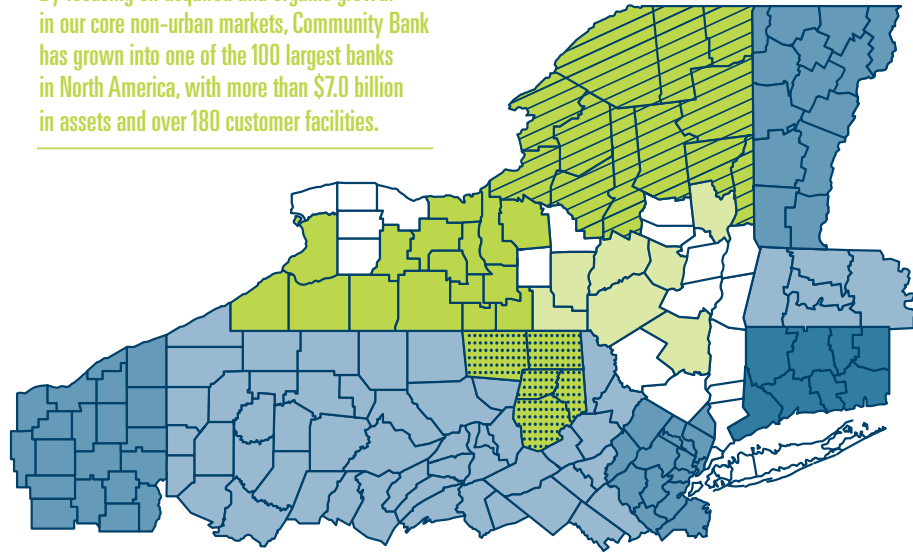


By focusing on acquired and organic growth in our core non-urban markets, Community Bank has grown into one of the 100 largest banks in North America, with more than \$7.0 billion in assets and over 180 customer facilities.



REGIONAL MARKETS

REGIONAL SUMMARIES

	NORTHERN NEW YORK	SOUTHERN NEW YORK	CENTRAL NEW YORK	PENNSYLVANIA
Branches	55	77	21	26
Deposits	\$2.0 billion	\$2.2 billion	\$0.7 billion	\$0.8 billion
Towns 1 <sup>st</sup> /2 <sup>nd</sup> Market Share	36	39	13	13
Financial Service Centers	5	5	1	1
Administrative/Operations Centers	1	2	-	1
Counties in Region	12	16	7	5
Total Market Population*	1.0 million	2.6 million	0.8 million	0.7 million

\* US Census estimate - 2011

COMMUNITY BANK SYSTEM, INC.

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COMMUNITY BANK SYSTEM, INC.  
 2013 FIRST QUARTER REPORT



## DEAR SHAREHOLDERS, CUSTOMERS AND EMPLOYEES

I am pleased to share with you that Community Bank delivered record operating performance for our first quarter reporting period. Along with strong revenue growth, the Company recorded its highest net income and earnings per share for any first quarter period. We believe that this early momentum will carry through the full year, as we continue our focus on efficiently growing our balance sheet and revenue sources, both organically and through disciplined acquisitions.

Our first quarter net income of \$20.2 million, increased by \$1.4 million, or 7.5%, over the prior year quarter. Total revenue for the quarter ended March 31, 2013 was \$84.5 million, an increase of \$7.2 million over 2012, reflecting an 11.6% increase in average interest earnings assets. Earnings per share increased over 4.0% to a first quarter record of \$0.50, compared to \$0.48 in the prior year quarter, despite an increase of nearly 1 million average shares outstanding.

First quarter 2013 net interest income was \$58.4 million, an increase of \$4.5 million, or 8.4%, compared to the first quarter of 2012. We continue to focus on diversifying our revenue streams, and to that end we delivered non-interest income growth of \$2.6 million, or over 11% versus the first quarter 2012, to \$26.1 million. Our employee benefits administration and consulting revenues grew nearly 9.0% to \$9.8 million, as we welcomed new customers and benefited from favorable market conditions. As expected, the benefits business we acquired in December 2011 contributed to our strong results and continues to provide significant opportunity for growth in and around the Metro New York area. Our wealth management business also generated very strong revenues, more than 18.0% higher than the first quarter 2012, driven in part by gains in trust, asset management and advisory services.

Our increased operating expenses of \$54.6 million in the first quarter 2013 reflect the additional recurring operating expenses related to the branches we acquired from HSBC and First Niagara during the third quarter 2012.

Community Bank continuously looks for, and acts on, opportunities to enhance our retail banking network through strategic acquisitions which support our organic growth. The HSBC and First Niagara branch transactions completed last summer have already proven incrementally beneficial to earnings. The new branches added to our core markets through this acquisition have contributed to growth in consumer loan portfolios and core customer deposits. We expect this transaction will remain solidly accretive to earnings per share this year.

Importantly, our asset quality metrics have remained superior to comparative peer and industry averages and clearly demonstrate our risk management and quality underwriting standards. Net charge-offs were \$1.4 million for the first quarter, down from \$2.6 million for the fourth quarter of 2012. Nonperforming loans as a percentage of total loans at March 31, 2013 were 0.71%, down from the 0.75% at December 31, 2012, and down 20 basis points from the first quarter 2012. Due to the lower net charge-offs and nonperforming loans during the first quarter 2013, our provision for loan losses declined 48.0% from the fourth quarter 2012 to \$1.4 million.

In every decision we make as a management team, the potential for creating incremental value for our shareholders is top of mind. This approach is mirrored in our decision to initiate a balance sheet restructuring during the first quarter which created more than \$35 million of incremental regulatory capital. This restructuring involved reducing both borrowings and investment securities and we believe that this action provides both qualitative and economic benefit for our shareholders. The additional regulatory capital resulting from this transaction better positions the Company to pursue the types of strategic acquisitions and organic growth that create long-term value for our shareholders.

On May 8, 2013, our Board of Directors declared a \$0.27 per share dividend payable on July 10, 2013, to shareholders of record as of June 14, 2013. The \$0.27 cash dividend represents an annualized yield of 3.7% based on the closing share price of \$29.36 on May 16, 2013. Our significant cash dividend represents the Board's continuing belief that payment of a meaningful dividend is an important component of providing consistent and favorable long-term returns to shareholders.

On April 15, 2013, *SNL Financial* released its ranking of the country's best-performing regional banks, based on six core financial performance metrics that focus on profitability, asset quality and growth for the 12-month period ended Dec. 31, 2012. Community Bank was ranked near the top of

this analysis that identified the best performing regional banks below \$50 billion in assets, which are well-capitalized according to regulatory standards, and have a branch network of greater than 60 offices. We were one of only four banks located in the Mid-Atlantic region to be ranked among the top 25 institutions.

We are pleased that 2013 is off to a strong start and we believe that Community Bank is well-positioned to realize solid performance during the remaining months. Your continued strong support of Community Bank is greatly appreciated, and we look forward to updating you on our efforts and progress through the remainder of 2013.

Sincerely,



Mark E. Tryniski  
President and Chief Executive Officer

### FINANCIAL HIGHLIGHTS

Income Statement Data <small>(in thousands)</small>	THREE MONTHS ENDED		
	3/31/13	3/31/12	% CHANGE
Net interest income	\$ 58,425	\$ 53,909	8.4%
Noninterest income	26,109	23,468	11.3%
Operating expenses	54,552	49,663	9.8%
Net income	\$ 20,241	\$ 18,826	7.5%
Diluted weighted average shares outstanding	40,321	39,323	2.5%
<b>Common Per Share Data</b>			
Net income – diluted	\$ 0.50	\$ 0.48	4.2%
Cash dividend declared	0.27	0.26	3.8%
Period-end book value-stated	21.94	21.32	2.9%
Period-end book value-tangible	\$ 13.01	\$ 12.84	1.3%
<b>Balance Sheet Data</b> <small>(in millions)</small>			
Total assets	\$ 7,221	\$ 6,912	4.5%
Loans	3,862	3,461	11.6%
Deposits	5,775	4,952	16.6%
Shareholders' equity	877	841	4.3%

NM = not meaningful

### STOCK PERFORMANCE

This table shows the high, low and closing price for CBU's common stock in recent quarters.

QUARTER ENDING	TRADE PRICE		CLOSING PRICE	VOLUME
	HIGH	LOW		
3/31/13	29.95	27.30	29.63	10,849,300
12/31/12	28.83	25.50	27.36	8,019,900
9/30/12	29.50	26.30	28.19	8,917,700
6/30/12	29.47	25.38	27.12	11,969,700
3/31/12	29.29	26.22	28.78	15,387,000

### INVESTOR MATERIALS

Annual and quarterly shareholder reports, regulatory filings, press releases, and articles about the corporation which have appeared in various publications are generally available in the "Investor Relations" section of our website, [www.communitybankna.com](http://www.communitybankna.com), or may be obtained from Ms. Josephine Rurka by calling (315) 445-7300 or via e-mail at [josie.rurka@communitybankna.com](mailto:josie.rurka@communitybankna.com).

### DIVIDEND REINVESTMENT AND STOCK PURCHASE PLAN

The corporation offers its shareholders a convenient and economical plan to increase their investment in Community Bank System, Inc. common stock. This plan provides a method of investing cash dividends and voluntary cash payments in additional shares of common stock without payment of brokerage commissions or service charges.

Individuals who wish to purchase CBU stock for the first time may also participate in this plan. For additional information about the plan and a prospectus, please contact either:

American Stock Transfer & Trust Company  
Operations Center  
6201 15<sup>th</sup> Avenue, Brooklyn, NY 11219  
[www.amstock.com](http://www.amstock.com)  
Reinvestment questions: (800) 278-4353  
General questions: (800) 937-5449

or  
Community Bank System, Inc.  
Ms. Donna Drenkel  
Shareholder Relations Department  
(315) 445-7313  
[donna.drenkel@communitybankna.com](mailto:donna.drenkel@communitybankna.com)