PATHFINDER BANCORP INC
Form 10-Q
August 14, 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 June 30, 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 filing 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 August 11, 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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PART I - FINANCIAL INFORMATION

ITEM 1-CONSOLIDATED FINANCIAL STATEMENTS

PATHFINDER BANCORP, INC.
CONSOLIDATED STATEMENTS OF CONDITION
JUNE 30, 2006 (UNAUDITED) AND DECEMBER 31, 2005

ASSETS	June 30, 2006	D
(Dollars in thousands except per share data)		
Cash and due from banks	$ 7,386	$
Interest earning deposits	317	
Total cash and cash equivalents	7,703	
Investment securities, at fair value	72,329	

Federal Home Loan Bank stock, at cost	2,024	
Loans	192,850	
Less: Allowance for loan losses	1,664	
Loans receivable, net	191,186	
Premises and equipment, net	7,721	
Accrued interest receivable	1,650	
Foreclosed real estate	887	
Goodwill	3,840	
Intangible asset, net	293	
Bank owned life insurance	6,087	
Other assets	3,233	
Total assets	$ 296,953	$
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Interest-bearing	$ 212,574	$
Noninterest-bearing	19,497	
Total deposits	232,071	
Short-term borrowings	7,900	
Long-term borrowings	28,360	
Junior subordinated debentures	5,155	
Other liabilities	2,888	
Total liabilities	276,374	
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	29	
Additional paid in capital	7,721	
Retained earnings	21,166	
Accumulated other comprehensive loss	(1,835)	
Treasury stock, at cost; 487,287 shares	(6,502)	
Total shareholders' equity	20,579	
Total liabilities and shareholders' equity	$ 296,953	$

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

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

For the three months ended	For the three months ended

	June 30, 2006	June 30, 2005
(Dollars in thousands, except per share data)		
INTEREST INCOME:		
Loans, including fees	$ 3,137	$ 2,929
Debt securities:		
Taxable	626	659
Tax-exempt	98	135
Dividends	67	56
Other	4	8
Total interest income	3,932	3,787
INTEREST EXPENSE:		
Interest on deposits	1,279	1,031
Interest on short-term borrowings	116	39
Interest on long-term borrowings	458	456
Total interest expense	1,853	1,526
Net interest income	2,079	2,261
Provision for loan losses	1	66
Net interest income after provision for loan losses	2,078	2,195
OTHER INCOME:		
Service charges on deposit accounts	350	319
Loan servicing fees	58	44
Earnings on bank owned life insurance	51	45
Net losses on sales of investment securities	(7)	-
Net gains on sales of loans and foreclosed real estate	2	-
Other charges, commissions and fees	152	138
Total other income	606	546
OTHER EXPENSES:		
Salaries and employee benefits	1,183	1,253
Building occupancy	306	287
Data processing expenses	306	319
Professional and other services	116	222
Amortization of intangible asset	55	55
Other expenses	344	374
Total other expenses	2,310	2,510
Income before income taxes	374	231
Provision for income taxes	71	(3)
NET INCOME	$ 303	$ 234
NET INCOME PER SHARE - BASIC	$ 0.12	$ 0.10
NET INCOME PER SHARE - DILUTED	$ 0.12	$ 0.09
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 INCOME
(UNAUDITED)

	For the six months ended June 30, 2006	For the six months ended June 30, 2005
(Dollars in thousands, except per share data)		
INTEREST INCOME:		
Loans, including fees	$ 6,194	$ 5,818
Debt securities:		
Taxable	1,267	1,263
Tax-exempt	196	238
Dividends	128	107
Other	12	59
Total interest income	7,797	7,485
INTEREST EXPENSE:		
Interest on deposits	2,528	2,061
Interest on short-term borrowings	177	49
Interest on long-term borrowings	896	915
Total interest expense	3,601	3,025
Net interest income	4,196	4,460
Provision for loan losses	23	138
Net interest income after provision for loan losses	4,173	4,322
OTHER INCOME:		
Service charges on deposit accounts	721	593
Loan servicing fees	105	85
Earnings on bank owned life insurance	100	89
Net losses on sales of securities	(9)	-
Net losses on sales of loans/real estate	(5)	(12)
Other charges, commissions & fees	287	280
Total other income	1,199	1,035
OTHER EXPENSES:		
Salaries and employee benefits	2,458	2,517
Building occupancy	622	562
Data processing expenses	630	639
Professional and other services	231	400

Amortization of intangible asset	111	111
Other expenses	669	701
Total other expenses	4,721	4,930
Income before income taxes	651	427
Provision for income taxes	108	44
NET INCOME	$ 543	$ 383
NET INCOME PER SHARE - BASIC	$ 0.22	$ 0.16
NET INCOME PER SHARE - DILUTED	$ 0.22	$ 0.15
DIVIDENDS PER SHARE	$ 0.205	$ 0.205

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

PATHFINDER BANCORP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
SIX MONTHS ENDED JUNE 30, 2006 AND JUNE 30, 2005
(unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid in Capital	Retained Earnings	A p In
(Dollars in thousands, except per share data)					
BALANCE, DECEMBER 31, 2005	2,950,419	$ 29	$ 7,721	$ 20,965	$
Comprehensive income (loss)					
Net income				543	
Other comprehensive loss, net of tax					
Unrealized net losses on securities					
Total Comprehensive Loss					
Dividends declared ($.2050 per share)				(342)	
BALANCE, JUNE 30, 2006	2,950,419	$ 29	$ 7,721	$ 21,166	$

	Treasury Stock	Total
(Dollars in thousands, except per share data)		
BALANCE, DECEMBER 31, 2005	$ (6,502)	$20,928
Comprehensive income (loss)		
Net income		543
Other comprehensive loss, net of tax		
Unrealized net losses on securities		(550)

Total Comprehensive Loss		(7)
Dividends declared ($.2050 per share)		(342)
BALANCE, JUNE 30, 2006	$ (6,502)	$20,579

	Common Stock Shares	Common Stock Amount	Additional Paid in Capital	Retained Earnings	A p In
BALANCE, DECEMBER 31, 2004	2,937,419	$ 29	$ 7,453	$ 21,186	$
Comprehensive income (loss)					
Net income				383	
Other comprehensive loss, net of tax					
Unrealized net losses on securities					
Total Comprehensive Income					
ESOP shares earned			40		
Stock option exercised	13,000	-	86		
Dividends declared ($.2050 per share)				(341)	
BALANCE, JUNE 30, 2005	2,950,419	$ 29	$ 7,579	$ 21,228	$

	Treasury Stock	Total
BALANCE, DECEMBER 31, 2004	$ (6,502)	$21,826
Comprehensive income (loss)		
Net income		383
Other comprehensive loss, net of tax		
Unrealized net losses on securities		(338)
Total Comprehensive Income		45
ESOP shares earned		62
Stock option exercised		86
Dividends declared ($.2050 per share)		(341)
BALANCE, JUNE 30, 2005	$ (6,502)	$21,678

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

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

(Dollars in thousands)	For the six months ended June 30, 2006	For the six months ends June 30, 2005
OPERATING ACTIVITIES		
Net income	$ 543	$ 383
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	23	138
ESOP shares earned	-	62
Proceeds from sale of loans	-	2,443
Realized (gains) losses on sale of:		
Real estate through foreclosure	5	19
Loans	-	(7)
Available-for-sale investment securities	9	-
Premises and equipment	(8)	-
Depreciation	377	332
Amortization of intangible asset	111	111
Amortization of deferred financing costs	15	15
Amortization of mortgage servicing rights	55	65
Earnings on bank owned life insurance	(100)	(89)
Net amortization of premiums on investment securities	65	182
Decrease (increase) in interest receivable	28	(178)
Net change in other assets and liabilities	1,267	24
NET CASH PROVIDED BY OPERATING ACTIVITIES	2,390	3,500
INVESTING ACTIVITIES		
Purchase of investment securities available-for-sale	(10,943)	(19,615)
Purchase of FHLB stock	(2,597)	(1,009)
Proceeds from maturities and principal reductions of investment securities available-for-sale	9,930	6,491
Proceeds from the redemption of FHLB stock	2,378	614
Proceeds from sale:		
Real estate acquired through foreclosure	50	169
Available-for-sale investment securities	1,941	-
Premises and equipment	145	
Net increase in loans	(3,523)	(1,622)
Purchase of premises and equipment	(215)	(777)
NET CASH USED IN INVESTING ACTIVITIES	(2,834)	(15,749)
FINANCING ACTIVITIES		
Net decrease in demand deposits, NOW accounts savings accounts, money market deposit accounts and escrow deposits	(10,435)	(6,717)
Net increase in time deposits	6,129	7,284
Increase in short-term borrowings	5,900	9,900
Payments on long-term borrowings	(1,000)	(2,000)
Proceeds from exercise of stock options	-	86
Cash dividends paid	(342)	(340)
NET CASH PROVIDED BY FINANCING ACTIVITIES	252	8,213

DECREASE IN CASH AND CASH EQUIVALENTS	(192)	(4,036)
Cash and cash equivalents at beginning of period	7,895	14,325
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 7,703	$ 10,289

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

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PATHFINDER BANCORP, INC.

Notes to Financial Statements

(1) BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Pathfinder Bancorp, Inc. and its wholly owned subsidiaries (the "Company") 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 U.S. generally accepted accounting principles. Certain amounts in the 2005 consolidated financial statements have been reclassified to conform to the current period presentation. These reclassifications had no effect on net income as previously reported. 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" was 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 and six months ended June 30, 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 have been computed by dividing net income by the weighted average number of common shares outstanding throughout the three months and six months ended June 30, 2006 and 2005, using 2,463,132 and 2,452,357 weighted average common shares outstanding for the three months ended, and 2,463,132 and 2,449,889 for the six months ended, respectively. Diluted earnings per share for the three months and six months ended June 30, 2006 and 2005 have been computed using 2,480,947 and 2,487,229 for the three months ended and 2,481,360 and 2,486,999 for the six months ended, 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 and six months ended June 30, 2006 and 2005 is as follows:

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS ENDED JUNE 30,	
	2006	2005	2006	2005
(In thousands)				
Service cost	$ 48	$ 38	$ 96	$ 76
Interest cost	63	57	126	114
Expected return on plan assets	(92)	(71)	(184)	(142)
Amortization of net losses	28	24	56	48
Net periodic benefit cost	$ 47	$ 48	$ 94	$ 96

The Company previously disclosed in its financial statements for the year ended December 31, 2005, that it expected to contribute $192,000 to its pension plan in 2006. As of June 30, 2006, $90,000 had been contributed to the pension plan.

(4) DIVIDEND RESTRICTIONS

The Company maintains a restricted capital account with a $1.7 million balance, representing Pathfinder Bancorp, MHC's portion of dividends waived as of June 30, 2006.

(5) COMPREHENSIVE LOSS

The components of other comprehensive loss and related tax effects for the three and six month periods ended June 30, 2006 and 2005 are as follows:

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS ENDED JUNE 30,	
	2006	2005	2006	2005
(In thousands)				
Gross change in unrealized gains (losses) on securities available for sale	$ (829)	$ 807	$ (917)	$ (565)
Reclassification adjustment for (gains) losses included in net income	7	-	9	-
	(822)	807	(908)	(565)
Tax effect	329	(322)	358	227
Net of tax amount	$ (493)	$ 485	$ (550)	$ (338)

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(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 $123,000 of standby letters of credit as of June 30, 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 June 30, 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 were 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 impact our consolidated financial position, results of operations or cash flows for the three or six-month period ended June 30, 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 Staff Position 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 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.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109" (FIN 48), which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that companies recognize in their financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is evaluating the impact of this new pronouncement 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. are the wholly owned subsidiaries of Pathfinder Bank. At June 30, 2006, Pathfinder Bancorp, MHC, 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 while the public held 35.7% of the Company's common stock.

The following discussion reviews the Company's financial condition at June 30, 2006 and the results of operations for the three and six months ended June 30, 2006 and June 30, 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.

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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 June 30, 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 $303,000, or $0.12 per diluted share, for the three months ended June 30, 2006 as compared to $234,000, or $0.09 per diluted share, for the same period in 2005. For the six months ended June 30, 2006, the Company reported net income of $543,000, or $0.22 per diluted share as compared to $383,000, or $0.15 per diluted share, for the same period in 2005. The Company continued its efforts toward transforming its traditional thrift balance sheet with mostly residential loans as interest 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 25.9% of the total gross loan portfolio at June 30, 2006, as compared to 25.0% of the portfolio at December 31, 2005. Asset quality continues to improve during 2006 as reflected by the improvement in the non-performing loan ratios.

Short-term borrowings increased $5.9 million during the first half 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 first 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 its 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 shareholders' equity were 0.40% and 5.85%, respectively, for the three months ended June 30, 2006, compared with 0.30% and 4.38%, respectively, for the three months ended June 30, 2005. During the second quarter of 2006, when compared to the second quarter of 2005, net interest income decreased $182,000, offset by a $200,000 reduction in other expenses, a decrease in the provision for loan losses of $65,000 and an increase in other income, exclusive of net gains on sales of securities and loans/real estate, by $65,000, or 12%.

For the six months ended June 30, 2006, net interest income decreased $264,000, or 6%, when compared to the six months ended June 30, 2005. This decrease was offset by a reduction in other expenses of $209,000, or 4%, an increase in other income, exclusive of net gains on sales of securities and loans/real estate, of $166,000, or 16%, and an 83%, or $115,000, reduction in provision for loan losses.

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 interest earning assets, interest-bearing liabilities, related yields and associated funding costs.

For the three months ended June 30, 2006, net interest income, on a tax-equivalent basis, decreased to $2.1 million from $2.3 million, when compared to the same quarter of 2005. The Company's net interest margin ratio for the second quarter of 2006 decreased to 3.11% from 3.30% 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 was attributable to the higher rates paid on both deposits and borrowings, offset by an increase of 34 basis points in average interest-earning asset yields. Average interest-earning assets decreased 3% to $273.5 million at June 30, 2006 as compared to $281.2 million at June 30, 2005. The decrease in average interest-earning assets was primarily attributable to an $11.1 million decrease in investment securities and a $1.1 million decrease in interest-earning deposits, offset by a $4.5 million increase in loans receivable. Average interest-bearing liabilities decreased $8.8 million, and the cost of funds increased 59 basis points to 2.88% for the quarter ended June 30, 2006, from 2.29% for the same period in 2005. The decrease in the average balance of interest-bearing liabilities resulted primarily from a $10.0 million reduction in average deposits, partially offset by a $1.2 million increase in borrowed funds. The reduction in deposits principally occurred in the municipal money management accounts due to the cyclical nature of the tax collections and expenditures of local municipal entities. The sharp increase in cost of funds can be attributed to the 200 basis point increase in short-term interest rates over the past 12 months, combined with a $7.8 million deposit migration from lower earning savings accounts to higher yielding certificates of deposit.

For the six months ended June 30, 2006, net interest income, on a tax-equivalent basis, decreased $271,000, to $4.3 million, from $4.6 million at June 30, 2005. Net interest margin decreased 13 basis points, to 3.12% at June 30, 2006 from 3.25% at June 30, 2005. Average interest-earning assets decreased 6% to $274.8 million at June 30, 2006 as compared to $280.7 million at June 30, 2005, while the yield on interest-earning assets increased 34 basis points to 5.74% from 5.40% for the comparable periods. The decrease in average interest-earning assets was primarily attributable to a $5.2 million decrease in investment securities and a $4.7 million decrease in interest-earning deposits, partially offset by a $4.0 million increase in loans receivable. Average interest-bearing liabilities decreased $5.9 million and the cost of funds increased 50 basis points to 2.78% for the six months ended June 30, 2006, from 2.28% for the same period in 2005. The decrease in the average balance of interest-bearing liabilities resulted primarily from a $6.4 million reduction in average deposits, partially offset by a $487,000 increase in borrowed funds.

INTEREST INCOME

Total interest income, on a tax-equivalent basis, for the quarter ended June 30, 2006 increased $133,000, or 4%, to $4.0 million from $3.9 million for the quarter ended June 30, 2005. The average balance of loans increased $4.5 million to $192.0 million, with yields increasing 28 basis points to 6.55% for the second quarter of 2006. Average commercial real estate loans increased $5.4 million, and the yield on those loans increased to 7.69% from 7.62% in 2005. Average commercial loans increased $2.9 million, and experienced an increase in the average tax-equivalent yield of 124 basis points, to 8.18% from 6.94%, in 2005. Average consumer loans increased $523,000, or 3%, and experienced an increase in yield of 80 basis points. The increase in the yield on commercial and consumer loans was primarily the result of new commercial loan originations occurring at market rates significantly higher than the weighted average existing portfolio rate as well as the adjustable rate portions of the portfolios repricing upward in connection with upward adjustments in the prime rate. Increases in the average balance of consumer and commercial loan portfolios were offset by decreases in the average balance of residential real estate loan portfolios and municipal loans. The average balance of the residential real estate portfolio decreased $3.3 million, or 3%, combined with a

slight decrease in yield to 5.77% from 5.80% for the same period in 2005. The Company's municipal loan portfolio decreased $965,000, or 26%, when comparing the second quarter of 2006 to the same period in 2005. The average yield on the municipal loan portfolio increased to 5.56% in 2006 from 3.25% for the same period in 2005.

Average investment securities (taxable and tax-exempt) for the quarter ended June 30, 2006 decreased by $11.1 million when compared to the same period a year ago, with a decrease in tax-equivalent interest income from investments of $68,000, or 8%, compared to the second quarter of 2005. The average tax-equivalent yield of the portfolio increased 19 basis points, to 4.07% from 3.88%. The decrease in average investment securities was primarily due to the December 2005 sale of agency and municipal securities which had been purchased as collateral for the additional municipal deposit relationships acquired during 2004 and 2005. Additional securities were sold during the first and second quarters of 2006 as a result of the outflow of municipal deposits.

Total interest income, on a tax-equivalent basis, for the six months ended June 30, 2006 increased $302,000, or 4%, when compared to the six months ended June 30, 2005. Average loans increased $4.0 million, with yields increasing 27 basis points to 6.49% from 6.22%. The average balance of commercial real estate increased $4.4 million, with yields increasing to 7.63% from 7.43%, average commercial loans increased $2.8 million, with yields increasing to 8.09% from 6.73% and average consumer loans increased $685,000 with yields increasing to 7.87% from 7.09% at June 30, 2005. These increases were offset by decreases in the average balance of residential real estate and municipal loans of $3.3 million and $591,000, respectively.

For the six months ended June 30, 2006, tax-equivalent interest income from investment securities decreased $31,000, or 2%, compared to the same period in 2005. The average tax-equivalent yield of the portfolio increased 16 basis points, to 4.02% from 3.86%, offset by a $5.1 million decrease in the average balance of investment securities.

INTEREST EXPENSE

Total interest expense increased $327,000 for the three months ended June 30, 2006, when compared to the same quarter in 2005. Deposit expense for the comparable periods increased $248,000, or 24%, as the average rate paid on higher yielding money management accounts increased 58 basis points to 2.51% in 2006 from 1.93% in 2005. The cost of time deposits increased 73 basis points as existing time deposits matured and repriced into higher rates and new higher priced promotional products were offered, combined with a 9% increase in the average balance of time deposit accounts to $99.7 million in 2006 from $91.8 million in 2005. The cost of other interest-bearing deposits increased 5 basis points, to 0.46% from 0.41% combined with an 8%, or $6.8 million, decrease in the average balance of these deposits. Interest expense on borrowings increased by $79,000, or 16%, from the prior period, resulting from an increase in the cost of borrowed funds to 5.26% from 4.66%, combined with an increase in the average balance of borrowed funds of $1.2 million. The increase in the cost of borrowings primarily resulted from an increase in the cost of the $5.0 million LIBOR (London Interbank Offered Rate) based junior subordinated debentures to 8.58% from 6.36%.

For the six months ended June 30, 2006, interest expense increased $576,000, or 19%, to $3.6 million from $3.0 million for the same period in 2005. The average deposit balance decreased $6.4 million, offset by a 48 basis point increase in the cost of deposits to 2.32% from 1.84%. The cost of borrowed funds increased 47 basis points to 5.16% from 4.69%, partially offset by a decrease in the average balance of borrowed funds by $487,000, or 1%.

PROVISION FOR LOAN LOSSES

Provision for loan losses for the quarter ended June 30, 2006 decreased to $1,000 from $66,000 for the same period in 2005, primarily as a result of improved asset quality and stable loan balances. The Company's ratio of

allowance for loan losses to period end loans has decreased to 0.86% at June 30, 2006 from 1.00% at June 30, 2005. Nonperforming loans to period end loans decreased to 0.73% at June 30, 2006 from 1.08% at June 30, 2005.

For the six months ended June 30, 2006, the provision for loan losses was $23,000 as compared to $138,000 for the same period in 2005 primarily resulting from a decrease in the level of charge-offs to $49,000 for the six months ended June 30, 2006 compared to $86,000 in 2005 and continued improvement in overall asset quality.

OTHER INCOME

The Company's other income is primarily comprised of fees charged 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 June 30,				Six Months	
(Dollars in thousands)	2006	2005	$Change	% Change	2006	2005
Service charges on deposit accounts	$ 350	$ 319	$ 31	9.7%	$ 721	$ 593
Loan servicing fees	58	44	14	31.8%	105	85
Earnings on bank owned life insurance	51	45	6	13.3%	100	89
Net gains/(losses) on sale of loans/ foreclosed real estate	2	-	2	-	(5)	(12)
Other operating income	152	138	14	10.1%	287	280
Core noninterest income	613	546	67	12.3%	1,208	1,035
Net losses on sales of securities	(7)	-	(7)	-	(9)	-
Total other income	$ 606	$ 546	$ 60	11.0%	$1,199	$ 1,035

For the three months ended June 30, 2006, core other income reflected an increase of $67,000, or 12%, when compared with the three months ended June 30, 2005. Income from service charges on deposit accounts increased because of the number of deposit accounts increased primarily attributable to the opening of a new branch, combined with an increase in fees associated with deposit accounts. The increase in loan servicing fees was primarily due to an increase in commercial loan volume, offset by a reduction in internal mortgage closing legal fees as the Company switched to an outside legal service for all closings. The increase in other operating income primarily resulted from fees associated with Pathfinder Bank debit card usage and fees generated by investment services.

For the six months ended June 30, 2006, core other income increased $173,000 or 17%, when compared with the six months ended June 30, 2005. The increase in core income for the six months ended June 30 2006, was primarily due to a fee enhancement program on deposit accounts which began in the second quarter of 2005 and an increase in loan servicing fees from commercial loan volume.

The increase in the net losses on sales of investment securities for the three and six month period was the result of the sale of corporate bonds in 2006. There were no investment security sale transactions during the first two quarters of 2005.

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OTHER EXPENSES

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

(Dollars in thousands)	Three Months Ended June 30, 2006	2005	$Change	% Change	Six Months Ended 2006	2005	$Chang
Salaries and employee benefits	$1,183	$ 1,253	$ (70)	-5.6%	$2,458	$ 2,517	$ (5
Building occupancy	306	287	19	6.6%	622	562	6
Data processing	306	319	(13)	-4.1%	630	639	(
Professional and other services	116	222	(106)	-47.7%	231	400	(16
Amortization of intangible assets	55	55	-	0.0%	111	111	
Other operating	344	374	(30)	-8.0%	669	701	(3
Total noninterest expense	$2,310	$ 2,510	$ (200)	-8.0%	$4,721	$ 4,930	$ (20

For the three months and six months ended June 30, 2006, salaries and employee benefits decreased as a result of personnel realignment, a reduction in commissions paid and a reduction in stock based compensation expense, as compared with the three and six months ended June 30, 2005. These reductions were offset by an increase in personnel expenses associated with the opening of a new branch in June 2005. The Company had 103 full time equivalent employees at June 30, 2006 compared to 113 at June 30, 2005. The increase in building occupancy expense for the three and six months ended June 30, 2006, was primarily the result of the operation of the new Central Square branch, including maintenance, property taxes, utilities and telephone expenses, combined with the recording of additional depreciation expense on the building and equipment. The decrease in data processing charges for the three and six months ended June 30, 2006 was due to a reduction in internet banking expenses and ATM processing fees as the number of ATM machines in operation declined, offset by increased depreciation expense and maintenance expense resulting from system hardware and software acquisitions. The decrease in professional and other services was primarily due to consulting expenses associated with a fee enhancement program, a leadership training program, strategic planning and a capital market analysis which occurred in 2005 with no similar expense in 2006. The reduction in other operating expenses for the three and six month periods was primarily due to lower ORE expenses due to the reduction in properties held, a lower FDIC assessment for the first quarter of 2006, a gain recorded on the sale of premises and equipment, lower ATM courier expenses (as the amount of ATM machines in operation has decreased) and a reduction in mortgage recording tax expense attributable to lower volume of residential mortgage originations. These decreases were partially offset by increases in New York State Banking Department exam expenses and increased travel and training expenses.

INCOME TAX EXPENSE

Income taxes increased $74,000 for the quarter ended June 30, 2006 as compared to the same period in 2005, which was attributable to an increase in the Company's pre-tax income and a decrease in tax-exempt interest income. The effective tax rate was 16.6% for the six months ended June 30, 2006. 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. The enactment of proposed state tax legislation, which would limit the benefit derived from Real Estate Investment Trusts, would result in a higher effective state tax rate for the Company.

CHANGES IN FINANCIAL CONDITION

ASSETS

Total assets remained constant at $296.9 million at June 30, 2006 when compared to December 31, 2005. Loans receivable increased $3.3 million, or 2%, offset by a decrease in investment securities of $1.9 million and a $1.2 million reduction in other assets. The increase in loans receivable was primarily the result of a $5.2 million, $1.0 million and $500,000 increase in the commercial adjustable real estate, commercial loan and adjustable residential real estate portfolios, respectively. These increases were offset by reductions of $1.7 million, $1.3 million and $500,000 in commercial fixed real estate loans, residential fixed real estate and municipal loan portfolios, respectively. The decrease in investment securities was primarily the result of a $1.0 million increase in portfolio unrealized losses and amortization and prepayments within the mortgage-backed security portfolio.

At June 30, 2006, the securities balance included a net unrealized loss on available for sale securities of $3.1 million, compared with 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 the book value of the Company. The Company has the intent and ability to hold the individual securities to maturity or market price recovery.

LIABILITIES

Total liabilities increased slightly to $276.4 million at June 30, 2006 from $276.0 million at December 31, 2005. The slight increase in liabilities was due to a $5.9 million increase in short-term borrowings, offset by a $4.3 million decrease in deposits and a $1.0 million reduction in long-term borrowings. The increase in short-term borrowings was a result of the deposit outflows of municipal customers that caused the Company to rely on short-term wholesale borrowings for liquidity needs. The decrease in deposits was primarily attributable to the cyclical declines in the deposit balances of certain large municipal customers.

LOAN AND ASSET QUALITY AND ALLOWANCE FOR LOAN LOSSES

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

(Dollars in thousands)	For the June 30, 2006	Period December 31, 2005	Ending June 30, 2005
Nonaccrual loans:			
Commercial	$ 376	$ 757	$ 633
Consumer	78	89	106
Real estate - Construction	0	0	0
Mortgage	964	834	1,290
Total nonaccrual loans	1,418	1,680	2,029

Loans past due 90 days or more and still accruing	0	0	0
Total non-performing loans	1,418	1,680	2,029
Foreclosed real estate	887	743	878
Total non-performing assets	2,305	2,423	2,907
Non-performing loans to total loans	0.73%	0.89%	1.08%
Non-performing assets to total assets	0.78%	0.82%	0.94%

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Total nonperforming loans and foreclosed real estate at June 30, 2006 decreased 4.9% when compared to December 31, 2005. Nonperforming loans continued to be addressed primarily through increased collection efforts and foreclosure proceedings. Management believes that adequate reserves exist for any potential losses that may occur from the remediation process.

The allowance for loan losses at June 30, 2006 was $1.7 million, or 0.86% of period end loans, compared to $1.7 million, or 0.89% of period end loans, at December 31, 2005.

CAPITAL

Shareholders' equity decreased $349,000, or 2%, to $20.6 million at June 30, 2006. The decrease in shareholders' equity primarily resulted from a $550,000 increase in accumulated other comprehensive loss offset by a $201,000 increase in retained earnings. The Company added $543,000 to retained earnings through net income and returned $342,000 to its shareholders in the form of cash dividends. The Company's mutual holding company parent, Pathfinder Bancorp, MHC waived the dividend for the quarter ended June 30, 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 June 30, 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 mortgage backed securities 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, and utilizes short-term borrowings as a source of liquidity when necessary.

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.

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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 June 30, 2006, management reported to the Board of Directors that the Company is in compliance with its liquidity policy guidelines.

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ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company continues to aggressively pursue delinquent loan relationships. While this aggressive pursuit, combined with conservative provisioning, has improved the overall quality of the loan portfolio, it has resulted in a temporary increase in other real estate. 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 primary objective of the Company's asset-liability management activities is to maximize net interest income while maintaining acceptable levels of interest rate risk. 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 assets 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 these committees.

From 2001 until June 2004, the Federal Reserve lowered interest rates thirteen times by a total of 550 basis points. These interest rate reductions have caused significant repricing of Pathfinder Bank's interest-earning assets and interest-bearing liabilities. Efforts have been made to shorten the repricing duration of its rate sensitive assets by purchasing investment securities with maturities within the next 3 to 5 years and promoting portfolio ARM (adjustable rate mortgage) and hybrid ARM products. In addition, the Company has extended the duration of its rate sensitive liabilities by lengthening the maturities of its existing borrowings and offering certificates of deposit with three and four year terms which allow depositors to make a one-time election, at any time during the term of the certificate of deposit, to adjust the rate of the instrument to the then prevailing rate for the certificate of deposit with the same term.

Since June of 2004, the Federal Reserve has raised its key short-term interest rate 250 basis points. Net interest margin compression has resulted as the yield curve flattened from sharp increases in short-term interest rates while longer-term rates have remained relatively stable. Management will continue to seek to minimize any reduction in net interest income in a period of rising short-term interest rates to the extent that it can resist raising its cost of funds during this period. The Company is continuing to explore transactions and strategies to both increase its net interest income and minimize its interest rate risk.

GAP ANALYSIS. At June 30, 2006, the total interest-bearing liabilities maturing or repricing within one year exceeded total interest-earning assets maturing or repricing in the same period by $35.5 million, representing a cumulative one-year gap ratio of a negative 11.94%.

EARNINGS AT RISK AND VALUE AT RISK. Management believes the simulation of net interest income (Earnings at Risk) and net portfolio value (Value at Risk) in different interest rate environments provides a more meaningful measure of interest rate risk. Income simulation analysis captures both the potential of all assets and liabilities to mature or reprice and the probability that they will do so. Income simulation also attends to the relative interest rate sensitivities of these items, and projects their behavior over an extended period of time. Finally, income simulation permits management to assess the probable effects on the 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.

Change in Interest Rates	NPV Capital Ratio	Percentage Change in Net Interest Income	Percentage Change in Net Portfolio Value
300	8.34%	-13.07%	-26.25%
200	9.10%	-8.31%	-17.83%
100	9.86%	-4.24%	-8.96%
0	----	----	----
-100	10.88%	1.36%	5.10%

-200	10.65%	-0.22%	4.57%
-300	10.13%	-3.84%	1.03%

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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.

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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

The Company's Annual Meeting of Shareholders was held on April 26, 2006. The following are the items voted on and the results of the shareholder voting:

1. The election of Bruce E. Manwaring, L. William Nelson, George P. Joyce and Lloyd "Buddy" Stemple to serve as directors of the Company, each for a term of three years or until his successor has been elected and qualified.

Name	For	Withheld
Bruce E. Manwaring	2,427,820	9,282
L. William Nelson	2,427,820	9,282
George P. Joyce	2,421,816	15,286
Lloyd "Buddy" Stemple	2,420,316	16,786

Set forth below are the names of the other directors of the Company and their terms of office.

Name	Term Expires
Steven W. Thomas	2007
Corte J. Spencer	2007
Janette Resnick	2007
Chris C. Gagas	2008
Thomas W. Schneider	2008
Chris R. Burritt	2008

2. The ratification of the appointment of Beard Miller Company LLP as auditors for the Company for the year ending December 31, 2006.

	For	Against	Abstain
Number of Votes	2,433,639	3,313	150

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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

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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)

August 14, 2006	/s/ Thomas W. Schneider
Date:	Thomas W. Schneider President, Chief Executive Officer
August 14, 2006	/s/ James A. Dowd
Date:	James A. Dowd Senior Vice President, Chief Financial Officer