PATHFINDER BANCORP INC
Form 10-Q
May 22, 2006

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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ending March 31, 2006
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: 000-23601

PATHFINDER BANCORP, INC.
(Exact Name of Registrant as Specified in its Charter)

FEDERAL	16-1540137
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

214 West First Street, Oswego, NY 13126
(Address of Principal Executive Office) (Zip Code)

(315) 343-0057
(Registrant's Telephone Number including area code)

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 twelve months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such requirements for the past 90 days. Yes [X] No [ ].

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer [] Accelerated Filer [] Non-Accelerated Filer [X]

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

As of May 10, 2006 there were 2,950,419 shares issued and 2,463,132 shares outstanding of the Registrant's Common Stock.

PATHFINDER BANCORP, INC.
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PATHFINDER BANCORP, INC.
CONSOLIDATED STATEMENTS OF CONDITION
MARCH 31, 2006 (UNAUDITED) AND DECEMBER 31, 2005

ASSETS	March 31 2006
(Dollars in thousands, except per share data)	
Cash and due from banks	$
Interest earning deposits	
Total cash and cash equivalents	
Investment securities, at fair value	
Federal Home Loan Bank stock, at cost	
Loans	
Less: Allowance for loan losses	

Loans receivable, net	
Premises and equipment, net	
Accrued interest receivable	
Foreclosed real estate	
Goodwill	
Intangible asset, net	
Bank owned life insurance	
Other assets	
Total assets	$

LIABILITIES AND SHAREHOLDERS' EQUITY

Deposits:	
Interest-bearing	$
Noninterest-bearing	
Total deposits	
Short-term borrowings	
Long-term borrowings	
Junior subordinated debentures	
Other liabilities	
Total liabilities	
Shareholders' equity:	
Preferred stock, authorized shares 1,000,000; no shares issued or outstanding	
Common stock, par value $.01; authorized 10,000,000 shares; 2,950,419 shares issued; and 2,463,132 shares outstanding, respectively	
Additional paid in capital	
Retained earnings	
Accumulated other comprehensive loss	
Treasury stock, at cost; 487,287 shares	
Total shareholders' equity	
Total liabilities and shareholders' equity	$

The accompanying notes are an integral part of the consolidated financial statements.

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PATHFINDER BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

(Dollars in thousands, except per share data)	For the three months ended March 31, 2006	For the three months ended March 31, 2005
INTEREST INCOME:		

Loans, including fees	$	3,057	$	2,889
Debt securities:				
Taxable		641		604
Tax-exempt		98		103
Dividends		61		51
Other		8		51
Total interest income		3,865		3,698
INTEREST EXPENSE:				
Interest on deposits		1,249		1,030
Interest on short-term borrowings		61		10
Interest on long-term borrowings		438		459
Total interest expense		1,748		1,499
Net interest income		2,117		2,199
Provision for loan losses		22		72
Net interest income after provision for loan losses		2,095		2,127
OTHER INCOME:				
Service charges on deposit accounts		371		274
Earnings on bank owned life insurance		49		44
Loan servicing fees		59		41
Net losses on sales of investment securities		(2)		-
Net losses on sales of loans and foreclosed real estate		(19)		(12
Other charges, commissions and fees		135		142
Total other income		593		489
OTHER EXPENSES:				
Salaries and employee benefits		1,275		1,264
Building occupancy		316		275
Data processing expenses		324		320
Professional and other services		115		178
Amortization of intangible asset		56		56
Other expenses		325		327
Total other expenses		2,411		2,420
Income before income taxes		277		196
Provision for income taxes		37		47
NET INCOME	$	240	$	149
NET INCOME PER SHARE - BASIC	$	0.10	$	0.06
NET INCOME PER SHARE - DILUTED	$	0.10	$	0.06
DIVIDENDS PER SHARE	$	0.1025	$	0.1025

The accompanying notes are an integral part of the consolidated financial statements.

PATHFINDER BANCORP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

THREE MONTHS ENDED MARCH 31, 2006 AND MARCH 31, 2005
(unaudited)

(Dollars in thousands, except per share data)	Common Stock Shares	Amount	Additional Paid in Capital	Retained Earnings	A In
BALANCE, DECEMBER 31, 2005	2,950,419	$ 29	$ 7,721	$ 20,965	$
Comprehensive income					
Net income				240	
Other comprehensive loss, net of tax					
Unrealized net losses on securities					
Total Comprehensive income					
Dividends declared ($.1025 per share)				(252)	
BALANCE, MARCH 31, 2006	2,950,419	$ 29	$ 7,721	$ 20,953	$
BALANCE, DECEMBER 31, 2004	2,937,419	$ 29	$ 7,453	$ 21,186	$
Comprehensive loss					
Net income				149	
Other comprehensive loss, net of tax					
Unrealized net losses on securities					
Total Comprehensive Loss					
ESOP shares earned			22		
Stock option exercised	3,000	-	20		
Dividends declared ($.1025 per share)				(251)	
BALANCE, MARCH 31, 2005	2,940,419	$ 29	$ 7,495	$ 21,084	$

(Dollars in thousands, except per share data)	Treasury Stock	Total
BALANCE, DECEMBER 31, 2005	$ (6,502)	$20,928
Comprehensive income		
Net income		240
Other comprehensive loss, net of tax		
Unrealized net losses on securities		(57)
Total Comprehensive income		183
Dividends declared ($.1025 per share)		(252)
BALANCE, MARCH 31, 2006	$ (6,502)	$20,859
BALANCE, DECEMBER 31, 2004	$ (6,502)	$21,826
Comprehensive income		
Net income		149

Other comprehensive loss, net of tax		
Unrealized net losses on securities		(823)
Total Comprehensive Income		(674)
ESOP shares earned		33
Stock option exercised		20
Dividends declared ($.1025 per share)		(251)
BALANCE, MARCH 31, 2005	$ (6,502)	$20,954

The accompanying notes are an integral part of the consolidated financial statements

PATHFINDER BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(Dollars in thousands)	March 31, 2006	March 31, 2005
OPERATING ACTIVITIES		
Net income	$ 240	$ 149
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	22	72
ESOP shares earned	-	33
Deferred income tax expense	31	34
Proceeds from sale of loans	-	1,120
Realized loss on:		
Sale of real estate through foreclosure	7	1
Loans	-	11
Available-for-sale investment securities	2	-
Depreciation	190	161
Amortization of intangible asset	56	56
Amortization of deferred financing costs	8	8
Amortization of mortgage servicing rights	28	37
Earnings on bank owned life insurance	(49)	(44)
Net amortization of premiums on investment securities	32	89
Decrease (increase) in interest receivable	36	(90)
Net change in other assets and liabilities	(475)	(294)
NET CASH PROVIDED BY OPERATING ACTIVITIES	128	1,343
INVESTING ACTIVITIES		
Purchase of investment securities available-for-sale	(12,013)	(17,810)
Proceeds from maturities and principal reductions of investment securities available-for-sale	2,366	1,577
Proceeds from sale:		
Real estate acquired through foreclosure	50	49

Available-for-sale investment securities	3,976	-
Net (increase) decrease in loans	(2,024)	997
Purchase of premises and equipment	(121)	(280)
NET CASH USED IN INVESTING ACTIVITIES	(7,766)	(15,467)
FINANCING ACTIVITIES		
Net decrease in demand deposits, NOW accounts savings accounts, money market deposit accounts and escrow deposits	(519)	(10,000)
Net increase in time deposits	1,818	18,308
Increase in short-term borrowings	7,100	1,000
Payments on long-term borrowings	(1,000)	(2,000)
Proceeds from exercise of stock options	-	20
Cash dividends paid	(90)	(89)
NET CASH PROVIDED BY FINANCING ACTIVITIES	7,309	7,239
DECREASE IN CASH AND CASH EQUIVALENTS	(329)	(6,885)
Cash and cash equivalents at beginning of period	7,895	14,325
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 7,566	$ 7,440

The accompanying notes are an integral part of the consolidated financial statements

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PATHFINDER BANCORP, INC.

Notes to Consolidated Financial Statements

(1) BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Pathfinder Bancorp, Inc. and its wholly owned subsidiaries have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes necessary for a complete presentation of consolidated financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included.

The following material under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" is written with the presumption that the users of the interim financial statements have read, or have access to, the Company's latest audited financial statements and notes thereto, together with Management's Discussion and Analysis of Financial Condition and Results of Operations as of December 31, 2005 and for the three year period then ended. Therefore, only material changes in financial condition and results of operations are discussed in the remainder of Part 1.

Operating results for the three months ended March 31, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

(2) EARNINGS PER SHARE

Basic earnings per share has been computed by dividing net income by the weighted average number of common shares outstanding throughout the three months ended March 31, 2006, and 2005, using 2,463,132 and 2,447,210 weighted average common shares outstanding, respectively. Diluted earnings per share for the three months ended March 31, 2006 and 2005 have been computed using 2,481,777 and 2,486,766 weighted average common shares outstanding, respectively. Diluted earnings per share gives effect to weighted average shares that would be outstanding assuming the exercise of issued stock options using the treasury stock method.

(3) PENSION BENEFITS

The composition of net periodic benefit plan cost for the three months ended March 31, is as follows:

	FOR THE THREE MONTHS ENDED MARCH 31,	
	2006	2005
(In thousands)		
Service cost	$ 48	$ 38
Interest cost	63	57
Expected return on plan assets	(92)	(71)
Amortization of net losses	28	24
Net periodic benefit cost	$ 47	$ 48

The Company previously disclosed in its consolidated financial statements for the year ended December 31, 2005, that it expected to contribute $192,000 to its pension plan in 2006. As of March 31, 2006, $45,013 had been contributed to the pension plan.

(4) DIVIDEND RESTRICTIONS

The Company maintains a restricted capital account with a $1.5 million balance, representing Pathfinder Bancorp, M.H.C.'s portion of dividends waived as of March 31, 2006.

(5) COMPREHENSIVE LOSS

The components of other comprehensive loss income and related tax effects for the three month periods ended March 31, 2006 and 2005 are as follows:

	For the three months ended March 31,	
	2006	2005
(In thousands)		
Gross change in unrealized losses on		

securities available for sale	$ (88)	$(1,372)
Reclassification adjustment for losses included in net income	2	-
	(86)	(1,372)
Tax effect	29	549
Net of tax amount	$ (57)	$ (823)

(6) GUARANTEES

The Company does not issue any guarantees that would require liability recognition or disclosure, other than its standby letters of credit. Standby letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as those that are involved in extending loan facilities to customers. The Company, generally, holds collateral and/or personal guarantees supporting these commitments. The Company had $134,000 of standby letters of credit as of March 31, 2006. Management believes that the proceeds obtained through a liquidation of collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The current amount of the liability as of March 31, 2006 for guarantees under standby letters of credit issued is not material.

(7) STOCK BASED COMPENSATION

Prior to 2006, the Company accounted for stock-based compensation issued to directors and employees using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25). This method required that compensation expense be recognized to the extent that the fair value of the stock exceeds the exercise price of the stock award at the grant date. The Company generally did not recognize compensation expense related to stock option awards because the stock options generally had fixed terms and exercise prices that were equal to or greater than the fair value of the Company's common stock at the grant date.

Effective January 1, 2006, the Company adopted Financial Accounting Standards Board (FASB) Statement No. 123(R), Share-Based Payment, ("SFAS 123(R)"). SFAS 123(R) requires compensation costs related to share-based payment transactions to be recognized in the income statement (with limited exceptions) using the modified prospective method based on the grant-date fair value of the stock-based compensation issued. Compensation costs are recognized over the period that an employee provides service in exchange for the award. As of the date of adoption of SFAS 123(R), the Company's options are fully granted and vested. There was no impact to the Company's consolidated financial position or results of operations.

In conjunction with SFAS 123(R), the Company also adopted FASB Staff Position ("FSP") SFAS 123(R)-2, "Practical Accommodation to the Application of Grant Date as Defined in SFAS 123(R)" effective January 1, 2006. FSP 123(R)-2 provides guidance on the application of grant date as defined in SFAS 123(R). In accordance with this standard a grant date of an award exists if (a) the award is a unilateral grant, and (b) the key terms and conditions of the award are expected to be communicated to an individual recipient within a relatively short time period from the date of approval. The adoption of this standard did not our

consolidated financial position, results of operations or cash flows for the three month period ended March 31, 2006.

In November 2005, the FASB issued final FSP No. 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards." The FSP provides an alternative method of calculating excess tax benefits (the Additional Paid-in Capital "APIC" pool) from the method defined in SFAS 123(R) for share-based payments. A one-time election to adopt the transition method in this FSP is available to those entities adopting SFAS 123(R) using either the modified retrospective or modified prospective method. Up to one year from the initial adoption of SFAS 123(R) or effective date of the FSP is provided to make this one-time election. However, until an entity makes its election, it must follow the guidance in SFAS 123(R). We are currently evaluating the potential impact of calculating the APIC pool with this alternative method and have not yet determined which method we will adopt, or the expected impact on our financial position or results of operations.

In February 2006, the FASB issued FSP No. 123(R)-4, "Classifications of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event." The position amends SFAS 123(R) to incorporate that a cash settlement feature that can be exercised only upon the occurrence of a contingent event that is outside the employee's control does not meet certain conditions in SFAS 123(R) until it becomes probable that the event will occur. The guidance in this FSP was required to be applied upon initial adoption of SFAS 123(R). The Company does not have any option grants that allow for cash settlement.

(8) NEW ACCOUNTING PRONOUNCEMENTS

In January 2006, the Company adopted Financial Accounting Standard Board ("FASB") Staff Position ("FSP") SFAS No. 115-1 and FAS 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." The FSP addresses when an investment is considered impaired, whether the impairment is other-than-temporary and the measurement of an impairment loss. The FSP also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary. The FSP did not have a significant impact on the Company's consolidated financial position or results of operations.

In January 2006, the Company adopted FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations - an interpretation of SFAS No. 143," ("FIN 47"). This Interpretation provides clarification with respect to the timing of liability recognition for legal obligations associated with the retirement of tangible long-lived assets when the timing and/or method of settlement of the obligation are conditional on a future event. The adoption of FIN 47 did not impact the Company's consolidated financial statements.

In January 2006, the Company adopted SFAS No. 154, Accounting Changes and Error Corrections ("SFAS 154"). SFAS No. 154 requires retroactive application of a voluntary change in accounting principle to prior period financial statements unless it is impracticable. SFAS No. 154 also requires that a change in method of depreciation, amortization, or depletion for long-lived, non-financial assets be accounted for as a change in accounting estimate that is affected by a change in accounting principle. The adoption of the provisions of SFAS 154 did not have a material impact on the Company's consolidated financial statements.

In January 2006, the Company adopted FASB Staff Position FAS 13-1 ("FSP 13-1"), which requires companies to expense rental costs associated with ground or

building operating leases that are incurred during a construction period, versus capitalizing these rental costs. The adoption of FSP 13-1 did not have a material impact on the Company's consolidated financial condition or results of operations.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments ("SFAS 155"). SFAS 155 amends FASB Statement No. 133 and FASB Statement No. 140, and improves the financial reporting of certain hybrid financial instruments by requiring more consistent accounting that eliminates exemptions and provides a means to simplify the accounting for these instruments. Specifically, SFAS 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. The Company is required to adopt the provisions of SFAS 155, as applicable, beginning in 2007. Management does not believe the adoption of SFAS 155 will have a material impact on the Company's consolidated financial position and results of operations.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets -An Amendment of FASB Statement No. 140 ("SFAS 156"). SFAS 156 requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. The statement permits, but does not require, the subsequent measurement of servicing assets and servicing liabilities at fair value. SFAS 156 is effective for the Company beginning in 2007. The Company does not believe that the adoption of SFAS 156 will have a significant effect on its consolidated financial statements.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

Throughout the Management's Discussion and Analysis ("MD&A") the term, "the Company", refers to the consolidated entity of Pathfinder Bancorp, Inc. Pathfinder Bank and Pathfinder Statutory Trust I are wholly owned subsidiaries of Pathfinder Bancorp, Inc. Pathfinder Commercial Bank, Pathfinder REIT, Inc. and Whispering Oaks Development, Inc. represent wholly owned subsidiaries of Pathfinder Bank. At March 31, 2006, Pathfinder Bancorp, M.H.C., the Company's mutual holding company parent, whose activities are not included in the MD&A, held 64.3% of the Company's common stock and the public held 35.7%.

The following discussion reviews the Company's financial condition at March 31, 2006 and the results of operations for the three months ended March 31, 2006 and March 31, 2005.

This Quarterly Report contains certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties, including, among other things, changes in economic conditions in the Company's market area, changes in policies by regulatory agencies, fluctuations in interest rates, demand for loans in the Company's market areas and competition, that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. The Company wishes to advise readers that the factors listed above could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.

The Company does not undertake, and specifically declines any obligation, to publicly release the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

The Company's net income is primarily dependent on its net interest income, which is the difference between interest income earned on its investments in mortgage loans, investment securities and other loans, and its cost of funds consisting of interest paid on deposits and borrowed funds. The Company's net income is also affected by its provision for loan losses, as well as by the amount of other income, including income from fees and service charges on deposit accounts, net gains and losses on sales of securities, loans and foreclosed real estate, and other expenses such as salaries and employee benefits, building occupancy and equipment costs, data processing and income taxes. Earnings of the Company also are affected significantly by general economic and competitive conditions, particularly changes in market interest rates, government policies and actions of regulatory authorities, which events are beyond the control of the Company. In particular, the general level of market rates tends to be highly cyclical.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and follow practices within the banking industry. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and information used to record valuation adjustments for certain assets and liabilities are based on quoted market prices or are provided by other third-party sources, when available. When third party information is not available, valuation adjustments are estimated in good faith by management.

The most significant accounting policies followed by the Company are presented in Note 1 to the consolidated financial statements included in the 2005 Annual Report on Form 10-K ("the Consolidated Financial Statements"). These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the consolidated financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions and estimates underlying those amounts, management has identified the determination of the allowance for loan losses to be the accounting area that requires the most subjective and complex judgments, and as such could be the most subject to revision as new information becomes available.

The allowance for loan losses represents management's estimate of probable loan

losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the consolidated balance sheet. Note 1 to the Consolidated Financial Statements describes the methodology used to determine the allowance for loan losses, and a discussion of the factors driving changes in the amount of the allowance for loan losses is included in this report.

The Company carries all of its investments at fair value with any unrealized gains or losses reported net of tax as an adjustment to shareholders' equity. Based on management's assessment, at March 31, 2006, the Company did not hold any security that had a fair value decline that is currently expected to be other than temporary. Consequently, any declines in a specific security's fair value below amortized cost have not been provided for in the consolidated income statement. The Company's ability to fully realize the value of its investment in various securities, including corporate debt securities, is dependent on the underlying creditworthiness of the issuing organization.

EXECUTIVE SUMMARY

Net income was $240,000, or $0.10 per share, for the three months ended March 31, 2006, as compared to $149,000, or $0.06 per share, for the same period in 2005. During the first quarter of 2006, the Company continued its efforts

toward transforming its more traditional thrift balance sheet with mostly residential loans as earning assets, toward that of a community bank with a more diverse mix of residential, consumer and commercial loans. On an average balance basis, commercial loans comprise 27.1% of the total gross loan portfolio at March 31, 2006, as compared to 21.3% of the portfolio at December 31, 2005. Asset quality continues to improve during 2006 as reflected in the decreasing non-performing loan ratios.

Short-term borrowings increased $7.1 million during the first quarter of 2006. The short-term borrowings were entered into as a replacement for outflow of municipal deposits from two large rate-sensitive customers toward the end of the quarter.

On April 23, 2006, Alliance Bank N.A. announced it had reached a definitive agreement to merge with the parent company of Oswego County National Bank (OCNB). OCNB, formerly, Oswego County Savings Bank has been domiciled in the city of Oswego since it's founding in 1870 and has been the primary local competitor for Pathfinder Bank. In management's view, the absorption of OCNB into Alliance bank, a $900 million bank headquartered in Syracuse, NY, will provide both challenges and opportunities for Pathfinder Bank. The challenge will be the ability of a larger competitor to more actively and aggressively market within the primary business area of Pathfinder Bank. Opportunities exist, as management believes that it's unique competencies and differentiators are more closely matched by a locally domiciled bank than one headquartered outside our primary market area. Opportunities may exist to garner additional business opportunities with the traditional customer base of OCNB which is more apt to conduct its business with a local bank.

RESULTS OF OPERATIONS

The return on average assets and return on average shareholders' equity were

0.31% and 4.54%, respectively, for the three months ended March 31, 2006, compared with 0.19% and 2.77%, respectively, for the three months ended March 31, 2005. During the first quarter of 2006 when compared to the first quarter of 2005, net interest income decreased $82,000, partially offset by a decrease in provision for loan losses of $50,000, a $113,000 increase in other income and a $9,000 decrease in other expenses.

NET INTEREST INCOME

Net interest income is the Company's primary source of operating income for payment of operating expenses and providing for loan losses. It is the amount by which interest earned on interest-earning deposits, loans and investment securities, exceeds the interest paid on deposits and other interest-bearing liabilities. Changes in net interest income and net interest margin ratio result from the interaction between the volume and composition of earning assets, interest-bearing liabilities, related yields and associated funding costs.

Net interest income, on a tax-equivalent basis remained relatively constant at $2.2 million for the three months ended March 31, 2006 when compared to the same period of 2005. The Company's net interest margin for the first quarter of 2006 decreased to 3.13% from 3.20% when compared to the same quarter in 2005. Management expects continued margin compression to adversely impact earnings as we perceive the yield curve will continue to be flat over the near term. The decline in net interest income is attributable to the higher rates paid on both deposits and borrowings, offset by an increase of 33 basis points in earning asset yields. Average interest-earning assets decreased 2% to $275.9 million at March 31, 2006 as compared to $280.2 million at March 31, 2005. The decrease in average earning assets is primarily attributable to an $8.7 million decrease in interest earning deposits, offset by a $3.6 million increase in loans receivable and an $863,000 increase in investment securities. Average interest-bearing

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liabilities decreased $948,000, and the cost of funds increased 39 basis points to 2.66% from 2.27% for the same period in 2005. The decrease in the average balance of interest-bearing liabilities resulted primarily from the anticipated cyclical outflow of municipal deposits during the second half of the first quarter.

INTEREST INCOME

Total interest income, on a tax-equivalent basis, for the quarter ended March 31, 2006 increased $169,000, or 5%, to $3.9 million from $3.7 million at the quarter ended March 31, 2005. The average balance of loans increased $3.6 million, with yields increasing 25 basis points to 6.42% for the first quarter of 2006. Average commercial loans increased $2.6 million, and experienced an increase in the average tax-equivalent yield of 149 basis points, to 8.00% from 6.51%, in 2006. The increase in the yield on commercial loans is primarily the result of the adjustable rate portions of the portfolio repricing upward in connection with upward adjustments in the prime rate, as well as new commercial loan originations occurring at market rates significantly higher than the weighted average existing portfolio rate. The average balance of loans to municipal entities for the first quarter of 2006 was $3.1 million, compared to $3.3 million for the same period in 2005. Average commercial real estate loans increased $3.5 million for the first quarter of 2006, with an increase in the yield of 34 basis points. The Company's residential mortgage loan portfolio decreased $3.1 million, or 3%, when comparing the first quarter of 2006 to the same period in 2005. The average yield on the residential mortgage loan portfolio decreased 13 basis points to 5.73% in 2006 from 5.86% in 2005. An increase in the average balance of consumer loans of $848,000, or 5%, resulted

from an increase in home equity loans. The average yield increased 75 basis points, to 7.65% from 6.90% in 2005 as a result of the increase in the prime rate. Average investment securities (taxable and tax-exempt) for the quarter ended March 31, 2006 increased by $863,000, compared to the same period a year ago, with an increase in tax-equivalent interest income from investments of $40,000, or 5%, compared to the first quarter of 2005. The average tax-equivalent yield of the portfolio increased 15 basis points, to 3.97% from 3.82%. The increase in the average balance of investment securities is a result of security acquisitions made during February in order to provide the necessary collateral for municipal deposit inflows.

INTEREST EXPENSE

Total interest expense increased $249,000 for the three months ended March 31, 2006, when compared to the same quarter in 2005. Deposit interest expense for the comparable periods increased $219,000, or 21%, as the average rate paid on higher earning money management accounts increased 97 basis points to 2.63% in 2006 from 1.66% in 2005, offset by a decrease in the average balance of money management accounts to $39.6 million in 2006 from $42.8 million in 2005. The cost of other interest-bearing deposits increased 27 basis points, to 2.15% from 1.88%, as the average balance of these deposits increased $2.4 million, or 1%. Interest expense on borrowings increased by $30,000, or 6%, from the prior period. The increase in interest expense on borrowings was the result of an increase in the cost of the floating rate junior subordinated debentures to 8.07% in 2006 from 5.97% in 2005 and an increase in the cost of borrowings to 4.60% in 2006 from 4.53% in 2005. The increase in borrowing expense is partially offset by a slight decrease in the average balance of borrowings of $220,000 or 1%.

PROVISION FOR LOAN LOSSES

Provision for loan losses for the quarter ended March 31, 2006 decreased to $22,000 from $72,000 for the same period in 2005, primarily as a result of a 19% decrease in non-performing loans due to the continued efforts to improve asset quality. The Company's ratio of allowance for loan losses to period end loans has decreased to 0.88% at March 31, 2006 from 1.01% at March 31, 2005. Non-performing loans to period end loans have decreased to 0.75% at March 31, 2006 from 0.94% at March 31, 2005.

OTHER INCOME

The Company's other income is primarily comprised of fees on deposit account balances and transactions, loan servicing, commissions, and net gains on securities, loans and foreclosed real estate.

The following table sets forth certain information on other income for the periods indicated:

	Three Months Ended March 31,			
	2006	2005	Change	
(Dollars in thousands)				
Service charges on deposit accounts	$371	$274	$ 97	35.4%
Earnings on bank owned life insurance	49	44	6	13.6%
Loan servicing fees	47	41	6	14.6%
Other charges, commissions and fees	135	142	(8)	-5.6%

Core noninterest income	602	501	101	20.2%
Net losses on sales and impairment of investment securities	(2)	-	(2)	-
Net losses on sales of loans and foreclosed real estate	(7)	(12)	5	-41.7%
Total noninterest income	$593	$489	$104	21.3%

For the three months ended March 31, 2006, core noninterest income reflected an increase of 20%, when compared with the three months ended March 31, 2005. The increase in income from service charges on deposit accounts is primarily the result of an increase in deposit accounts attributable to the opening of the Central Square branch and additional customer acquisition efforts in all markets served, combined with an increase in fees on all deposit accounts. Income from loan servicing fees reflects an increase in commercial loan origination related fees earned, combined with a decrease in the amortization of mortgage servicing rights. The reduction in other charges, commissions and fees was primarily due to recording a grant from New York State in March 2005 for a company wide Leadership Training Program. This reduction was offset by increases in fees associated with the Bank's debit card usage of $9,000.

OTHER EXPENSE

The following table sets forth certain information on other expense for the quarters indicated:

	Three Months Ended March 31,			
	2006	2005	Change	
(Dollars in thousands)				
Salaries and employee benefits	$1,275	$1,264	$ 11	0.9%
Building occupancy	316	275	41	14.9%
Data processing	324	320	4	1.3%
Professional and other services	115	178	(63)	-35.4%
Amortization of intangible assets	56	56	-	0.0%
Other operating	325	327	(2)	-0.6%
Total other expense	$2,411	$2,420	$ (9)	-0.4%

Total other expense decreased slightly for the three months ended March 31, 2006 when compared to the same quarter of 2005. The reduction in professional and other services from 2005 was primarily due to consulting expenses associated with a fee enhancement program and a company wide Leadership Training program being recognized in the prior year. A portion of the expenses associated with the Leadership Training program were offset by corresponding grant income in other charges, commission and fees. The increase in building occupancy expenses is primarily attributable to the operation of the Central Square branch that opened in May 2005. Salaries and employee benefits also increased as a result of the opening of the Central Square branch. These increases were offset by a reduction in staffing and expenses recognized on the employee stock ownership plan.

INCOME TAX EXPENSE

Income taxes decreased $10,000 for the quarter ended March 31, 2006 as compared to the same period in 2005. The Company continues to strive to reduce its tax rate from the statutory rate primarily through the ownership of tax-exempt investment securities, bank owned life insurance and other tax savings strategies. Enactment of proposed state tax legislation regarding Real Estate Investment Trusts would increase the state tax rate for the Company.

CHANGES IN FINANCIAL CONDITION

ASSETS

Total assets increased approximately $6.8 million, or 2%, to $303.8 million at March 31, 2006, from $296.9 million at December 31, 2005. The increase in total assets was primarily the result of an increase in investment securities of $5.3 million and a $1.8 million, or 1%, increase in loans receivable. The growth in investment securities was a result of security acquisitions during January and February 2006 in order to obtain the required collateral for increased municipal deposit inflows. The deposit inflows were substantially offset by municipal outflows from two large rate-sensitive customers during March.

At March 31, 2006, the securities balance included a net unrealized loss on available for sale securities of $2.2 million, versus a net unrealized loss of $2.1 million at December 31, 2005. These unrealized losses relate principally to changes in interest rates subsequent to the acquisition of specific securities. None of the securities in this category had an unrealized loss that exceeded 8% of book value. The Company has the intent and ability to hold the individual securities to maturity or market price recovery.

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LIABILITIES

Total liabilities increased $6.9 million, or 3%, to $282.9 million at March 31, 2006 from $276.0 million at December 31, 2005. The increase in liabilities is primarily due to a $7.1 million increase in short-term borrowings and a $1.3 million increase in interest-bearing deposits, partially offset by a $1.0 million decrease in long-term borrowings. The increase in short-term borrowings primarily resulted from the replacement of substantial municipal deposit outflows of two large rate-sensitive, municipal customers occurring during the latter half of the first quarter.

LOAN AND ASSET QUALITY AND ALLOWANCE FOR LOAN LOSSES

The following table represents information concerning the aggregate amount of nonperforming assets:

	March 31, 2006	December 31, 2005	March 31, 2005
(Dollars In thousands)			
Nonaccrual loans:			
Commercial real estate and commercial	$ 486	$ 757	$ 840
Consumer	81	89	117
Real estate - Construction	0	0	0
Mortgage	860	834	805

Total nonaccrual loans	1,427	1,680	1,762
Loans past due 90 days or more and still accruing	0	0	0
Total non-performing loans	1,427	1,680	1,762
Foreclosed real estate	887	743	850
Total non-performing assets	$ 2,314	$ 2,423	$ 2,612
Non-performing loans to total loans	0.75%	0.89%	0.94%
Non-performing assets to total assets	0.76%	0.82%	0.85%

Total nonperforming loans decreased 15% at March 31, 2006 when compared to December 31, 2005. Management believes that adequate reserves exist for any potential losses that may occur from the remediation process. The 19% increase in foreclosed real estate is primarily due to carrying 13 foreclosed real estate properties at March 31, 2006 versus 10 properties at December 31, 2005.

The allowance for loan losses at March 31, 2006 and December 31, 2005 was $1.7 million, or 0.88% and 0.89% of period end loans, respectively.

CAPITAL

Shareholders' equity remained constant at $20.9 million at March 31, 2006 when compared to December 31, 2005. The Company added $240,000 to retained earnings through net income and returned $252,000 to its shareholders in the form of cash dividends. The Company's mutual holding company parent, Pathfinder Bancorp, M.H.C, accepted the dividend for the quarter ended March 31, 2006. (See Footnote 4).

Risk-based capital provides the basis for which all banks are evaluated in terms of capital adequacy. Capital adequacy is evaluated primarily by the use of ratios which measure capital against total assets, as well as against total assets that are weighted based on defined risk characteristics. The Company's goal is to maintain a strong capital position, consistent with the risk profile of its subsidiary banks that supports growth and expansion activities while at the same time exceeding regulatory standards. At March 31, 2006, Pathfinder Bank

exceeded all regulatory required minimum capital ratios and met the regulatory definition of a "well-capitalized" institution, i.e. a leverage capital ratio exceeding 5%, a Tier 1 risk-based capital ratio exceeding 6% and a total risk-based capital ratio exceeding 10%.

LIQUIDITY

Liquidity management involves the Company's ability to generate cash or otherwise obtain funds at reasonable rates to support asset growth and reduce assets to meet deposit withdrawals, to maintain reserve requirements, and to otherwise operate the Company on an ongoing basis. The Company's primary sources of funds are deposits, borrowed funds, amortization and prepayment of loans and maturities of investment securities and other short-term investments, and earnings and funds provided from operations. While scheduled principal repayments on loans are a relatively predictable source of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. The Company manages the pricing of deposits to maintain a desired deposit balance. In addition, the Company invests excess funds in short-term interest-earning and other assets, which provide liquidity

to meet lending requirements.

The Company's liquidity has been enhanced by its membership in the Federal Home Loan Bank of New York, whose competitive advance programs and lines of credit provide the Company with a safe, reliable and convenient source of funds. A significant decrease in deposits in the future could result in the Company having to seek other sources of funds for liquidity purposes. Such sources could include, but are not limited to, additional borrowings, trust preferred security offerings, brokered deposits, negotiated time deposits, the sale of "available-for-sale" investment securities, the sale of securitized loans, or the sale of whole loans. Such actions could result in higher interest expense costs and/or losses on the sale of securities or loans.

The Asset Liability Management Committees of the Company are responsible for implementing the policies and guidelines for the maintenance of prudent levels of liquidity. As of March 31, 2006, management reported to the Board of Directors that the Company is in compliance with its liquidity policy guidelines.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's risk of loss arising from adverse changes in the fair value of financial instruments, or market risk, is composed primarily of interest rate risk. The management of interest rate sensitivity seeks to avoid fluctuating net interest margins and to provide consistent net interest income through periods of changing interest rates. The Company has Asset-Liability Management Committees which are responsible for establishing policies to limit exposure to interest rate risk, and to ensure procedures are established to monitor compliance with those policies. Those procedures include reviewing the Company's asset and liability policies, setting prices and terms on rate-sensitive products, and monitoring and measuring the impact of interest rate changes on the Company's earnings and capital. The Company's Board of Directors reviews the guidelines established by the Committees.

Since December of 2004, the Federal Reserve has increased short-term target rates 10 times, 25 basis points each time to 5.00% from 2.50%. During this time frame longer-term interest rates have remained relatively unchanged resulting in a flattening and inversion of the yield curve. The short-term interest rate increases have caused continued net interest margin compression as short-term deposits and borrowings on the Company's liability sensitive balance sheet reprice into the current rate environment while security purchases and loan originations and refinances were being done at the stable longer-term rates. During the period of rising short-term interest rates, the Company has continued to practice conservative balance sheet management strategies by attempting to extend the maturities of its rate sensitive liabilities and shorten the maturity or repricing term of its rate sensitive assets. This conservative balance sheet management strategy has resulted in additional margin pressure and reduction in net interest income during the prior two years. Management believes this balance sheet strategy best positions the Company and lessens its risk against future interest rate fluctuations.

The primary objective of the Company's asset/liability management process is to maximize earnings and return on capital within acceptable levels of risk. The Company does not believe it is possible to reliably predict future interest rate movements, and it seeks to maintain an appropriate process and set of measurement tools that enable it to identify and quantify sources of interest rate risk ("IRR") in varying rate environments. The primary tools used by the Company in managing rate risk are income simulation and net portfolio value modeling techniques.

Interest rate risk can result from timing differences in the maturity/repricing of an institution's assets, liabilities and off balance sheet contracts; the effect of embedded options, such as loan prepayments, interest rate caps/floors, and deposit withdrawals; and the difference in the behavior of the various lending and funding rates, sometimes referred to as basis risk.

Given the potential types and differing related characteristics of IRR, it is important that the Company maintains an appropriate process and set of measurement tools that enable it to identify and quantify its primary sources of IRR. The Company also recognizes that effective management of IRR includes an understanding of when potential adverse changes in interest rates will flow through its consolidated income statements. Accordingly, the Company not only looks at a 12 month horizon when managing its exposure to IRR, it also considers a longer-term strategic horizon.

It is the Company's objective to manage its exposure to interest rate risk, understanding that it is in the business of taking on rate risk and the elimination of such risk is not possible. It is also understood that as exposure to interest rate risk is reduced, it may also result in net interest margin being reduced.

Management believes the modeling and analysis of net interest income (Earnings at Risk) and net portfolio value (Value at Risk) in different interest rate

environments provides the most meaningful measure of interest rate risk. Net interest income simulation analysis captures both the potential of all assets and liabilities to mature or reprice and the probability that they will do so. Net interest income simulation also attends to the relative interest rate sensitivities of these items, and projects their behavior over an extended period of time. Finally, net interest income simulation permits management to assess the probable effects on the consolidated balance sheet not only of changes in interest rates, but also of proposed strategies for responding to them. Net portfolio value represents the fair value of net assets (determined as the market value of assets minus the market value of liabilities using a discounted cash flow technique).

The following table measures the Company's interest rate risk exposure in terms of the percentage change in its net interest income and net portfolio value as a result of hypothetical changes in 100 basis point increments in market interest rates. The table quantifies the changes in net interest income and net portfolio value to parallel shifts in the yield curve. The column "Percentage Change in Net Interest Income" measures the change to the next twelve month's projected net interest income, due to parallel shifts in the yield curve. The column "Percentage Change in Net Portfolio Value" measures changes in the current fair value of assets and liabilities to parallel shifts in the yield curve. The column "NPV Capital Ratio" measures the ratio of the fair value of net assets to the fair value of total assets at the base case and in 100 basis point incremental interest rate shocks. The Company uses these percentage changes as a means to measure interest rate risk exposure and quantifies those changes against guidelines set by the Board of Directors as part of the Company's Interest Rate Risk policy. The Company's interest rate risk exposure as of March 31, 2006 is within those guidelines set forth.

Change in Interest Rates	NPV Capital Ratio	Percentage Change in Net Interest Income	Percentage Change in Net Portfolio Value
300	8.14%	-13.92%	-28.33%
200	9.16%	-9.10%	-19.03%
100	10.21%	-4.48%	-9.45%
0	11.24%	--	--
-100	11.79%	1.79%	5.60%
-200	11.65%	-2.17%	4.86%
-300	10.61%	-8.54%	1.10%

GAP ANALYSIS. At March 31, 2006, the total interest bearing liabilities maturing or repricing within one year exceeded the total interest-earning assets maturing or repricing in the same period by $39.2 million, representing a cumulative one-year gap ratio of a negative 12.91%.

ITEM 4 - CONTROLS AND PROCEDURES

Under the supervision and with the participation of the Company's management, including our Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. There has been no change in the Company's internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonable likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

None

ITEM 1A - RISK FACTORS

There have been no significant changes in the risk factors affecting Pathfinder Bancorp, Inc. that were identified in Item 1A of Part 1 of the Company's Form 10-K for the year ended December 31, 2005.

ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5 - OTHER INFORMATION

None

ITEM 6 - EXHIBITS

Exhibit No.	Description
31.1	Rule 13a-14(a) / 15d-14(a) Certification of the Chief Executive Officer
31.2	Rule 13a-14(a) / 15d-14(a) Certification of the Chief Financial Officer
32.1	Section 1350 Certification of the Chief Executive Officer and Chief Financial Officer

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PATHFINDER BANCORP, INC.
(Registrant)

May 22, 2006 /s/ Thomas W. Schneider
Date: Thomas W. Schneider
President, Chief Executive Officer

May 22, 2006 /s/ James A. Dowd
Date: James A. Dowd
Vice President, Chief Financial Officer