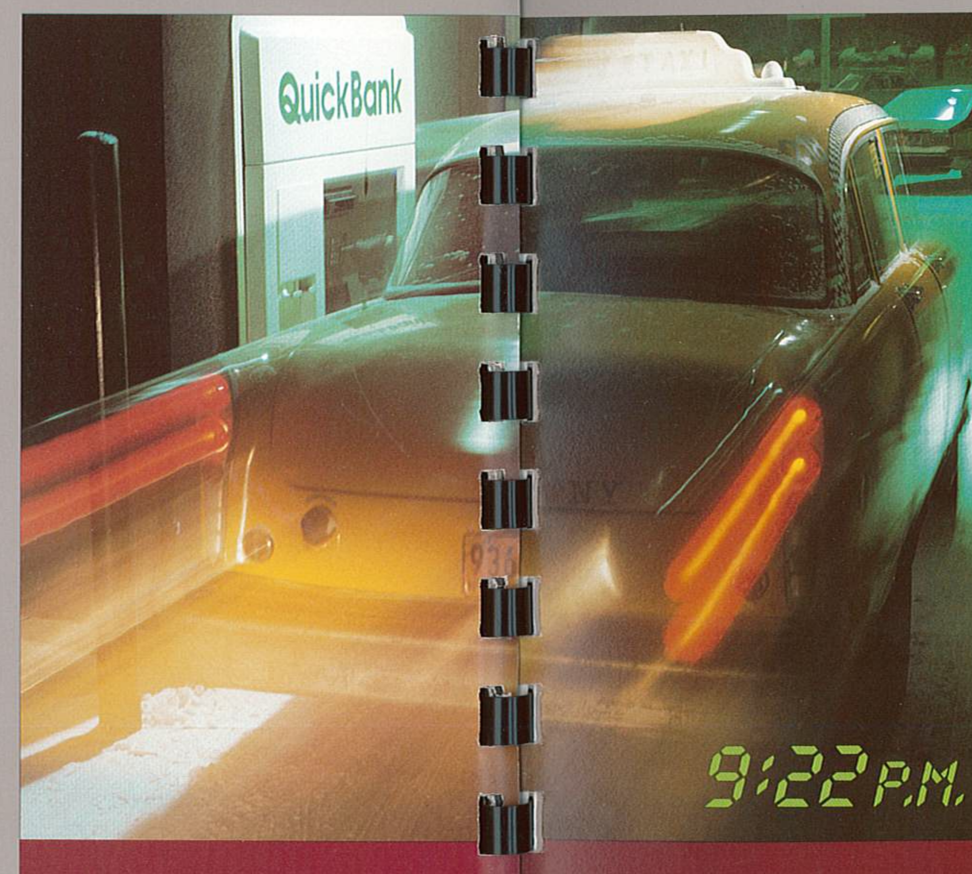
M&T has strengthened its trust area with the addition of personnel recruited from some of the leading organizations in the money-management field. They include professionals in each of the areas critical to a successful trust business: investment, administration, operations and marketing.

The important responsibility of the trust division – more than $2.6 billion in assets under administration – is directed by Harry Stainrook, Executive Vice President, who joined M&T Bank in 1985. With Susan Keaton, Eugene Miller and John Noll.

Coordination between M&T and First of Highland is yielding benefit to both banks. In cases where customers' credit requirements have exceeded the Highland bank's lending limit, M&T has joined in making loans. This has enabled Highland to maintain and enhance important banking relationships while also providing M&T with attractive lending opportunities.

Automated tellers already process 20% of our routine transactions. By the end of 1986, more than 60 QuickBanks will be on line.

First National's total loans, at $81 million, averaged 17% higher in 1985 than the year before. Net income more than doubled. The bank's Hudson Valley market area, which has one of the fastest-growing economies in New York State, was broadened last year with the acquisition of a branch in prosperous Rockland County.



First Empire and M&T Bank will lose the valued services of a long-time director when Henry H. Coords retires from the boards of both companies in April of this year.

Mr. Coords has been a director of M&T since 1966 and of the holding company since its formation in 1969. He has brought a wealth of business experience and wise judgment to the work of both boards.

Frank P. Smeal has been elected to the directors advisory councils of First Empire and M&T. He is a limited partner of Goldman, Sachs & Co.

Three new directors were elected to the board of M&T Bank last year. They are David Campbell, chairman of the board and chief executive officer of Computer Task Group, Inc.; Richard Garman, president of Buffalo Crushed Stone, Inc.; and Wilfred Larson, president of Westwood Pharmaceuticals Inc.

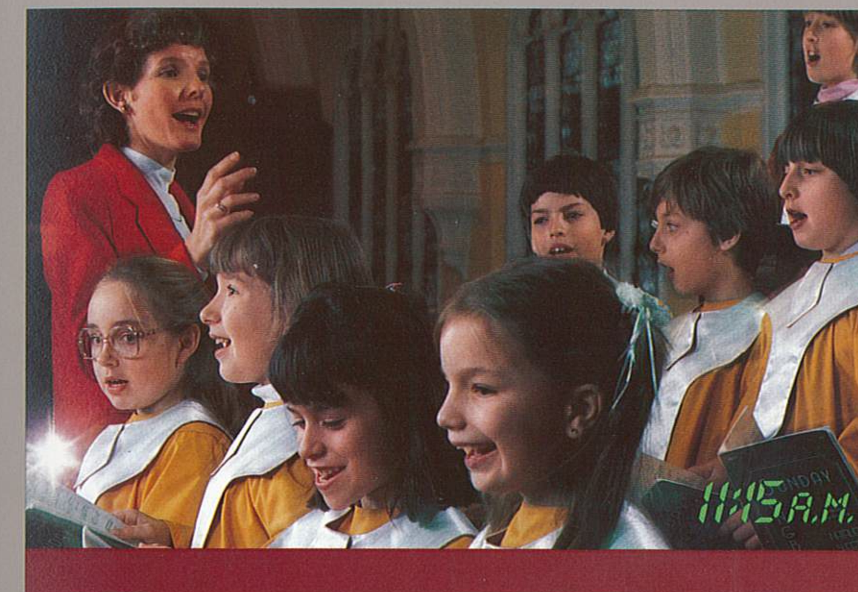
Gerald Kreisberg, president and chief executive officer of Bloomingrove Associates, was elected a director of The First National Bank of Highland last year. In January 1986 Ernest Herzog, chairman of

Kedem Royal Wine Company, and John P. O'Shea, president and chief executive officer of Marshall & Sterling Insurance Agency, were elected directors of the Highland bank. Stephen E. Miron has resigned from the bank's board in order to devote more time to his duties as vice president and general counsel of Miron Building Products.

From major charitable and cultural organizations to Junior Achievement, Scouting and Little League, people in every part of our organization share a sincere commitment to community service. Cynthia Baker directs the Children's Choir of Central Presbyterian Church.

In December 1985 legislation was enacted in New York State designed to impede "unfriendly takeovers" of corporations – that is, changes in control of a company whose board of directors is opposed to the change. Simply stated, the legislation seeks to do this mainly through a provision severely limiting the courses of action open to a stockholder who acquires 20% or more of a company's voting stock without obtaining advance approval of the acquisition from the company's board of directors. Another integral provision requires stockholder approval before a company can purchase more than 10% of its own outstanding shares at a price above market value.

A company may elect, by means of an amendment to its by-laws, not to be covered by the legislation. The board of directors of First Empire State Corporation has adopted such an amendment. In the board's judgment, the basic thrust of the legislation is adverse to the interests of stockholders; the board also believes that the legislation, viewed in a broader context, is unsound public policy.



By giving a company's directors power in effect to limit the acquisition of shares by outside investors, the board feels, coverage under the law would lessen the attractiveness of a company's stock in relation to that of companies not subject to the law. As for the provision relating to purchases by a company of its own stock, the board is sympathetic to the provision's intent to deter the payment of so-called "greenmail," an anti-takeover tactic which the board regards as inherently unfair to most stockholders. Quite apart from the context of takeovers, however, the board believes that the measure interferes excessively with the role and responsibility of directors and management in the conduct of a company's affairs.

Looking at the larger implications, the board believes the legislation as a whole is contrary to the principle of free capital markets, that it favors incumbent managements at some cost to stockholders, and that it is likely to hinder desirable changes in corporate control for the sake of trying to prevent undesirable change.

The board emphasized that its decision to exclude First Empire from coverage by the new legislation does not indicate any change in the position frequently stated by the management with the full support of the board – namely, that First Empire has no intention of being acquired, merged or otherwise absorbed.

Robert G. Wilmers

Robert G. Wilmers
Chairman of the Board
and Chief Executive Officer

March 5, 1986

First Empire State Corporation

One M&T Plaza, Buffalo, New York 14240 716/842-5445

Officers

Chairman of the Board and Chief Executive Officer
ROBERT G. WILMERS

Vice President
DENNIS C. SMITH

Executive Vice President and Chief Financial Officer
JAMES L. VARDON

General Counsel and Secretary
RICHARD A. LAMMERT

Directors

• ROBERT G. WILMERS
Chairman of the Board

JORGE G. PEREIRA
Vice Chairman
Chairman and Chief Executive Officer
Patino Mining N.V.
Financial investments

• BRENT D. BAIRD
Limited Partner
Trubee, Collins & Co.
Stockbrokers

▪ HENRY H. COORDS
Retired President of
Fisher-Price Toys

ROY M. GOODMAN
New York State Senator

▪ L.J. LAMBROS
Private investor

• ARTHUR H. MARSHALL
President
Marshall's News Company, Inc.
Distributor of magazines and newspapers

• RAYMOND D. STEVENS, JR.
Chairman of the Board and Chief Executive Officer
Pratt & Lambert, Inc.

• PETER TOWER
President and Treasurer
C.J. Tower & Sons of Buffalo, Inc.
Customhouse brokers

▪ SAMUEL F. WARD
President
Ward Beals & McCarthy Inc.
Industrial distributors

Directors Advisory Council

ROBERT J.A. IRWIN, JR.
President
Niagara Share Corporation

FRANK P. SMEAL
Limited Partner
Goldman Sachs & Co.

• Executive Committee
▪ Audit Committee

Quotation and Trading of Common Stock

The company's common stock is traded under the symbol FEMP on the NASDAQ National Market System. Quarterly information on the market price of the stock is included in the table on page 16.

Availability of SEC Form 10-K

A copy of the company's 1985 annual report to the Securities and Exchange Commission (Form 10-K) will be available in April 1986 at no charge.

Dividend Reinvestment Plan

A plan is available to stockholders whereby they may invest their dividends and voluntary cash payments in additional shares of the company's stock.

Inquiries

Requests for information about the Dividend Reinvestment Plan and questions about stock certificates or dividend checks should be addressed to the company's transfer agent, registrar and dividend disbursing agent:
The First National Bank of Boston
Investor Relations Department
P.O. Box 644
Boston, MA 02102

Questions on other matters and requests for SEC Form 10-K may be directed to:
Dennis C. Smith, Vice President
First Empire State Corporation
One M&T Plaza
Buffalo, NY 14240

RAK

For banking, 1986 brought a business climate mildly favorable on balance but with enough adverse elements to challenge the skill and resources of all in the industry. The domestic economy lurched indecisively through much of the year, often mocking its most esteemed prophets. Conjecture about the likely shape of tax overhaul was an unsettling influence, and so was the reality that finally emerged. The continued downtrend of interest rates, which had brought banks a series of quarter-to-quarter improvements in their interest-rate spreads, started taking back some of that benefit. And further market incursions were made by non-bank lenders, including automobile companies offering car buyers below-below-cost financing rates.

Despite these and other patches of inclemency in 1986, for First Empire State Corporation the vintage proved rewarding. The company achieved net income of $26.2 million, an increase of 18% over 1985, itself a good year. On a per share basis, the gain was 16%, to $9.59 from $8.25. The year's results added $22.7 million, or $8.55 per share, to stockholders' equity, bringing that measure of the company's net worth to $171.9 million, or $65.35 per share.

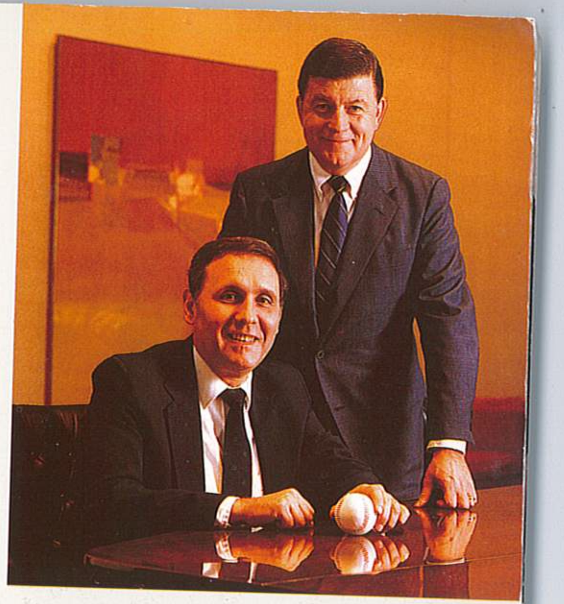
The increase in net income carried our annual rates of return on average total assets and average stockholders' equity to new high levels. Return on assets was 1.02%, compared with 0.95% in 1985. Return on equity was 16.51%, compared with 15.91%.

The year saw growth of 15% in the company's total assets, which went from $2,548 million at the end of 1985 to $2,919 million at the recent year-end. Most of the increase came in loans by our two subsidiary banks, Manufacturers and Traders Trust Company (M&T Bank) and The First National Bank of Highland. At $1,904 million after deduction of unearned discount, total loans and leases were up 19%, or $299 million. A high standard of credit quality was maintained: only 1.06% of total loans and leases were in a nonperforming status at the year-end.

The liabilities side of the balance sheet at the close of 1986 showed total deposits up 14% for the year at $2,523 million. All deposit categories shared in the increase.

Pilot Field under construction, Buffalo, New York

M&T Bank is proud to be a leading participant in the construction of Buffalo's new downtown baseball stadium. With the purchase of over 4 million dollars of Erie County bonds, M&T helped get this needed construction underway. M&T Bank also bought the entire $4 million issue to fund the stadium parking ramp. With M&T's corporate headquarters looming in the background, our commitment to Buffalo and Western New York is reinforced with this investment.



Kenneth W. Paulin, Administrative Vice President Specialized Lending

Harland Gonya, Assistant Vice President Commercial Real Estate (seated)

On February 17, 1987, First Empire's Board of Directors voted to raise the quarterly dividend to 40 cents per share, an increase of 14% over the former rate of 35 cents. This was the third increase in a little over two years. The first distribution at the new rate will be made on March 23 to stockholders of record on March 2.

Last April, my report to you on our results in the first quarter of the year cautioned that declining interest rates, while they contribute to positive business sentiment, also can put pressure on the spread between banks' cost of money and the yields they earn on loans and investments. "The company's financial performance in the months ahead," the report said, "will be affected importantly by the degree to which we are able to avoid a narrowing of the interest-rate spread."

As the year progressed, it became apparent that our spread, calculated on a taxable-equivalent basis, had reached its peak for the current interest-rate cycle at the first-quarter level of 4.43%. From there, it slanted gradually down in succeeding quarters as the declining rate trend exerted more impact on our asset structure than on the liabilities side.

Two factors worked to moderate the erosion. The steady increase in the volume of loans, which typically earn higher yields than most other asset categories, cushioned the attrition in the average yield on total earning assets. Also, protective transactions undertaken in advance by our treasury division provided partial insulation against the effect of lower rates. These arrangements, using facilities of both domestic and international money markets, included interest-rate "swaps," in which one party agrees to pay interest at a rate varying with some market indicator in exchange for the other party's agreement to pay at a fixed rate.

With these offsets to the shrinkage, our spread for 1986 as a whole was a favorable 4.34%, compared with 4.00% in 1985. As the new year proceeds, however, it must be recognized that the lower rates continue to exert pressure and that maintaining the spread even at the fourth-quarter 1986 level of 4.19% will be difficult and perhaps impossible.

Thomas F. Keefe,
Executive Vice President
The First National Bank
of Highland (right)

John J. Jones,
Sr. Vice President
Commercial Lending
The First National Bank
of Highland

Hess's Department Store, Poughkeepsie, New York

Hess's new 80,000 square foot store inside a multi-million dollar mall in Poughkeepsie, represents a milestone for First Empire. It was financed by The First National Bank of Highland and M&T Bank, and at more than 4 million dollars it then represented the largest joint venture between our two bank subsidiaries.

Net interest income, in taxable-equivalent terms, was $125.4 million last year, 13% above 1985's $110.9 million. Growth in loans was the chief factor in the increase, with the year-to-year improvement in the interest-rate spread also contributing.

The average volume of loans and leases net of unearned discount rose by $302 million, or 21%, in 1986 – to $1,765 million from $1,463 million the year before. Commercial and real estate lending accounted for most of the increase. New extensions of home mortgage credit by M&T Bank totaled $110 million, almost double the 1985 amount; net of amortization and refinancings, the total outstanding rose by $62 million.

Early in 1987 M&T began offering mortgages geared to bi-weekly, rather than monthly, payment of interest and principal. This innovative feature, popular in Canada but thus far adopted by relatively few banks in the United States, and available only from M&T in its market area, affords the home buyer substantial savings in interest and a faster build-up of equity compared with the traditional way of payment. The First National Bank of Highland will begin offering the bi-weekly plan soon. Enthusiastic customer response to M&T's innovation, along with an expected surge in "home equity" borrowing because of the new rule on deductibility of interest for federal income tax purposes, indicates another strong year for mortgage credit.

We financed last year's loan growth partly by reducing the average level of money-market assets, especially Eurodollars placed with overseas offices of U.S. banks. But the funding of the expansion in loans came mainly from increased deposits. Average total deposits, at $2,203 million, were 11% above 1985's $1,977 million. More than two-thirds of the gain came in lower-cost savings and checking categories and interest-free demand deposits.

Net interest margin, the ratio of net interest income to average earning assets, combines the effect of the interest-rate spread and the contribution of interest-free funds. First Empire's net margin in 1986 was 5.34%; the year before it was 5.20%.

William J. Newman,
Sr. Vice President
Chief Investment Officer
Trust and Investment
Services Division

Duane E. Lee,
Administrative
Vice President
Administration and
Operations
Trust and Investment
Services Division (seated)

M&T Bank Trust & Investment Service Reception Area

The warm elegance of the newly remodeled Trust and Investment Services reception area hints at the high technology employed by Trust and Investment Officers through its new computer system. This unique system underscores management's commitment to providing the very best in customer service.

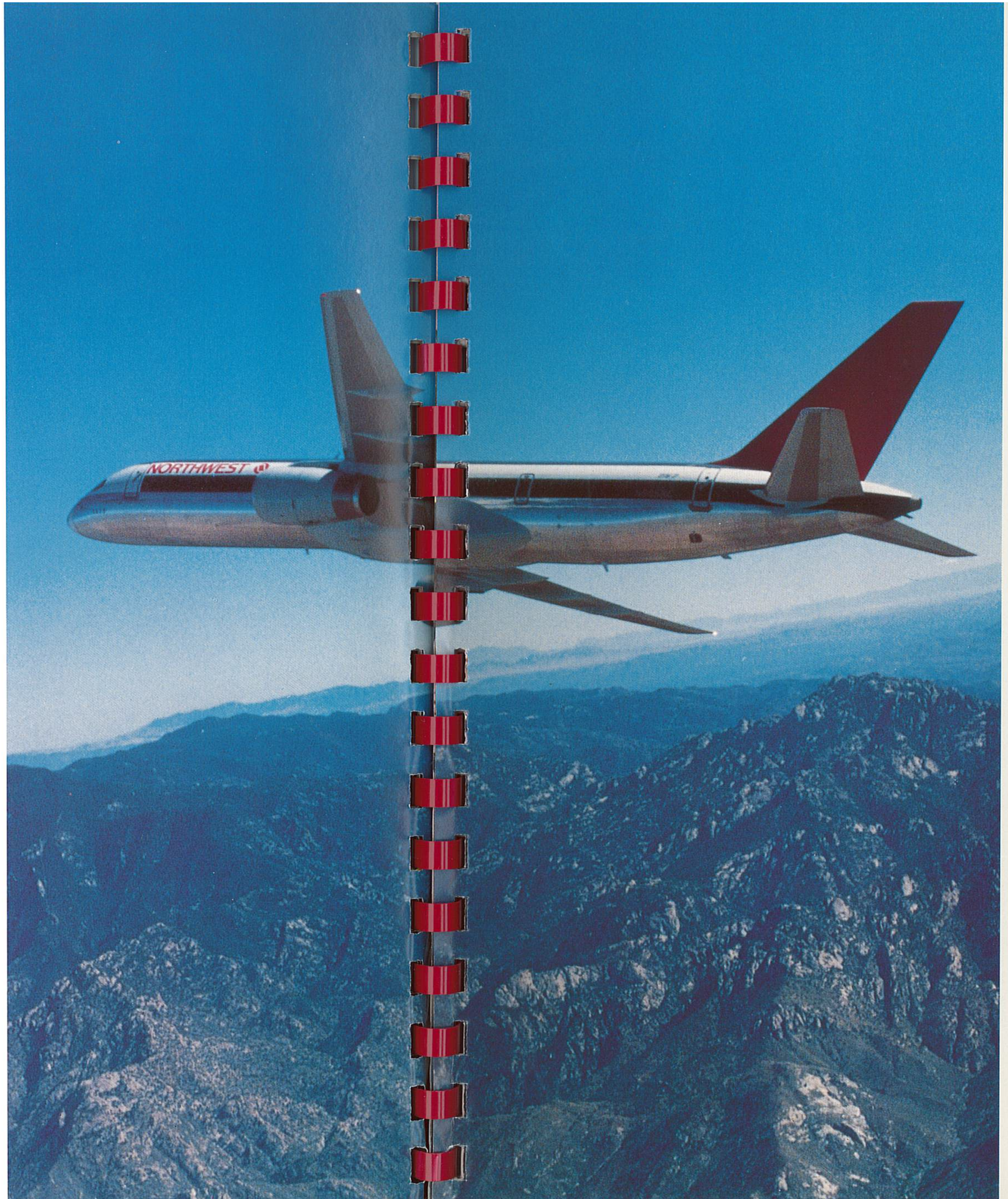
The activities which earn interest also incur expenses which do not enter into the computation of net interest income – among them salaries, office expense and, in the case of loans, the provision for possible credit losses. The provision last year was $9.0 million, compared with just under $6 million in 1985. The increase reflected the rise in loan volume during the year and also a higher – though still modest – level of loan losses. Net charge-offs totaled $2.7 million, compared with $909,000 in the previous year.

At December 31, 1986 the allowance for possible credit losses amounted to $33.7 million, equal to 1.77% of total loans and leases net of unearned discount. At the prior year-end the allowance stood at $27.4 million and the ratio was 1.71%.

Income from sources other than interest rose 13% in 1986 to $38.2 million. All major categories of noninterest income but one increased. Gains realized on the sale of venture capital investments were the exception at $1.2 million, compared with $2.2 million in 1985. The principal advances among the other categories came in trust department income, reflecting new business and appreciation in the market value of managed assets, on which fees are based; securities trading profits; charges for services related to deposit accounts; and the composite "other revenues from operations," which benefited from fees generated by the high volume of mortgage originations. There was little year-to-year change in gains on sales of investment securities from bank portfolios – $1.8 million last year, $1.7 million the year before.

Expense other than interest and the provision for possible credit losses totaled $104 million, an increase of 9%. Salaries and employee benefits, which account for more than half of this aggregate, were up 7%.

A discussion of the activities and financial results of First Empire State Corporation is, of course, predominately about M&T Bank, which represents more than 92% of First Empire's consolidated total assets. It is worth noting, however, that The First National Bank of Highland, while far the smaller of the two banking



Paul H. Muenzner,
President
M&T Financial
Corporation (left)

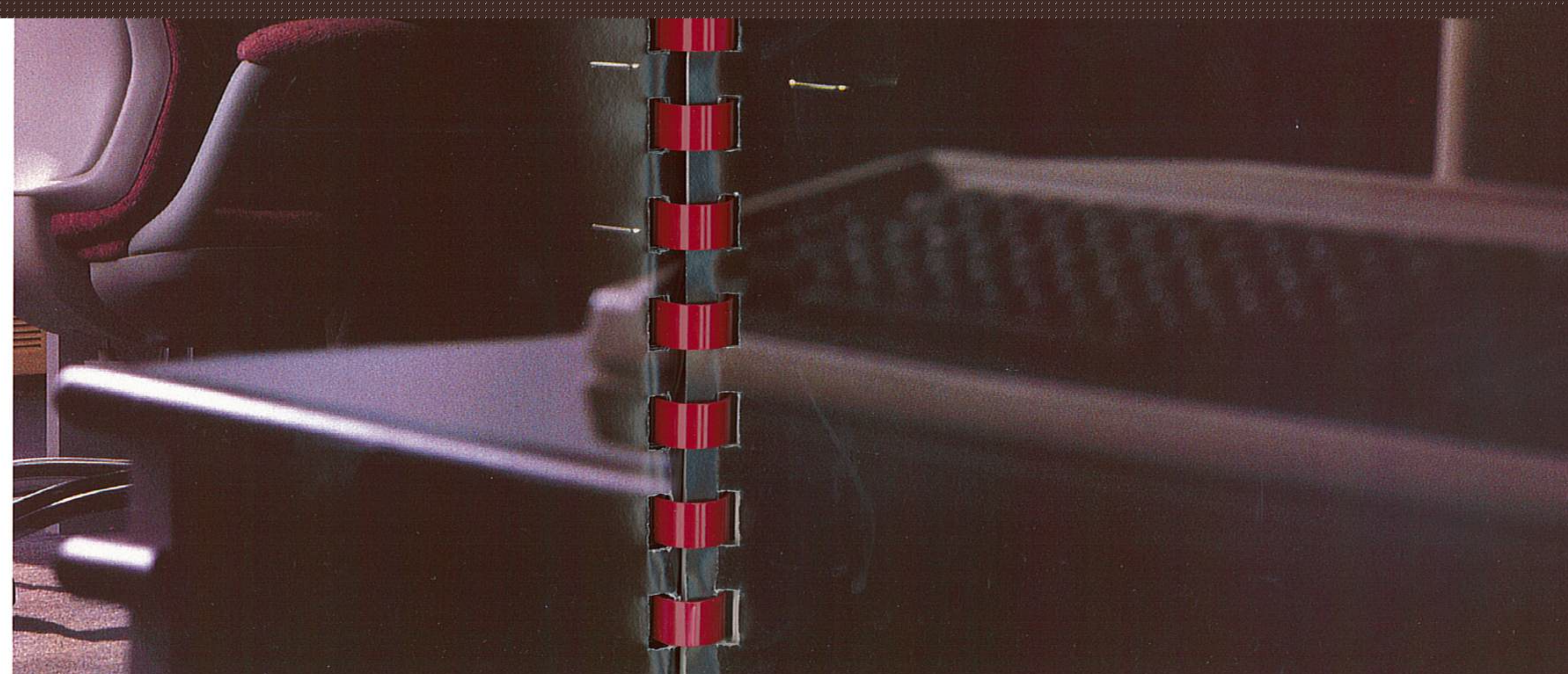
Franklin E. Hawk,
Executive
Vice President
M&T Financial
Corporation

Boeing 757 Leased by M&T Financial Corp

M&T Financial Corporation has added two new Boeing aircraft to the list of major capital equipment that it leases to customers. In 1986, a Boeing 757 was purchased and leased to Northwest Airlines and a Boeing 737 was leased to Piedmont. These two soaring acquisitions represent First Empire's aspirations and the spirit that moves us to explore new business challenges.

stant involvement in key financial markets contributes important "feel" to bank decisions concerning the investment portfolio.

As a long-term investment in the technological proficiency essential to a growing bank, M&T last year acquired an established data-processing business. A new subsidiary, First Operations Resource, Inc., was formed to own and operate the business, which formerly was conducted by a division of The Boeing Company. Combining M&T's existing data processing resources with those of First Operations will enable M&T Bank to meet its own future systems needs while producing revenue by furnishing services to other financial institutions.



Treasury Department Trading Floor

Our new state-of-the-art treasury facilities in both New York City and, pictured here at One M&T Plaza, are a demonstration of bank management's commitment to broadening the scope of Treasury's services and capabilities. With advanced technology performing the most sophisticated transactions, M&T Bank can meet its customers' and its own increasingly complex financial requirements.