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PATHFINDER BANCORP INC
Form 10-Q
November 13, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OF THE SECURITIES EXCHANGE ACT OF
1934 FOR THE QUARTER ENDED SEPTEMBER 30, 2001

SEC Exchange Act No. 000-23601

Pathfinder Bancorp, Inc.

(Exact name of issuer as specified in its charter)

Federal

(State or jurisdiction of incorporation or organization)

16-1540137

(I.R.S. Employer Identification Number)

214 W. 1st Street
Oswego, New York

13126

(Address of principal executive office)

(Zip Code)

Company's telephone number, including area code: (315) 343-0057

Not Applicable

(Former name, former address and former fiscal year, if changed since
last report)

Indicate by check mark whether the Company (1) has filed all reports
required to be filed by Section 13 of the Securities Exchange Act of 1934 during
the preceding 12 months (or for such shorter period that the Registrant was
required to file such reports), and (2) has been subject to such filing
requirements for the past 90 days. Yes X No

Indicate the number of shares outstanding of each of the issuer's classes
of common stock, as of the latest practicable date: There were 2,601,495 shares
of the Company's common stock outstanding as of November 09, 2001.

PATHFINDER BANCORP, INC.
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SIGNATURES

PATHFINDER BANCORP, INC.
CONSOLIDATED STATEMENTS OF CONDITION
September 30, 2001 (unaudited) and December 31, 2000

	September 30, 2001	
ASSETS	-----	
Cash and due from banks	\$ 3,633,754	\$
Interest earning deposits	1,931,495	
	-----	-----
Total cash and cash equivalents	5,565,249	
Investment securities	58,746,473	
Mortgage loans held-for-sale	2,658,359	
Loans:		
Real estate residential	110,057,711	1
Real estate commercial	28,504,888	
Consumer	3,133,936	

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Commercial	14,439,908	

Total loans	156,136,443	1
Less: Allowance for loan losses	1,576,615	
Unearned discounts and origination fees	(7,891)	

Loans receivable, net	154,567,719	1
Premises and equipment, net	4,560,830	
Accrued interest receivable	1,627,929	
Other real estate	882,566	
Intangible assets, net	2,420,794	
Other assets	6,756,435	

Total assets	\$237,786,354	\$2
	=====	==
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Interest bearing	\$155,486,908	\$1
Non-interest bearing	11,980,174	

Total deposits	167,467,082	1
Borrowed funds	44,772,500	
Other liabilities	3,049,158	

Total liabilities	215,288,740	2
Shareholders' equity:		
Common stock, par value \$.10 per share; authorized 9,000,000 shares; issued 2,884,720 shares; and 2,601,495 shares outstanding for 2001 and 2000, respectively.	288,472	
Additional paid in capital	6,579,830	
Retained earnings	18,547,952	
Accumulated other comprehensive income	818,556	
Unearned ESOP shares	(186,037)	
Treasury stock, at cost; 283,225 shares	(3,551,159)	

Total shareholders' equity	22,497,614	

Total liabilities and shareholders' equity	\$237,786,354	\$2
	=====	==

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PATHFINDER BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME

For the three months ended September 30, 2001 and September 30, 2000
(unaudited)

September 30,
2001

INTEREST INCOME:

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Loans	\$3,133,892
Interest and dividends on investments:	
U.S. Treasury and agencies	89,132
State and political subdivisions	81,313
Corporate obligations	373,385
Marketable equity securities	54,489
Mortgage-backed securities	309,416
Federal funds sold and interest-bearing deposits	32,718

Total interest income	4,074,345

INTEREST EXPENSE:	
Interest on deposits	1,544,769
Interest on borrowed funds	552,730

Total interest expense	2,097,499

Net interest income	1,976,846
Provision for loan losses	38,528

Net interest income after provision for loan losses	1,938,318

OTHER INCOME:	
Service charges on deposit accounts	136,552
Loan servicing fees	53,937
Cash surrender value	61,868
Net losses on securities and loans	(38,192)
Other charges, commission and fees	122,052

Total other income	336,217

OTHER EXPENSES:	
Salaries and employee benefits	752,666
Building occupancy	190,391
Data processing expenses	192,725
Professional and other services	170,053
Deposit insurance premium	7,680
Amortization of intangible asset	78,939
Other expenses	301,683

Total other expenses	1,694,137

Income before income taxes	580,398
Provision for income taxes	137,415

Net income	\$ 442,983
	=====
Net income per share - basic	\$.17
	=====
Net income per share - diluted	\$.17
	=====

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

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PATHFINDER BANCORP, INC.
 CONSOLIDATED STATEMENTS OF INCOME For
 the nine months ended September 30, 2001 and September
 30, 2000
 (unaudited)

	September 30, 2001 -----
INTEREST INCOME:	
Loans	\$9,360,114
Interest and dividends on investments:	
U.S. Treasury and agencies	327,472
State and political subdivisions	253,889
Corporate	1,165,198
Marketable equity securities	137,605
Mortgage-backed securities	1,005,702
Federal funds sold and interest-bearing deposits	56,989

Total interest income	12,306,969

INTEREST EXPENSE:	
Interest on deposits	4,760,037
Interest on borrowed funds	1,827,401

Total interest expense	6,587,438

Net interest income	5,719,531
Provision for loan losses	578,739

Net interest income after provision for loan losses	5,140,792

OTHER INCOME:	
Service charges on deposit accounts	392,418
Loan servicing fees	126,154
Cash surrender value	143,041
Net gains (losses) on securities and loans	453,143
Other charges, commission and fees	332,833

Total other income	1,447,589

OTHER EXPENSES:	
Salaries and employee benefits	2,239,876
Building occupancy	617,502
Data processing expenses	566,881
Professional and other services	525,577
Deposit insurance premiums	23,252
Amortization of intangible asset	236,817
Other expenses	921,428
Unusual items	-

Total other expenses	5,131,333

Income before income taxes	1,457,048
Provision for income taxes	391,435

Net income (loss)	\$1,065,613 =====

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Net income (loss) per share - basic	\$ 0.42
	=====
Net income (loss) per share - diluted	\$ 0.41
	=====

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

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PATHFINDER BANCORP, INC.
STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
NINE MONTHS ENDED SEPTEMBER 30, 2001
(unaudited)

	Common Shares	Stock Amount	Add't Paid in Capital	Retained Earnings	Compr In

Balance, December 31, 2000	2,884,720	\$288,472	\$6,562,085	\$17,859,388	\$
Comprehensive income:					
Net income				1,065,613	1,06
Other comprehensive income, net of tax:					
Unrealized gains on securities					
Unrealized holding gains arising during period					1,75
Reclassification adjustment for gains Included in net income					(44
Other comprehensive income, before tax					1,31
Income tax provision					52
Other comprehensive income, net of tax					78
Comprehensive income					1,85
					=====
ESOP shares earned			17,745		
Dividends declared (.19 per share)				(377,049)	
Balance, September 30, 2001	2,884,720	\$288,472	\$6,579,830	\$18,547,952	\$
	=====	=====	=====	=====	=====

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	ESOP Shares	Unearned Treasury Stock
Balance, December 31, 2000	\$ (227,230)	\$ (3,551,159) \$2
Comprehensive income:		
Net income		
Other comprehensive income, net of tax:		
Unrealized gains on securities		
Unrealized holding gains arising during period		
Reclassification adjustment for gains Included in net income		
Other comprehensive income, before tax		
Income tax provision		
Other comprehensive income, net of tax		
Comprehensive income		
ESOP shares earned	41,193	
Dividends declared (.19 per share)		
Balance, September 30, 2001	\$ (186,037)	\$ (3,551,159) \$2

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

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PATHFINDER BANCORP, INC.
STATEMENTS OF CASH FLOWS
For the nine months ended September 30, 2001 and September 30, 2000
(unaudited)

	September 30, 2001
OPERATING ACTIVITIES:	
Net income (loss)	\$1,065,613
Adjustments to reconcile net income to net cash provided by operating activities:	
Provision for loan losses	578,739
ESOP and other stock-based compensation earned	58,938
Deferred income tax benefit	(201,213)
Proceeds from sale of loans	9,257,819

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Originations of loans held-for-sale	(12,514,787)
Realized loss/(gain) on:	
Sale of real estate acquired through foreclosure	33,602
Sale of loans	(16,714)
Available-for-sale investment securities	(446,229)
Depreciation	351,108
Amortization of intangibles	236,817
Increase in surrender value of life insurance	(143,040)
Net accretion of premiums and discounts on investment securities	(7,675)
Decrease (increase) in interest receivable	50,660
Net change in other assets and liabilities	(993,308)

Net cash (used in) provided by operating activities	(2,689,670)

INVESTING ACTIVITIES:	
Purchase of investment securities available for sale	(1,823,332)
Proceeds from maturities and principle reductions of investment securities available for sale	4,584,055
Proceeds from sale of:	
Real estate acquired through foreclosure	306,065
Available-for-sale investment securities	5,372,845
Net increase in loans	(7,122,340)
Purchase of premises and equipment	(300,240)

Net cash provided by (used in) investing activities	1,017,053

FINANCING ACTIVITIES	
Net increase in demand deposits, NOW accounts, savings accounts, money market deposit accounts and escrow accounts and escrow deposits	8,361,232
Net (decrease) increase in time deposits	(2,353,440)
Net (repayments)/proceeds from borrowings	(2,457,000)
Cash dividends	(468,269)
Treasury stock purchased	-

Net cash provided by financing activities	3,082,523

Increase/(decrease) in cash and cash equivalents	1,409,906
Cash and cash equivalents at beginning of period	4,155,343

Cash and cash equivalents at end of period	\$5,565,249
	=====

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September 30,
2001

CASH PAID DURING THE PERIOD FOR:

Interest	\$6,568,104
Income taxes paid	419,618

NON-CASH INVESTING ACTIVITY:

Transfer of loans to other real estate	\$337,913
Increase in unrealized gains and losses on available for sale investment securities	(1,313,031)
Loans securitized and held as investments	1,355,095

NON-CASH FINANCING ACTIVITY:

Dividends declared and unpaid	\$69,068
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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 financial statements were prepared in accordance with the instructions for Form 10-Q and Regulation S-X and, therefore, do not include information for footnotes necessary for a complete presentation of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. 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 Bank'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, 2000 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.

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All adjustments (consisting of only normal recurring accruals) which, in the opinion of management, are necessary for a fair presentation of the financial statements have been included in the results of operations for the three months and nine months ended September 30, 2001 and 2000.

Operating results for the three months and nine months ended September 30, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001.

(2) Earnings per Share

Basic earnings per share have been computed by dividing net income (loss) for the three months and nine months ended September 30, using 2,567,722 and 2,565,364 weighted average common shares outstanding for 2001 and 2,557,189 and 2,537,425 for 2000. Diluted earnings per share for the three and nine month periods ending September 30, 2001 and the three month period ending September 30, 2000 have been computed using 2,626,470, 2,592,793 and 2,558,596 weighted average common shares outstanding, respectively. Due to the loss incurred by the company during the first nine months of 2000, the impact of outstanding options is anti-dilutive and, therefore, their impact has not been included in the diluted earnings per share disclosure for the nine months ended September 30, 2000.

(3) Reclassifications

Certain prior period information has been reclassified to conform to the current period's presentation. These reclassifications had no effect on net income as previously reported.

(4) New Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets" effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill will no longer be amortized but will be subject to annual impairment tests in accordance with the statements. Other intangible asset will continue to be amortized over their useful lives. The Company will apply the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of 2002. Application of the non-amortization provisions of the statement is expected to increase pre-tax income by approximately \$316,000 on the Company annual financial statements. The Company will perform the first of the required impairment tests of goodwill as of January 1, 2002 and has not determined what the effect of these tests will be on the earning and financial position of the Company.

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Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operation

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,

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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 which 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.

General

Throughout the Management's Discussion and Analysis the term, "the Company", refers to the consolidated entity of Pathfinder Bancorp, Inc., Pathfinder Bank, Pathfinder REIT Inc., and Whispering Oaks Development Corp. At September 30, 2001, Pathfinder Bancorp, Inc.'s only business was the 100% ownership of Pathfinder Bank. At September 30, 2001, 1,583,239 shares, or 60.9%, of the Company's common stock was held by Pathfinder Bancorp, MHC, the Company's mutual holding company parent and 1,018,256 shares, or 39.1%, was held by the public.

The Company's net income is primarily dependent on its net interest income, which is the difference between interest income earned on its loans, investment securities, federal funds sold and interest-bearing deposits, and its cost of funds consisting of interest expense on deposits and borrowed funds. The Company's net income also is affected by its provision for loan losses, noninterest income and noninterest expense. Noninterest income is comprised of service charges on deposit accounts, loan fees, cash surrender value, other charges, commissions and fees and net securities gain and losses. Noninterest expense includes salaries and employee benefits, building occupancy, data processing expenses, professional and other services and amortization of intangible assets. Earnings of the Company are affected significantly by general economic and competitive conditions, particularly changes in market interest rates, government policies and actions of regulatory authorities. These events are beyond the control of the Company.

For the third quarter ending September 30, 2001, the Company's parent, Pathfinder Bancorp, MHC, waived its right to receive its portion of the cash dividends declared on September 18, 2001. The Mutual Holding Company's \$111,000 of waived cash dividends is maintained in the Company's restricted retained earnings account.

During July 2001, Pathfinder Bancorp, Inc. completed its conversion to a federal charter. The charter conversion was completed pursuant to plans of charter conversion which were approved by the Office of Thrift Supervision. The Company's charter conversion was approved by stockholders at the annual meeting on April 25, 2001. Upon completion of the conversion, the outstanding shares of common stock, par value \$.10 per share of Pathfinder Bancorp, Inc. became, by operation of law, common stock, par value \$.01 per share of the Company on a one-for-one basis and the shares of the Company will continue to be traded under the symbol PBHC on the Nasdaq Small Cap Market.

On October 16, 2001, the Board of Directors of Pathfinder Bancorp, Inc. resolved to increase the number of Directors from nine to ten. Pursuant to this action, Thomas Schneider, President and Chief Executive Officer of the Company, was

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appointed to the Board of Directors. Mr. Schneider's term will end in 2002, subject to re-election at the annual shareholders' meeting.

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The following discussion presents material changes to the Company's financial condition from December 31, 2000 to September 30, 2001, and the results of operations for the three and nine months ended September 30, 2001.

Financial Condition

Assets

Total assets increased approximately \$5.4 million, or 2.3%, to \$237.8 million at September 30, 2001 from \$232.4 million at December 31, 2000. The increase in total assets was primarily the result of a \$6.2 million increase in net loans receivable, a \$1.9 million increase in mortgage loans-held-for-sale, a \$1.4 million increase in cash and cash equivalents and a \$1.2 million increase in other assets. These increases were partially offset by a \$5.0 million decrease in investment securities. The increase in net loans receivable is primarily due to a \$3.6 million increase in residential real estate loans, a \$1.1 million increase in commercial real estate loans, and a \$1.6 million increase in commercial loans. The increases in loan balances are a result of the Company competitively pricing residential real estate mortgages and continued emphasis on increased commercial customer relationships. The increase in loans was principally funded by an increase of \$6.0 million in deposits and by proceeds from amortization, maturities and sales of investment securities.

Liabilities

Total liabilities increased by \$3.9 million, to \$215.3 million at September 30, 2001 from \$211.4 million at December 31, 2000. The increase is primarily attributable to a \$6.0 million, or 3.7%, increase in total deposits, and an increase of \$346,000, or 12.8%, in other liabilities, partially offset by a decrease in borrowed funds of \$2.5 million, or 5.2%. The increase in deposits was primarily comprised of a \$3.9 million increase in interest bearing deposits and a \$2.1 million increase in noninterest bearing deposits. The increase in interest earning deposits was comprised of a \$1.6 million increase in NOW deposit accounts and a \$4.8 million increase in savings accounts, partially offset by a decrease in time deposits of \$2.5 million. The increase in deposit accounts is primarily due to the Company's active efforts to obtain additional deposit relationships garnered through expanded lending relationships, as well as funds moving out of equity markets into fixed income products.

Liquidity and Capital Resources

Shareholders' equity increased \$1.5 million, or 7.3%, to \$22.5 million at September 30, 2001 from \$21.0 million at December 31, 2000. The increase in shareholders' equity is primarily the result of a \$788,000 increase in accumulated other comprehensive income and a \$689,000 increase in retained earnings (net of \$377,000 in dividends paid).

The Company's primary sources of funds are deposits, amortization and prepayment of loans and maturities of investment securities, federal funds sold, earnings

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and funds provided from operations and borrowings. While scheduled principal amortization 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-bearing instruments and other assets which provide liquidity to meet lending requirements. For additional information about cash flows from the Company's operating, financing, and investing activities, see The Statements of Cash Flows included in the Financial Statements. The Company adjusts its liquidity levels in order to meet funding needs of deposit outflows, payment of real estate taxes on mortgage loans and loan commitments. The Company also adjusts liquidity as appropriate to meet its assets and liability management objectives.

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Results of Operations

The Company recorded net income of \$443,000 and \$257,000 for the three months ended September 30, 2001 and 2000, respectively. The increase in net income of \$186,000, or 72.1%, for the three months ended September 30, 2001, resulted primarily from an increase of \$139,000 in net interest income after provision for loan losses, an increase in other income of \$48,000, or 16.7%, and a reduction of \$20,000, or 1.2%, in operating expenses. For the nine months ended September 30, 2001, the Company recorded net income of approximately \$1.1 million as compared to net a net loss of \$75,000 for the same period in the prior year. The net loss recorded for the first nine months of 2000 was a direct result of the net loss recorded by the Company during the first quarter of the year. The Company's first quarter earnings were adversely impacted by certain unusual items, totaling approximately \$578,000, and non-recurring charges totaling approximately \$270,000. Additionally, the Company incurred losses of approximately \$195,000 on the sale of investment securities during the first quarter of 2000. The tax benefit of the unusual items, non-recurring charges and securities losses totals approximately \$241,000.

Annualized return on average assets and return on average shareholders equity were .75% and 7.99%, respectively for the three months ended September 30, 2001 as compared to .46% and 5.16% for the third quarter of 2000. For the nine months ended September 30, 2001, annualized return on average assets and return on average shareholders' equity were .60% and 6.58%, as compared to (.05)% and (.51)% for the same period in the prior year.

Interest Income

Three month period

Interest income, on a tax-equivalent basis, remained consistent at \$4.1 million for the quarter ended September 30, 2001 as compared to the same period in 2000. Interest income was affected by an increase in the average balance of interest earning assets to \$218.1 million from \$207.9 million, offset by a decrease in the tax equivalent yield on interest earning assets to 7.52% from 7.91%. The decrease in the tax equivalent yield was a result of the declining interest rate environment during the 3rd quarter of 2001. The yield decrease was somewhat mitigated by increased originations of residential and commercial real estate loans.

Interest income on loans receivable increased \$175,000, or 5.9%, to \$3.1 million for the three months ended September 30, 2001 as compared to the same period in the prior year. The increase in interest income on loans occurred from an

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increase in the average balance of loans receivable of \$14.9 million, or 10.5%, to \$156.2 million at September 30, 2001, from \$141.3 million at September 30, 2000, and a decrease in the average yield on loans receivable to 8.03% from 8.38%.

Interest income on the mortgage-backed securities portfolio decreased by \$46,000, or 13.0%, to \$309,000 for the three months ended September 30, 2001, from \$356,000 for the three months ended September 30, 2000. The decrease in interest income on mortgage-backed securities resulted generally from a reduction in the average balance on mortgage-backed securities of \$1.7 million and the decrease in the average yield on mortgage-backed securities to 6.36% from 6.71%.

Interest income on investment securities, on a tax equivalent basis, decreased \$165,000, or 20.9%, for the three months ended September 30, 2001 to \$623,000 from \$788,000 for the same period in 2000. The decrease resulted from a reduction in the average balance on investment securities, on a tax equivalent basis of \$6.1 million, combined with a decrease in the average tax equivalent yield of investment securities to 6.42% from 7.01%. The decrease in the average balance resulted from the proceeds from calls and maturities of investment securities primarily being utilized to fund the Company's loan growth.

Interest income on interest-earning deposits increased \$26,000, to \$32,000 from \$6,000 for the three months ended September 30, 2001 and 2000, respectively. The increase is primarily the result of a \$3.2 million increase in the average balance of interest earning deposits.

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Nine Month Period

Interest income, on a tax equivalent basis, totaled \$12.4 million for the nine months ended September 30, 2001, as compared to \$11.9 million for the same period in 2000, an increase of \$523,000, or 4.4%. The increase resulted primarily from an increase in the average balance of interest-earning assets of \$12.6 million, or 6.2%, partially offset by a decrease in the tax-equivalent yield on interest-earning assets to 7.63% from 7.76%.

For the nine months ended September 30, 2001 and 2000, interest income on loans receivable increased \$871,000, or 10.3%. Average loans receivable increased \$16.6 million while the yield on average loans receivable decreased to 8.15% from 8.30%. The increase in the average balance of loans receivable is comprised of originations of one-to-four family adjustable rate and fixed rate mortgage loans. The origination of adjustable rate mortgage loans is primarily comprised of "5/1 ARMS" which have interest rates which are fixed for the first five years and are adjustable annually thereafter, and generally amortize over 30 years. The Company also experienced an increase in the origination of commercial real estate and business loans. The decrease in the yield on average loans receivable was attributable to the lower rates charged on residential loans. In addition, the 300 basis point decline in the Company's prime rate has affected the yield on prime-based commercial lending.

For the nine months ended September 30, 2001 and 2000, interest income on mortgage-backed securities was \$1.0 million and \$1.1 million, respectively, a decrease of \$120,000, or 10.7%. The decrease in the average balance of mortgage backed securities reflects the scheduled amortization and prepayments of principle on the underlying mortgage loans. The principle reductions have been

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utilized to fund existing loan demand, rather than being reinvested into the mortgage-backed security portfolio.

For the nine months ended September 30, 2001, tax equivalent interest income on investment securities decreased \$270,000, or 12.1%, to \$2.0 million compared to \$2.2 million for the same period in 2000. The decrease resulted primarily from a decrease in the average balance of investment securities of \$4.4 million, combined with a decrease in the tax equivalent yield on investment securities to 6.50% from 6.66%.

For the nine months ended September 30, 2001, interest income on interest-earning deposits increased \$50,000. This increase is principally the result of a \$2.0 million increase in the average balance of interest-earning deposits, partially offset by a decrease in the average yield on interest earning deposits to 3.48% from 5.16%.

Interest Expense

Three Month Period

Interest expense for the quarter ended September 30, 2001 decreased by approximately \$112,000, or 5.1%, to \$2.1 million from \$2.2 million when compared to the same quarter for 2000. The decrease in interest expense for the period was principally the result of a decrease in the average balance of borrowed funds of \$1.2 million, or 2.7%, to \$43.3 million for the three months ended September 30, 2001, from \$44.6 million for the three months ended September 30, 2000, a decrease in the average cost of borrowed funds to 5.10% from 6.33%, and a decrease in the average cost of interest bearing deposits to 3.91% from 4.08% for the same period. These decreases were partially offset by an increase of \$10.2 million in the average balance of interest bearing deposits.

Nine Month Period

For the nine months ended September 30, 2001, interest expense increased \$427,000, or 6.9%, when compared to the first nine months of 2000. The increase in interest expense for the period was the result of an increase in the average balance of interest bearing liabilities of \$11.1 million, combined with an increase in the average cost of interest bearing liabilities to 4.40% from 4.36%.

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Net Interest Income

Net interest income increased \$104,000, or 5.5%, to \$2.0 million, on a tax equivalent basis, for the three months ended September 30, 2001 when compared to the same period in the prior year.

For the nine months ended September 30, 2001, net interest income increased \$98,000, or 1.7%, when compared to the same period in 2000.

Net interest margin for the quarter ended September 30, 2001 increased slightly from 3.65% to 3.67% when compared to the same period in the prior year.

For the nine months ended September 30, 2001, net interest margin decreased from

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3.73% to 3.57%, when compared to the same period in the prior year. This is due to the decrease in the average yield on loans and investment securities, combined with a slight increase in the average cost of interest-bearing liabilities.

Provision for Loan Losses

The Company maintains an allowance for loan losses based upon a quarterly evaluation of known and inherent risks in the loan portfolio, which includes a review of the balances and composition of the loan portfolio as well as analyzing the level of delinquencies in each segment of the loan portfolio. Loan loss provisions are based upon management's estimate of the fair value of the collateral and the Company's actual loss experience, as well as standards applied by the FDIC. The Company established a provision for possible loan losses for the three months ended September 30, 2001 of \$39,000, as compared to a provision of \$50,000 for the three months ended September 30, 2000. For the nine months ended September 30, 2001 and 2000, the provision for loan losses was \$579,000 and \$193,000, respectively. The increase in the provision for loan losses for the year is principally the result of increased loan charge offs, implementation of a more comprehensive loan review process and management's desire to increase coverage ratios due to the slowing economy. The Company's ratios of allowance for loan losses to total loans receivable and to non-performing loans at September 30, 2001 were .99% and 74.21%, respectively, as compared to .86% and 69.68% at September 30, 2000.

Noninterest Income

Noninterest income consists of servicing income on deposit accounts, loan fee income, cash surrender value from bank owned life insurance, gain (loss) on sales of loans and investment securities and other operating income.

Noninterest income increased approximately \$48,000, to \$336,000 for the three months ended September 30, 2001 as compared to \$288,000 for the prior year quarter. The increase in noninterest income is attributable to a \$22,000 increase in commission and fees, a \$21,000 increase in loan servicing fees, partially offset by realized securities losses of \$38,000.

For the nine months ended September 30, 2001, noninterest income increased \$841,000 to \$1.4 million from \$606,000 to the same period in 2000. Noninterest income, exclusive of securities gains and losses, increased \$179,000, or 21.9%, for the nine months ended September 30, 2001 as compared to the same period in the prior year. This was primarily due to an increase in service charges on deposit accounts, loan servicing fees and other fee income. Net securities gains (losses) increased \$663,000, to a net gain of \$453,000 for the period ending September 30, 2001, as compared to a loss of \$209,000 in the prior year.

Noninterest Expense

Noninterest expense remained consistent at \$1.7 million for the three months ended September 30, 2001, as compared to the same period in 2000. Within noninterest expense, increases in salaries and employee benefits of

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\$35,000 and professional and other services of \$34,000 were offset by decreases

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in data processing expenses of \$66,000 and other expenses of \$28,000, as compared to the prior period.

For the nine months ended September 30, 2001, noninterest expense decreased \$860,000, or 14.4%, to \$5.1 million as compared to \$6.0 million for the same period in 2000. Noninterest expenses for the first quarter of 2000 were adversely impacted by unusual items and non-recurring charges of approximately \$789,000. Exclusive of the unusual and non-recurring charges, noninterest expenses decreased \$342,000, or 6.2%, for the nine months ended September 30, 2001 from \$5.5 million in the prior year.

Income Taxes

Income taxes increased approximately \$21,000, or 18.5%, for the quarter ended September 30, 2001 as compared to the same period in the prior year. The increase is primarily a result of an increase in pretax income for the third quarter of 2001.

For the nine months ended September 30, 2001 and 2000, income tax expense was \$391,000 and \$90,000, respectively.

Other Matters

In June 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets" effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill will no longer be amortized, but will be subject to annual impairment tests in accordance with the statements. Other intangible assets will continue to be amortized over their useful lives. The Company will apply the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of 2002. Application of the non-amortization provisions of the statement is expected to increase pre-tax income by approximately \$316,000 on the Company's annual financial statements. The Company will perform the first of the required impairment tests of goodwill as of January 1, 2002 and has not determined what the effect of these tests will be on the earnings and financial position of the Company.

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Item 3 - Quantitative and Qualitative Disclosure about Market Risk

The Company's most significant form of market risk is interest rate risk, as the majority of the Company's assets and liabilities are sensitive to changes in interest rates. The Company's mortgage loan portfolio, consisting primarily of loans on residential real property located in Oswego County, is subject to risks associated with the local economy. The Company's interest rate risk management program focuses primarily on evaluating and managing the composition of the Company's assets and liabilities in the context of various interest rate scenarios. Factors beyond management's control, such as market interest rates and competition, also have an impact on interest income and interest expense.

The extent to which such assets and liabilities are "interest rate sensitive" can be measured by an institution's interest rate sensitivity "gap". An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets

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maturing or repricing within a specific time period and that amount of interest-bearing liabilities maturing or repricing within that time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. During a period of rising interest rates, a negative gap would tend to adversely affect net interest income while a positive gap would tend to positively affect net interest income. Conversely, during a period of falling interest rates, a negative gap would tend to positively affect net interest income while a positive gap would tend to adversely affect net interest income.

The Company does not generally maintain in its portfolio fixed interest rate loans with terms exceeding 20 years. In addition, ARM loans are originated with terms that provide that the interest rate on such loans cannot adjust below the initial rate. Generally, the Company tends to fund longer-term loans and mortgage-backed securities with shorter-term time deposits, repurchase agreements, and advances. The impact of this asset/liability mix creates an inherent risk to earnings in a rising interest rate environment. In a rising interest rate environment, the Company's cost of shorter-term deposits may rise faster than its earnings on longer-term loans and investments. Additionally, the prepayment of principal on real estate loans and mortgage-backed securities tends to decrease as rates rise, providing less available funds to invest in the higher rate environment. Conversely, as interest rates decrease, the prepayment of principal on real-estate loans and mortgage-backed securities tends to increase, causing the Company to invest funds in a lower rate environment. The potential impact on earnings from this mismatch is mitigated to a large extent by the size and stability of the Company's savings accounts. Savings accounts have traditionally provided a source of relatively low cost funding that have demonstrated historically a low sensitivity to interest rate changes. The Company generally matches a percentage of these, which are deemed core, against longer-term loans and investments. In addition, the Company has sought to extend the terms of its time deposits. In this regard, the Company has, on occasion, offered certificates of deposits 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 certificate of deposit to the then prevailing rate for a certificate of deposit with the same term. The Company has further sought to reduce the term of a portion of its rate sensitive assets by originating one year ARM loans, five year/one year ARM loans (mortgage loans which are fixed rate for the first five years and adjustable annually thereafter), and by maintaining a relatively short term investment securities (original maturities of three to five years) portfolio with staggered maturities.

The Company manages its interest rate sensitivity by monitoring (through simulation and net present value techniques) the impact on its GAP position, net interest income, and net portfolio value to changes in interest rates on its current and forecast mix of assets and liabilities. The Company has an Asset-Liability Management Committee which is responsible for 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. The Committee meets monthly on a formal basis and reports to the Board of Directors on interest rate risks and trends, as well as liquidity and capital ratios and requirements. The Company does not have a targeted gap range; rather the Board of Directors has set parameters of percentage change by which net interest margin and the net portfolio value are affected by

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changing interest rates. The Board and management deem these measures to be a more significant and realistic means of measuring interest rate risk.

Gap Analysis. At September 30, 2001, the total interest bearing liabilities maturing or repricing within one year exceeded total interest-earning assets maturing or repricing in the same period by \$23.0 million, representing a cumulative one-year gap ratio of a negative 9.70%.

Changes in Net Interest Income and Net Portfolio Value. 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. Net portfolio value (also referred to as market value of portfolio equity) represents the fair value of net assets (determined as the market value of assets minus the market value of liabilities). Market value is derived by using the present value of the discounted cash flows of the financial instruments. The table quantifies the changes in net interest income and net portfolio value to parallel shifts in the yield curve. The column "Net Interest Income Percent Change" measures the change to the next twelve months' projected net interest income, due to parallel shifts in the yield curve. The column "Net Portfolio Value Percent Change" measures changes in the current net mark-to-market value of assets and liabilities due to parallel shifts in the yield curve. The base case assumes September 30, 2001 interest rates. 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 current interest rate risk exposure is within those guidelines set forth.

Change in Interest Rates

Increase (Decrease) Basis Points (Rate Shock)	Net Interest Income Percentage Change	Net Portfolio Value Percentage Change
-----	-----	-----
300	-11.45%	-22.30%
200	- 7.32%	-14.58%
100	- 3.42%	- 6.86%
Base Case		
-100	1.57%	2.56%
-200	0.37%	-0.96%
-300	-1.15%	-3.78%

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Part II - Other Information

Legal Proceedings

From time to time, the Company is involved as a plaintiff or defendant in various legal actions incident to its business. None of these actions individually or in the aggregate is believed to be material to the financial condition of the Company

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Changes in Securities

Not applicable

Defaults upon Senior Securities

Not applicable

Submission of Matter to a Vote of Security Holders

Not applicable

Other Information

On September 18, 2001 the Board of Directors declared a \$.07 cash dividend to shareholders of record as of September 30, 2001, payable on October 15, 2001.

Exhibits and Reports on Form 8-K

None

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SIGNATUARES

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

PATHFINDER BANCORP, INC.

Date: November 13, 2001

/s/ Thomas W. Schneider

Thomas W. Schneider
President, Chief Executive
Officer

Date: November 13, 2001

/s/ James A. Dowd

James A. Dowd
Vice President, Chief Financial

Officer

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