PATHFINDER BANCORP INC
Form 10-K
March 31, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

[X]ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2003
OR
[ ]TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transaction 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)

Securities Registered Pursuant to Section 12(b) of the Act:

NONE

Securities Registered Pursuant to Section 12(g) of the Act:

COMMON STOCK, PAR VALUE $.01 PER SHARE
(Title of Class)

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 reports) and (2) has been subject to such requirements for the past 90 days.
YES X NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. [ ]

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).
YES NO X

As of June 30, 2003 there were 2,916,919 shares issued and 2,431,632 shares outstanding of the Registrant's Common Stock. The aggregate value of the voting stock held by non-affiliates of the Registrant, computed by reference to the average bid and asked prices of the Common Stock as of June 30, 2003 ($14.20) was $8,130,892.

DOCUMENTS INCORPORATED BY REFERENCE

1. Sections of Annual Report to Stockholders for the fiscal year ended December 31, 2003 (Parts II and IV).
2. Proxy Statement for the 2003 Annual Meeting of Stockholders (Parts I and III).

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PART I

ITEM 1. BUSINESS

GENERAL

PATHFINDER BANCORP, INC.

Pathfinder Bancorp, Inc. (the "Company") is a Federal corporation. On July 19, 2001, the Company completed its conversion from a Delaware chartered company to a federal charter. As a result of the charter conversion the Company's chartering authority and primary federal regulator is the Office of Thrift Supervision. References to the Company include the Company before or after the charter conversion. Upon completion of the charter conversion, the outstanding shares of common stock, par value $0.10 per share of Pathfinder Bancorp, Inc. become, by operation of law, common stock, par value $0.01 per share of the Company on a one-for-one basis. The primary business of the Company is its investment in Pathfinder Bank (the "Bank") and Pathfinder Statutory Trust I. The Company is majority owned by Pathfinder Bancorp, M.H.C., a Federally-chartered mutual holding company (the "Mutual Holding Company"). At December 31, 2003 the Mutual Holding Company held 1,583,239 shares of Common Stock and the public held 848,860 shares of Common Stock (the "Minority Shareholders"). At December 31, 2003, Pathfinder Bancorp, Inc. had total assets of $277.9 million, total deposits of $206.9 million and shareholders' equity of $21.8 million.

On June 26, 2002, the Company formed a wholly owned subsidiary, Pathfinder Statutory Trust I, a Connecticut business trust. The trust issued $5,000,000 of 30-year floating rate Company-obligated pooled capital securities of Pathfinder Statutory Trust I. The Company borrowed the proceeds of the capital securities from its subsidiary by issuing floating rate junior subordinated deferrable interest debentures having substantially similar terms. The capital securities mature in 2032 and qualify as Tier 1 capital by the Federal Deposit Insurance Company and the Office of Thrift Supervision. The capital securities of the trust are a pooled trust preferred fund of Preferred Term Securities VI, Ltd. and are tied to the 3 month LIBOR plus 3.45% with a five year call provision. These securities are guaranteed by the Company.

The Company's executive office is located at 214 West First Street, Oswego, New York and the telephone number at that address is (315) 343-0057.

PATHFINDER BANK

The Bank is a New York-chartered savings bank headquartered in Oswego, New York. The Bank has six full-service offices located in its market area consisting of Oswego County and the contiguous counties. The Bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"). The Bank was chartered as a New York savings bank in 1859 as Oswego City Savings Bank. The Bank is a consumer-oriented institution dedicated to providing mortgage loans and other traditional financial services to its customers. The Bank is committed to meeting the financial needs of its customers in Oswego County, New York, the county in which it operates. At December 31, 2003, the Bank had total assets of $277.5 million, total deposits of $208.4 million, and shareholders' equity of $24.9 million.

On October 25, 2002, Pathfinder Bank completed the purchase of assets and the assumption of non-municipal deposits of the Lacona, New York branch of Cayuga Bank (the "Branch Acquisition"). In addition, Pathfinder Bank formed a limited purpose commercial bank subsidiary, Pathfinder Commercial Bank. Pathfinder Commercial Bank was established to serve the depository needs of public entities in its market area and it assumed the municipal deposit liabilities acquired as part of the Branch Acquisition. The transaction included approximately $26.4 million in deposits, $2.3 million in loans and $430,000 in vault cash and facilities and equipment. The acquisition reflects a premium on deposit liabilities assumed of approximately $2.4 million. As of December 31, 2003, no impairment has been recognized.

The Bank is primarily engaged in the business of attracting deposits from the general public in the Bank's market area, and investing such deposits, together with other sources of funds, in loans secured by one- to four-family residential real estate. At December 31, 2003, $173.2 million, or 90% of the Bank's total loan portfolio consisted of loans secured by real estate, of which $129.0 million, or 67%, were loans secured by one- to four-family residences and $31.3 million, or 16%, were secured by commercial real estate. Additionally, $12.9 million, or 7%, of total real estate loans, were secured by second liens on residential properties that are classified in consumer loans. The Bank also originates commercial and consumer loans that totaled $15.1 and $3.9 million, respectively, or 10%, of the Bank's total loan portfolio. The Bank invests a portion of its assets in securities issued by the United States Government, state and municipal obligations, corporate debt securities, mutual funds, and equity securities. The Bank also invests in mortgage-backed securities

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primarily issued or guaranteed by the United States Government or agencies thereof. The Bank's principal sources of funds are deposits, principal and interest payments on loans and borrowings from correspondent financial institutions. The principal source of income is interest on loans and investment securities. The Bank's principal expenses are interest paid on deposits, and employee compensation and benefits.

The Bank's executive office is located at 214 West First Street, Oswego, New York, and its telephone number at that address is (315) 343-0057.

In April 1999, the Bank established Pathfinder REIT, Inc. as the Bank's wholly-owned real estate investment trust subsidiary. At December 31, 2003, Pathfinder REIT, Inc. held $26.7 million in mortgage and mortgage related assets. All disclosures in the Form 10-K relating to the Bank's loans and investments include loan and investments that are held by Pathfinder REIT, Inc.

MARKET AREA AND COMPETITION

The economy in the Bank's market area is manufacturing-oriented and is also significantly dependent upon the State University of New York College at Oswego. The major manufacturing employers in the Bank's market area are National Grid, Alcan, Constellation, NRG and Huhtamaki. The Bank is the second largest financial institution headquartered in Oswego County. However, the Bank encounters competition from a variety of sources. The Bank's business and operating results are significantly affected by the general economic conditions prevalent in its market areas.

The Bank encounters strong competition both in attracting deposits and in originating real estate and other loans. Its most direct competition for deposits has historically come from commercial and savings banks, savings associations and credit unions in its market area. Competition for loans comes from such financial institutions as well as mortgage banking companies. The Bank expects continued strong competition in the foreseeable future, including increased competition from "super-regional" banks entering the market by purchasing large banks and savings banks. Many such institutions have greater financial and marketing resources available to them than does the Bank. The Bank competes for savings deposits by offering depositors a high level of personal service and a wide range of competitively priced financial services. The Bank competes for real estate loans primarily through the interest rates and loan fees it charges and advertising, as well as by originating and holding in its portfolio mortgage loans which do not necessarily conform to secondary market underwriting standards.

REGULATION AND SUPERVISION

REGULATION

GENERAL. The Bank is a New York-chartered stock savings bank and its deposit accounts are insured up to applicable limits by the FDIC through the Bank Insurance Fund. The Bank is subject to extensive regulation by the Department, as its chartering agency, and by the FDIC, as its deposit insurer and primary federal regulator. The Bank is required to file reports with, and is periodically examined by, the FDIC and the Superintendent concerning its activities and financial condition and must obtain regulatory approvals prior to entering into certain transactions, including, but not limited to, mergers with or acquisitions of other banking institutions. The Bank is a member of the FHLB of New York and is subject to certain regulations by the Federal Home Loan Bank System. On July 19, 2001 the Company and the Mutual Holding Company completed their conversion to federal charters. Consequently, they are subject to regulations of the Office of Thrift Supervision ("OTS") as savings and loan holding companies. Any change in such regulations, whether by the Department, the FDIC, or the OTS could have a material adverse impact on the Bank, the Company or the Mutual Holding Company.

Regulatory requirements applicable to the Bank, the Company and the Mutual Holding Company are referred to below or elsewhere herein.

NEW YORK BANK REGULATION. The exercise by an FDIC-insured savings bank of the lending and investment powers under the New York State Banking Law is limited by FDIC regulations and other federal law and regulations. In particular, the applicable provisions of New York State Banking Law and regulations governing the investment authority and activities of an FDIC insured state-chartered savings bank have been substantially limited by the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") and the FDIC regulations issued pursuant thereto.

The Bank derives its lending, investment and other authority primarily from the applicable provisions of New York State Banking Law and the regulations of the Department, as limited by FDIC regulations. Under these laws and regulations, savings banks, including the Bank, may invest in real estate mortgages, consumer and commercial loans, certain types of debt securities, including certain corporate debt securities and obligations of federal, state and local governments and agencies, certain types of corporate equity securities and certain other assets. Under the statutory authority for investing in equity securities, a savings bank may invest up to 7.5% of its assets in corporate stock, with an overall limit of 5% of its assets invested in common stock. Investment in the stock of a single corporation is limited to the lesser of 2% of the outstanding stock of such corporation or 1% of the savings bank's assets, except as set forth below. Such equity securities must meet certain earnings ratios and other tests of financial performance. A savings bank's lending powers are not subject to percentage of assets limitations, although there are limits applicable to single borrowers. A savings bank may also, pursuant to the "leeway" power, make investments not otherwise permitted under the New York State Banking Law. This power permits investments in otherwise impermissible investments of up to 1% of assets in any single investment, subject to certain restrictions and to an aggregate limit for all such investments of up to 5% of assets. Additionally, in lieu of investing in such securities in accordance with and reliance upon the specific investment authority set forth in the New York State Banking Law, savings banks are authorized to elect to invest under a "prudent person" standard in a wider range of investment securities as compared to the types of investments permissible under such specific investment authority. However, in the event a savings bank elects to utilize the "prudent person" standard, it will be unable to avail itself of the other provisions of the New York State Banking Law and regulations which set forth specific investment authority. The Bank has not elected to conduct its investment activities under the "prudent person" standard. A savings bank may also exercise trust powers upon approval of the Department.

New York State chartered savings banks may also invest in subsidiaries under their service corporation investment authority. A savings bank may use this power to invest in corporations that engage in various activities authorized for savings banks, plus any additional activities which may be authorized by the Banking Board. Investment by a savings bank in the stock, capital notes and debentures of its service corporations is limited to 3% of the bank's assets, and such investments, together with the bank's loans to its service corporations, may not exceed 10% of the savings bank's assets. Furthermore, New York banking regulations impose requirements on loans which a bank may make to its executive officers and directors and to certain corporations or partnerships in which such persons have equity interests. These requirements include, but are not limited to, requirements that (i) certain loans must be approved in advance by a majority of the entire board of trustees and the interested party must abstain from participating directly or indirectly in the voting on such loan, (ii) the loan must be on terms that are not more favorable than those offered to unaffiliated third parties, and (iii) the loan must not involve more than a normal risk of repayment or present other unfavorable features.

Under the New York State Banking Law, the Superintendent may issue an order to a New York State chartered banking institution to appear and explain an apparent violation of law, to discontinue unauthorized or unsafe practices and to keep prescribed books and accounts. Upon a finding by the Department that any director, trustee or officer of any banking organization has violated any law, or has continued unauthorized or unsafe practices in conducting the business of the banking organization after having been notified by the

Superintendent to discontinue such practices, such director, trustee or officer may be removed from office after notice and an opportunity to be heard.

INSURANCE OF ACCOUNTS AND REGULATION BY THE FDIC. The Bank is a member of the BIF, which is administered by the FDIC. Deposits are insured up to applicable limits by the FDIC and such insurance is backed by the full faith and credit of the U.S. Government. As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of and to require reporting by FDIC-insured institutions. It also may prohibit any FDIC-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious risk to the FDIC. The FDIC also has the authority to initiate enforcement actions against savings banks, after giving the Superintendent an opportunity to take such action, and may terminate the deposit insurance if it determines that the institution has engaged or is engaging in unsafe or unsound practices or is in an unsafe or unsound condition.

The FDIC establishes deposit insurance premiums based upon the risks a particular bank or savings association poses to its deposit insurance funds. Under the risk-based deposit insurance assessment system, the FDIC assigns an institution to one of three capital categories based on the institution's financial information, as of the reporting period ending six months before the assessment period, consisting of: (i) well capitalized; (ii) adequately capitalized; or (iii) undercapitalized and one of three supervisory subcategories within each capital group. With respect to the capital ratios, institutions are classified as well capitalized or adequately capitalized using ratios that are substantially similar to the prompt corrective action capital ratios discussed above. Any institution that does not meet these two definitions is deemed to be undercapitalized for this purpose. The supervisory

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subgroup to which an institution is assigned is based on a supervisory evaluation provided to the FDIC by the institution's primary federal regulator and information that the FDIC determines to be relevant to the institution's financial condition and the risk posed to the deposit insurance funds (which may include, if applicable, information provided by the institution's state supervisor). An institution's assessment rate depends on the capital category and supervisory category to which it is assigned. Under the final risk-based assessment system, there are nine assessment risk classifications (i.e., combinations of capital groups and supervisory subgroups) to which different assessment rates are applied. Assessments rates for deposit insurance currently range from 0 basis points to 27 basis points. The capital and supervisory subgroup to which an institution is assigned by the FDIC is confidential and may not be disclosed. The Bank's rate of deposit insurance assessments will depend upon the category and subcategory to which the Bank is assigned by the FDIC. Any increase in insurance assessments could have an adverse effect on the earnings of the Bank.

REGULATORY CAPITAL REQUIREMENTS. The FDIC has adopted risk-based capital guidelines to which the Bank is subject. The guidelines establish a systematic analytical framework that makes regulatory capital requirements more sensitive to differences in risk profiles among banking organizations. The Bank is required to maintain certain levels of regulatory capital in relation to regulatory risk-weighted assets. The ratio of such regulatory capital to regulatory risk-weighted assets is referred to as the Bank's "risk-based capital ratio." Risk-based capital ratios are determined by allocating assets and specified off-balance sheet items to four risk-weighted categories ranging from 0% to 100%, with higher levels of capital being required for the categories perceived as representing greater risk.

These guidelines divide a savings bank's capital into two tiers. The first tier ("Tier I") includes common equity, retained earnings, certain non-cumulative perpetual preferred stock (excluding auction rate issues) and minority interests in equity accounts of consolidated subsidiaries, less goodwill and other intangible assets (except mortgage servicing rights and purchased credit card relationships subject to certain limitations). Supplementary ("Tier II") capital includes, among other items, cumulative perpetual and long-term limited-life preferred stock, mandatory convertible securities, certain hybrid capital instruments, term subordinated debt and the allowance for loan and lease losses, subject to certain limitations, less required deductions. Savings banks are required to maintain a total risk-based capital ratio of at least 8%, of which at least 4% must be Tier I capital.

In addition, the FDIC has established regulations prescribing a minimum Tier I leverage ratio (Tier I capital to adjusted total assets as specified in the regulations). These regulations provide for a minimum Tier I leverage ratio of 3% for banks that meet certain specified criteria, including that they have the highest examination rating and are not experiencing or anticipating significant growth. All other banks are required to maintain a Tier I leverage ratio of 3% plus an additional cushion of at least 100 to 200 basis points. The FDIC and the other federal banking regulators have proposed amendments to their minimum capital regulations to provide that the minimum leverage capital ratio for a depository institution that has been assigned the highest composite rating of 1 under the Uniform Financial Institutions Rating System will be 3% and that the minimum leverage capital ratio for any other depository institution will be 4% unless a higher leverage capital ratio is warranted by the particular circumstances or risk profile of the depository institution. The FDIC may, however, set higher leverage and risk-based capital requirements on individual institutions when particular circumstances warrant. Savings banks experiencing or anticipating significant growth are expected to maintain capital ratios, including tangible capital positions, well above the minimum levels.

LIMITATIONS ON DIVIDENDS AND OTHER CAPITAL DISTRIBUTIONS. The FDIC has the authority to use its enforcement powers to prohibit a savings bank from paying dividends if, in its opinion, the payment of dividends would constitute an unsafe or unsound practice. Federal law also prohibits the payment of dividends by a bank that will result in the bank failing to meet its applicable capital requirements on a pro forma basis. New York law also restricts the Bank from declaring a dividend which would reduce its capital below (i) the amount required to be maintained by state law and regulation, or (ii) the amount of the Bank's liquidation account established in connection with the Reorganization.

PROMPT CORRECTIVE ACTION. The federal banking agencies have promulgated regulations to implement the system of prompt corrective action required by federal law. Under the regulations, a bank shall be deemed to be (i) "well capitalized" if it has total risk-based capital of 10.0% or more, has a Tier I risk-based capital ratio of 6.0% or more, has a Tier I leverage capital ratio of 5.0% or more and is not subject to any written capital order or directive; (ii) "adequately capitalized" if it has a total risk-based capital ratio of 8.0% or more, a Tier I risk-based capital ratio of 4.0% or more and a Tier I leverage capital ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of "well capitalized"; (iii) "undercapitalized" if it has a total risk-based capital ratio that is lessthan 8.0%, a Tier I risk-based capital ratio that is less than 4.0% or a Tier I leverage capital ratio that is less than 4.0% (3.0% under certain circumstances); (iv) "significantly undercapitalized" if it has a total risk-based capital ratio that is less than 6.0%, a Tier I risk-based capital ratio that is less than 3.0% or a Tier I leverage capital ratio that is less than 3.0%; and (v) "critically

undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. Federal law and regulations also specify circumstances under which a federal banking agency may reclassify a well capitalized institution as adequately capitalized and may require an adequately capitalized institution to comply with supervisory actions as if it were in the next lower category (except that the FDIC may not reclassify a significantly undercapitalized institution as critically undercapitalized).

Based on the foregoing, the Bank is currently classified as a "well capitalized" savings institution.

TRANSACTIONS WITH AFFILIATES. Under current federal law, transactions between depository institutions and their affiliates are governed by Sections 23A and 23B of the Federal Reserve Act and its implementing regulations. An affiliate of a savings bank is any company or entity that controls, is controlled by, or is under common control with the savings bank, other than a subsidiary of the savings bank. In a holding company context, at a minimum, the parent holding company of a savings bank and any companies which are controlled by such parent holding company are affiliates of the savings bank. Generally, Section 23A limits the extent to which the savings bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10% of such savings bank's capital stock and surplus and contains an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus. The term "covered transaction" includes the making of loans or other extensions of credit to an affiliate; the purchase of assets from an affiliate, the purchase of, or an investment in, the securities of an affiliate; the acceptance of securities of an affiliate as collateral for a loan or extension of credit to any person; or issuance of a guarantee, acceptance, or letter of credit on behalf of an affiliate. Section 23A also establishes specific collateral requirements for loans or extensions of credit to, or guarantees, acceptances on letters of credit issued on behalf of an affiliate. Section 23B requires that covered transactions and a broad list of other specified transactions be on terms substantially the same, or no less favorable, to the savings bank or its subsidiary as similar transactions with nonaffiliates.

Further, Section 22(h) of the Federal Reserve Act and its implementing regulations restrict a savings bank with respect to loans to directors, executive officers, and principal stockholders. Under Section 22(h), loans to directors, executive officers and stockholders who control, directly or indirectly, 10% or more of voting securities of a savings bank and certain related interests of any of the foregoing, may not exceed, together with all other outstanding loans to such persons and affiliated entities, the savings bank's total capital and surplus. Section 22(h) also prohibits loans above amounts prescribed by the appropriate federal banking agency to directors, executive officers, and stockholders who control 10% or more of voting securities of a stock savings bank, and their respective related interests, unless such loan is approved in advance by a majority of the board of directors of the savings bank. Any "interested" director may not participate in the voting. The loan amount (which includes all other outstanding loans to such person) as to which such prior board of director approval is required, is the greater of $25,000 or 5% of capital and surplus or any loans over $500,000. Further, pursuant to Section 22(h), loans to directors, executive officers and principal stockholders must generally be made on terms substantially the same as offered in comparable transactions to other persons. Section 22(g) of the Federal Reserve Act places additional limitations on loans to executive officers.

FEDERAL HOLDING COMPANY REGULATION.

GENERAL. The Company and the Mutual Holding Company are nondiversified mutual savings and loan holding companies within the meaning of the Home Owners' Loan Act. As such, the Company and the Mutual Holding Company are registered with the OTS and are subject to OTS regulations, examinations, supervision and reporting requirements. In addition, the OTS has enforcement authority over the

Company and the Mutual Holding Company, and their subsidiaries. Among other things, this authority permits the OTS to restrict or prohibit activities that are determined to be a serious risk to the subsidiary savings institution.

PERMITTED ACTIVITIES. Under OTS regulation and policy, a mutual holding company and a federally chartered mid-tier holding company such as the Company may engage in the following activities: (i) investing in the stock of a savings association; (ii) acquiring a mutual association through the merger of such association into a savings association subsidiary of such holding company or an interim savings association subsidiary of such holding company; (iii) merging with or acquiring another holding company, one of whose subsidiaries is a savings association; (iv) investing in a corporation, the capital stock of which is available for purchase by a savings association under federal law or under the law of any state where the subsidiary savings association or associations share their home offices; (v) furnishing or performing management services for a savings association subsidiary of such company; (vi) holding, managing or liquidating assets owned or acquired from a savings subsidiary of such company; (vii) holding or managing properties used or occupied by a savings association subsidiary of such company; (viii) acting as trustee under deeds of trust; (ix) any other activity (A) that the Federal Reserve Board, by regulation, has determined to be permissible for bank holding companies under Section 4(c) of the Bank Holding Company Act of 1956, unless the Director, by regulation, prohibits or limits any such activity for savings and loan holding companies; or (B) in which multiple savings and loan holding companies were authorized (by regulation) to directly engage on March 5, 1987; (x) any activity permissible for financial holding companies under Section 4(k) of the Bank Holding Company Act, including securities and insurance underwriting; and (xi) purchasing, holding, or disposing of stock acquired in connection with a qualified stock issuance if the purchase of such stock by such savings and loan holding company is approved by the Director. If a mutual holding company acquires or merges with another holding company, the holding company acquired or the holding company resulting from such merger or acquisition may only invest in assets and engage in activities listed in (i) through (xi) above, and has a period of two years to cease any nonconforming activities and divest of any nonconforming investments.

The Home Owners' Loan Act prohibits a savings and loan holding company, directly or indirectly, or through one or more subsidiaries, from acquiring another savings association or holding company thereof, without prior written approval of the OTS. It also prohibits the acquisition or retention of, with certain exceptions, more than 5% of a nonsubsidiary savings association, a nonsubsidiary holding company, or a nonsubsidiary company engaged in activities other than those permitted by the Home Owners' Loan Act; or acquiring or retaining control of an institution that is not federally insured. In evaluating applications by holding companies to acquire savings association, the OTS must consider the financial and managerial resources, future prospects of the company and association involved, the effect of the acquisition on the risk to the insurance fund, the convenience and needs of the community and competitive factors.

The Office of Thrift Supervision is prohibited from approving any acquisition that would result in a multiple savings and loan holding company controlling savings association in more than one state, subject to two exceptions: (i) the approval of interstate supervisory acquisitions by savings and loan holding companies, and (ii) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

WAIVERS OF DIVIDENDS BY MUTUAL HOLDING COMPANY. Office of Thrift

Supervision regulations require the Mutual Holding Company to notify the OTS of any proposed waiver of its receipt of dividends from the Company. The OTS reviews dividend waiver notices on a case-by-case basis, and, in general, does not object to any such waiver if: (i) the mutual holding company's board of directors determines that such waiver is consistent with such directors' fiduciary duties to the mutual holding company's members; (ii) for as long as the savings association subsidiary is controlled by the mutual holding company, the dollar amount of dividends waived by the mutual holding company are considered as a restriction on the retained earnings of the savings association, which restriction, if material, is disclosed in the public financial statements of the savings association as a note to the financial statements; (iii) the amount of any dividend waived by the mutual holding company is available for declaration as a dividend solely to the mutual holding company, and, in accordance with SFAS 5, where the savings association determines that the payment of such dividend to the mutual holding company is probable, an appropriate dollar amount is recorded as a liability; and (iv) the amount of any waived dividend is considered as having been paid by the savings association in evaluating any proposed dividend under OTS capital distribution regulations. The Mutual Holding Company generally intends to waive dividends paid by the Company in excess of its operating cash requirements. Under OTS regulations, our public stockholders would not be diluted because of any dividends waived by the Mutual Holding Company (and waived dividends would not be considered in determining an appropriate exchange ratio) in the event the Mutual Holding Company converts to stock form.

CONVERSION OF THE MUTUAL HOLDING COMPANY TO STOCK FORM. OTS regulations permit the Mutual Holding Company to convert from the mutual form of organization to the capital stock form of organization (a "Conversion Transaction"). There can be no assurance when, if ever, a Conversion Transaction will occur, and the Board of Directors has no current intention or plan to undertake a Conversion Transaction. In a Conversion Transaction a new holding company would be formed as the successor to the Company (the "New

Holding Company"), the Mutual Holding Company's corporate existence would end, and certain depositors of the Bank would receive the right to subscribe for additional shares of the New Holding Company. In a Conversion Transaction, each share of common stock held by stockholders other than the Mutual Holding Company ("Minority Stockholders") would be automatically converted into a number of shares of common stock of the New Holding Company determined pursuant an exchange ratio that ensures that Minority Stockholders own the same percentage of common stock in the New Holding Company as they owned in the Company immediately prior to the Conversion Transaction. Under OTS regulations, Minority Stockholders would not be diluted because of any dividends waived by the Mutual Holding Company (and waived dividends would not be considered in determining an appropriate exchange ratio), in the event the Mutual Holding Company converts to stock form. The total number of shares held by Minority Stockholders after a Conversion Transaction also would be increased by any purchases by Minority Stockholders in the stock offering conducted as part of the Conversion Transaction.

NEW YORK STATE BANK HOLDING COMPANY REGULATION. In addition to the federal regulation, a holding company controlling a state chartered savings bank organized or doing business in New York State also may be subject to regulation under the New York State Banking Law. The term "bank holding company," for the purposes of the New York State Banking Law, is defined generally to include any person, company or trust that directly or indirectly either controls the election of a majority of the directors or owns, controls or holds with power to vote more than 10% of the voting stock of a bank holding company or, if the Company is a banking institution, another banking institution, or 10% or more of the voting stock of each of two or more banking institutions. In general, a bank holding company controlling, directly or indirectly, only one banking institution will not be deemed to be a bank holding company for the purposes of the New York State Banking Law. Under New York State Banking Law, the prior approval of the Banking Board is required before: (1) any action is taken that causes any company to become a bank holding company; (2) any action is taken that causes any banking institution to become or be merged or consolidated with a subsidiary of a bank holding company; (3) any bank holding company acquires direct or indirect ownership or control of more than 5% of the voting stock of a banking institution; (4) any bank holding company or subsidiary thereof acquires all or substantially all of the assets of a banking institution; or (5) any action is taken that causes any bank holding company to merge or consolidate with another bank holding company. Additionally, certain restrictions apply to New York State bank holding companies regarding the acquisition of banking institutions which have been chartered five years or less and are located in smaller communities. Officers, directors and employees of New York State bank holding companies are subject to limitations regarding their affiliation with securities underwriting or brokerage firms and other bank holding companies and limitations regarding loans obtained from its subsidiaries.

FEDERAL SECURITIES LAW. The common stock of the Company is registered with the SEC under the Exchange Act, prior to completion of the Offering and Reorganization. The Company is subject to the information, proxy solicitation, insider trading restrictions and other requirements of the SEC under the Exchange Act.

The Company Common Stock held by persons who are affiliates (generally officers, directors and principal stockholders) of the Company may not be resold without registration or unless sold in accordance with certain resale restrictions. If the Company meets specified current public information requirements, each affiliate of the Company is able to sell in the public market, without registration, a limited number of shares in any three-month period.

FEDERAL RESERVE SYSTEM. The Federal Reserve Board requires all depository institutions to maintain noninterest-bearing reserves at specified levels against their transaction accounts (primarily checking, money management and NOW checking accounts). At December 31, 2003, the Bank was in compliance with these reserve requirements.

FEDERAL REGULATION. Under the Community Reinvestment Act, as amended (the "CRA"), as implemented by FDIC regulations, a savings bank has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires the FDIC, in connection with its examination of a savings institution, to assess the institution's record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by such institution. The CRA requires the FDIC to provide a written evaluation of an institution's CRA performance utilizing a four-tiered descriptive rating system. The Bank's latest CRA rating was "outstanding."

NEW YORK STATE REGULATION. The Bank is also subject to provisions of the New York State Banking Law which impose continuing and affirmative obligations

upon banking institutions organized in New York State to serve the credit needs of its local community ("NYCRA") which are substantially similar to those imposed by the CRA. Pursuant to the NYCRA, a bank must file an annual NYCRA report and copies of all federal CRA reports with the Department. The NYCRA requires the Department to make a biennial written assessment of a bank's compliance with the NYCRA, utilizing a four-tiered rating system and make such assessment available to the public. The NYCRA also requires the Superintendent to consider a bank's NYCRA rating when reviewing a bank's application to engage in certain transactions, including mergers, asset purchases and the establishment of branch offices or automated teller machines, and provides that such assessment may serve as a basis for the denial of any such application.

The Bank's NYCRA rating as of its latest examination was "satisfactory."

THE USA PATRIOT ACT

In response to the events of September 11, 2001, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, or the USA PATRIOT Act, was signed into law on October 26, 2001. The USA PATRIOT Act gives the federal government new powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. Financial institutions, such as the Bank, have had a federal anti-money laundering obligations for years. As such, the Bank does not believe the USA Patriot Act will have a material impact on its operations.

SARBANES-OXLEY ACT OF 2002

On July 30, 2002, the President signed into law the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), which implemented legislative reforms intended to address corporate and accounting fraud. In addition to the establishment of a new accounting oversight board that will enforce auditing, quality control and independence standards and will be funded by fees from all publicly traded companies, Sarbanes-Oxley places certain restrictions on the scope of services that may be provided by accounting firms to their public company audit clients. Any non-audit services being provided to a public company audit client will require preapproval by the company's audit committee. In addition, Sarbanes-Oxley makes certain changes to the requirements for audit partner rotation after a period of time. Sarbanes-Oxley requires chief executive officers and chief financial officers, or their equivalent, to certify to the accuracy of periodic reports filed with the Securities and Exchange Commission, subject to civil and criminal penalties if they knowingly or willingly violate this certification requirement. The Company's Chief Executive Officer and Chief Financial Officer have signed certifications to this Form 10-K as required by Sarbanes-Oxley. In addition, under Sarbanes-Oxley, counsel will be required to report evidence of a material violation of the securities laws or a breach of fiduciary duty by a company to its chief executive officer or its chief legal officer, and, if such officer does not appropriately respond, to report such evidence to the audit committee or other similar committee of the board of directors or the board itself.

Under Sarbanes-Oxley, longer prison terms will apply to corporate executives who violate federal securities laws; the period during which certain types of suits can be brought against a company or its officers is extended; and bonuses issued to top executives prior to restatement of a company's financial statements are now subject to disgorgement if such restatement was due to corporate misconduct. Executives are also prohibited from trading the company's securities during retirement plan "blackout" periods, and loans to company executives (other than loans by financial institutions permitted by federal rules and regulations) are restricted. In addition, a provision directs that civil penalties levied by the Securities and Exchange Commission as a result of any judicial or administrative action under Sarbanes-Oxley be deposited to a fund for the benefit of harmed investors. The Federal Accounts for Investor Restitution provision also requires the Securities and Exchange Commission to develop methods of improving collection rates. The legislation accelerates the time frame for disclosures by public companies, as they must immediately disclose any material changes in their financial condition or operations. Directors and executive officers must also provide information for most changes in ownership in a company's securities within two business days of the change.

Sarbanes-Oxley also increases the oversight of, and codifies certain requirements relating to audit committees of public companies and how they interact with the company's "registered public accounting firm." Audit committee members must be independent and are absolutely barred from accepting consulting, advisory or other compensatory fees from the issuer. In addition, companies must disclose whether at least one member of the committee is a "financial expert" (as such term is defined by the Securities and Exchange Commission) and if not, why not. Under Sarbanes-Oxley, a company's registered public accounting firm is prohibited from performing statutorily mandated audit

services for a company if such company's chief executive officer, chief financial officer, comptroller, chief accounting officer or any person serving in equivalent positions had been employed by such firm and participated in the audit of such company during the one-year period preceding the audit initiation date. Sarbanes-Oxley also prohibits any officer or director of a company or any other person acting under their direction from taking any action to fraudulently influence, coerce, manipulate or mislead any independent accountant engaged in the audit of the company's financial statements for the purpose of rendering the financial statements materially misleading. Sarbanes-Oxley also requires the Securities and Exchange Commission to prescribe rules requiring inclusion of any internal control report and assessment by management in the annual report to shareholders. Sarbanes-Oxley requires the company's registered public accounting firm that issues the audit report to attest to and report on management's assessment of the company's internal controls.

Although we anticipate that we will incur additional expense in complying with the provisions of the Sarbanes-Oxley Act and the resulting regulations, management does not expect that such compliance will have a material impact on our results of operations or financial condition.

FEDERAL AND STATE TAXATION

FEDERAL TAXATION. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to the Company or the Bank.

BAD DEBT RESERVES. Prior to the 1996 Act, the Bank was permitted to establish a reserve for bad debts and to make annual additions to the reserve. These additions could, within specified formula limits, be deducted in arriving at the Bank's taxable income. As a result of the 1996 Act, the Bank must use the small bank experience method in computing its bad debt deduction beginning with its 1996 Federal tax return. In addition, the federal legislation requires the recapture (over a six year period) of the excess of tax bad debt reserves at December 31, 1995 over those established as of December 31, 1987.

TAXABLE DISTRIBUTIONS AND RECAPTURE. Prior to the 1996 Act, bad debt reserves created prior to January 1, 1988 were subject to recapture into taxable income should the Bank fail to meet certain thrift asset and definitionaltests. New federal legislation eliminated these thrift related recapture rules. However, under current law, pre-1988 reserves remain subject to recapture should the Bank cease to retain a bank or thrift charter or make certain non-dividend distributions.

MINIMUM TAX. The Code imposes an alternative minimum tax ("AMT") at a rate of 20% on a base of regular taxable income plus certain tax preferences ("alternative minimum taxable income" or "AMTI"). The AMT is payable to the extent such AMTI is in excess of an exemption amount. Net operating losses can offset no more than 90% of AMTI. Certain payments of alternative minimum tax may be used as credits against regular tax liabilities in future years.

NET OPERATING LOSS CARRYOVERS. A financial institution may carry back net operating losses to the preceding two taxable years and forward to the succeeding 20 taxable years. This provision applies to losses incurred in taxable years beginning after August 5, 1997.

The Internal Revenue Service has examined the federal income tax return for the fiscal year ended 1992; the New York State fiscal year-end tax returns for 1998 through 1999 are currently under examination by the New York State Department of Taxation and Finance. See Note 13 to the Financial Statements.

STATE TAXATION

NEW YORK TAXATION. The Bank is subject to the New York State Franchise Tax on Banking Corporations in an annual amount equal to the greater of (i) 8.0% of the Bank's "entire net income" allocable to New York State during the taxable year, or (ii) the applicable alternative minimum tax. The alternative minimum tax is generally the greater of (a) 0.01% of the value of the Bank's assets allocable to New York State with certain modifications, (b) 3% of the Bank's "alternative entire net income" allocable to New York State, or (c) $250. Entire net income is similar to federal taxable income, subject to certain modifications and alternative entire net income is equal to entire net income without certain modifications. Net operating losses arising in can be carried forward to the succeeding 20 taxable years.

The availability of the Company's Annual Report on Form 10-K may be accessed on the Company's website at WWW.PATHFINDERBANK.COM.

ITEM 2. PROPERTIES

The Bank conducts its business through its main office located in Oswego, New York, and five full service branch offices located in Oswego County. The following table sets forth certain information concerning the main office and each branch office of the Bank at December 31, 2003. The aggregate net book value of the Bank's premises and equipment was $6.7 million at December 31, 2003. For additional information regarding the Bank's properties, see Note 8 to Notes to Financial Statements.

LOCATION	OPENING DATE	OWNED/LEASED	ANNUAL RENT
Main Office	1874	Owned	-
214 West First Street			
Oswego, New York 13126			
Plaza Branch.	1989	Owned (1)	-

Route 104, Ames Plaza Oswego, New York 13126			
Mexico Branch	1978	Owned	-
Norman & Main Streets Mexico, New York 13114			
Oswego East Branch. . . .	1994	Owned	-
34 East Bridge Street Oswego, New York 13126			
Fulton Branch	1994	Owned (2)	-
114 Oneida Street Fulton, New York 13069			
Lacona Branch	2002	Owned	-
1897 Harwood Drive Lacona, New York 13083			
Fulton Branch	2003	Owned (3)	-
5 West First Street South Fulton, New York 13069			

(1) The building is owned; the underlying land is leased paying an annual rent of $20,000
(2) This branch closed in July of 2003 and the branch was relocated to the 5 West First Street South location in Fulton
(3) The existing Fulton Branch was moved to this location in July of 2003. The building is owned; the underlying land is leased paying an annual rent of $21,000

ITEM 3. LEGAL PROCEEDINGS

There are various claims and lawsuits to which the Company is periodically involved incident to the Company's business. In the opinion of management such claims and lawsuits in the aggregate are immaterial to the Company's consolidated financial condition and results of operations.

PART II

ITEM 5. MARKET FOR COMPANY'S COMMON STOCK AND RELATED SECURITY HOLDER MATTERS

The "Market for Common Stock" section of the Company's Annual Report to Stockholders, except for information below, is incorporated herein by reference.

DIVIDENDS AND DIVIDEND HISTORY

The Company has historically paid regular quarterly cash dividends on its common stock, and the Board of Directors presently intends to continue the payment of regular quarterly cash dividends, subject to the need for those funds for debt service and other purposes. Payment of dividends on the common stock is subject to determination and declaration by the Board of Directors and will depend upon a number of factors, including capital requirements, regulatory limitations on the payment of dividends, Pathfinder Bank and its subsidiaries results of operations and financial condition , tax considerations, and general economic conditions. The Company's mutual holding company, Pathfinder Bancorp, M.H.C., may elect to waive or receive dividends each time the Company declares a dividend. The election to waive the dividend receipt requires prior consent from the Office of Thrift Supervision.

ITEM 6. SELECTED FINANCIAL DATA

The selected financial information for the year ended December 31, 2003 is filed as part of the Company's Annual Report to Stockholders and is incorporated by reference.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of the Company's Annual Report to Stockholders is incorporated herein by reference.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by this item is set forth under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Annual Report to Stockholders which is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements are contained in the Company's Annual Report to Stockholders and are incorporated herein by reference.

The following supplementary data schedules are not included in the Company's Annual Report.

LOAN DATA

The following table show the amounts of loans outstanding as of December 31, 2003 which, based on remaining scheduled repayments of principal, are due in the periods indicated. Demand loans having no stated schedule of repayments and no stated maturity, and overdrafts are reported as due in one year or less. Adjustable and floating rate loans are included in the period in which interest rates are next scheduled to adjust rather than the period in which they contractually mature, and fixed rate loans are included in the period in which the final contractual repayment is due.

	Due Under One Year	Due 1-5 Years	Due Over Five Years	Total
(In thousands)				
Real estate:				
Commercial mortgage.	$ 6,703	$ 18,437	$ 6,138	$ 31,278
Construction and land development.	4,375	0	0	4,375

Residential mortgage	31,254	46,588	43,252	121,094
	42,332	65,025	49,390	156,747
Commercial	1,264	8,862	4,964	15,090
Consumer	10,557	2,620	3,703	16,880
Total loans.	$ 54,153	$ 76,507	$ 58,057	$188,717
Interest rates:.	0			
Fixed.	11,770	51,091	55,570	118,431
Variable	42,383	25,416	2,487	70,286
Total Loans.	$ 54,153	$ 76,507	$ 58,057	$188,717

ANALYSIS OF THE RESERVE FOR LOAN LOSSES DATA

The following table sets forth the analysis of the allowance for loan losses at or for the periods indicated.

	2003	2002	2001	2000	1999
(In thousands)					
Balance at beginning of year.	$1,481	$ 1,679	$1,274	$1,150	$ 939
Provisions charged to operating expenses. . .	598	1,375	708	244	373
Recoveries of loans previously charged-off					
Commercial.	3	56	53	0	0
Consumer.	17	33	9	19	28
Real estate	17	0	0	0	0
Total recoveries.	37	89	62	19	28
Loans charged off:					
Commercial.	(128)	(1,285)	(72)	(38)	0
Consumer.	(189)	(291)	(184)	(61)	(190)
Real estate	(84)	(86)	(109)	(40)	0
Total charged-off	(401)	(1,662)	(365)	(139)	(190)
Net charge-offs	(364)	(1,573)	(303)	(120)	(162)
Balance at end of year.	$1,715	$ 1,481	$1,679	$1,274	$1,150
Net charge-offs to average loans outstanding.	0.19%	0.89%	0.19%	0.08%	0.12%
Allowance for loan losses to year-end loans .	0.91%	0.82%	1.03%	0.86%	0.88%

ALLOCATION OF ALLOWANCE FOR LOAN LOSSES

The following table sets forth the allocation of allowance for loan losses by loan category for the periods indicated. The allocation of the allowance by category is not necessarily indicative of future losses and does not restrict the use of the allowance to absorb losses in any category.

	2003		2002		2001		2000		
	Amount .	% Gross. . Loans	Amount	% Gross Loans	Amount	% Gross Loans	Amount	% Gross Loans	Amo
Commercial loans	$1,218	8.0%	$1,042	7.3%	$1,083	8.8%	$ 455	8.6%	$ 3
Consumer loans .	120	8.9%	136	8.3%	100	7.7%	353	8.6%	3
Real estate. . .	377	83.1%	303	84.4%	496	83.5%	466	82.8%	4
Total.	$1,715	100.0%	$1,481	100.0%	$1,679	100.0%	$1,274	100.0%	$1,1

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INVESTMENT PORTFOLIO

The following table sets forth the carrying value of the Company's investment portfolio and Federal Home Loan Bank Stock at the dates indicated.

	At December 31,		
	2003	2002	2001
(In Thousands)			
Investment Securities:			
US Government and agency obligations	$ 6,354	$ 4,378	$ 5,971
State and municipal obligations.	7,359	8,549	6,012
Corporate debt issues.	6,421	15,375	20,949
Mortgage-backed securities	29,734	24,440	14,121
Equity securities.	2,932	6,225	3,227
Mutual funds	6,200	3,070	3,007
	59,000	62,037	53,287
Unrealized loss on available for sale portfolio.	607	469	135
Total investments.	$59,607	$62,506	$53,422

SECURITIES PORTFOLIO MATURITIES

The following table sets forth the scheduled maturities, carrying values, market values and average yields for the Bank's investment securities and Federal Home Loan Bank ("FHLB") Stock at December 31, 2003. Yield is calculated on the amortized cost to maturity and adjusted to a fully tax-equivalent basis.

	ONE YEAR OR LESS		ONE TO FIVE YEARS	
	CARRYING	ANNUALIZED WEIGHTED	CARRYING	ANNUALIZED WEIGHTED

	VALUE	AVERAGE YIELD	VALUE	AVERAGE YIELD
(Dollars in Thousands)				
Debt investment securities:				
U.S. Agency securities	$ 0	0.0%	$ 5,590	2.7%
U.S. Treasury securities	$ 0	0.0%	$ 0	0.0%
State and political subdivision. . .	$ 575	5.7%	$ 2,661	6.6%
Corporate debt issues.	$ 8	2.9%	$ 3,791	5.8%
Total.	$ 583	5.7%	$ 12,042	4.4%
Equity and mortgage-backed securities:				
Mutual funds	$ 6,200	1.0%	$ 0	0.0%
Mortgage-backed securities	$ 0	0.0%	$ 2,413	5.8%
Common stock and FHLB stock.	$ 2,932	3.7%	$ 0	0.0%
Total.	$ 9,132	1.9%	$ 2,413	5.8%
TOTAL INVESTMENT SECURITIES.	$ 9,715	2.1%	$ 14,455	4.8%

	MORE THAN TEN YEARS		TOTAL INVESTMENT SECURITIE		
	CARRYING VALUE	ANNUALIZED WEIGHTED AVERAGE YIELD	CARRYING VALUE	MARKET VALUE	ANNUAL WEIGH AVERAGE
(Dollars in Thousands)					
Debt investment securities:					
U.S. Agency securities	$ -	0.0%	$ 6,334	$ 6,304	2.8
U.S. Treasury securities	-	0.0%	20	22	10.8
State and political subdivisions . . .	2,795	6.4%	7,359	7,663	6.4
Corporate debt issues.	2,125	1.9%	6,421	6,696	5.0
Total	4,920	4.6%	20,134	20,685	4.8
Equity and mortgage-backed securities:					
Mutual funds	-	0.0%	6,200	5,715	1.0
Mortgage-backed securities	20,031	4.0%	29,734	29,934	4.1
Common stock and FHLB stock.	-	0.0%	2,932	3,273	3.7
Total	20,031	4.0%	38,866	38,922	3.6
	$ 24,951	4.1%	$59,000	$59,607	4.0

DEPOSIT STRUCTURE

The following table indicates the amount of the Bank's certificates of deposit of $100,000 or more by time remaining until maturity as of December 31, 2003.

Remaining Maturity	Certificates of Deposit of $100,000 or more
	(In Thousands)
Three Months or less . . .	$ 2,336
Three through Six months .	2,987
Six through twelve months.	3,536
Over twelve months	5,759
Total.	$ 14,618

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

During 2003, the Company analyzed the service provided by and associated costs of its external auditing firm. After reviewing proposals from a number of independent accounting firms, the Board of Directors approved the appointment of Beard Miller Company LLP as auditors for the fiscal year ended December 31, 2003. The Company's previous auditor, PricewaterhouseCoopers, LLP ("PwC") was engaged for the examination of the first two quarters Form 10-Q filings during 2003. PwC performed audits of the consolidated financial statements for the two years ended December 31, 2002 and 2001. Their reports on the financial statements did not contain an adverse opinion or a disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope, or accounting principles. During the two years ended December 31, 2002 and from December 31, 2002 through the effective date of the PwC termination, there have been no disagreements between the Registrant and PwC on any matter of accounting principles or practice, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of PwC, would have caused PwC to make reference to the subject matter of such disagreements in connection with their reports on the financial statements for such years.

During the two years ended December 31, 2002, and from December 31, 2002 until the effective date of the dismissal of PwC, PwC did not advise the Registrant of any of the following matters:

1. That the internal controls necessary for the Registrant to develop reliable financial statements did not exist.

2. That information had come to PwC's attention that had lead it to no longer be able to rely on management's representations, or that had made it unwilling to be associated with the financial statements prepared by management;

3. That there was a need to expand significantly the scope of the audit of the Registrant, or that information had come to PwC's attention that if further investigated: (i) may materially impact the fairness or reliability of either a previously-issued audit report or underlying financial statements, or the financial statements issued or to be issued covering the fiscal periods subsequent to the date of the most recent financial statement covered by an audit report (including information that may prevent it from rendering an unqualified audit report on those financial statements) or (ii) may cause it to be unwilling to rely on management's representation or be associated with the Registrant's financial statements and that, due to its dismissal,

PwC did not so expand the scope of its audit or conduct such further investigation;

4. That information had come to PwC's attention that it had concluded materially impacted the fairness or reliability of either: (i) a previously-issued audit report or the underlying financial statements or (ii) the financial statements issued or to be issued covering the fiscal period subsequent to the date of the most recent financial statements covered by an audit report (including information that, unless resolved to the accountant's satisfaction, would prevent it from rendering an unqualified report on those financial statements), or that, due to its dismissal, there were no such unresolved issues as of the date of its dismissal.

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During the two years ended December 31, 2002, and from December 31, 2002 through the engagement of Beard Miller Company LLP as the Registrant's independent accountant, neither the Registrant nor anyone on its behalf had consulted Beard Miller Company LLP with respect to any accounting, auditing or financial reporting issues involving the Registrant. In particular, there was no discussion with the Registrant regarding the application of accounting principles to a specified transaction, the type of audit opinion that might be rendered on the financial statement, or any related item.

ITEM 9A. 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 annual report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. There has been no change in the Company's internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonable likely to materially affect, the Company's internal control over financial reporting.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE COMPANY

(a) Information concerning the directors of the Company is incorporated by reference hereunder in the Company's Proxy Materials for the Annual Meeting of Stockholders.

(b) Set forth below is information concerning the Executive Officers of the Company at December 31, 2003.

NAME	AGE	POSITIONS HELD WITH THE COMPANY
Thomas W. Schneider	42	President and Chief Executive Officer
James A. Dowd, CPA	36	Vice President, Chief Financial Officer
Edward A. Mervine	47	Vice President, General Counsel

John F. Devlin	39	Vice President, Senior Commercial Lender
Melissa A. Miller	46	Vice President, Operations, Corporate, Secretary, Compliance Officer
Gregory L. Mills	43	Vice President, Director of Marketing, Branch Administrator

ITEM 11. EXECUTIVE COMPENSATION

Information with respect to management compensation and transactions required under this item is incorporated by reference hereunder in the Company's Proxy Materials for the Annual Meeting of Stockholders under the caption "Compensation".

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information contained under the sections captioned "Stock Ownership of Management" is incorporated by reference to the Company's Proxy Materials for its Annual Meeting of Stockholders.

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ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is set forth under the caption "Certain Transactions" in the Definitive Proxy Materials for the Annual Meeting of Stockholders and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is set forth under the caption "Audit and Related Fees" in the Definitive Proxy Materials for the Annual Meeting of Stockholders and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a)(1) Financial Statements

The exhibits and financial statement schedules filed as a part of this Form 10-K are as follows:

(A) Independent Auditors' Report;

(B) Consolidated Statements of Condition - December 31, 2003 and 2002.

(C) Consolidated Statements of Income - years ended December 31, 2003, 2002 and 2001.

(D) Consolidated Statements of Changes in Shareholders' Equity - years ended December 31, 2003, 2002 and 2001.

(E) Consolidated Statements of Cash Flows - years ended December 31, 2003, 2002 and 2001; and

(F) Notes to Consolidated Financial Statements.

(a)(2) Financial Statement Schedules

All financial statement schedules have been omitted as the required information is inapplicable or has been included in the Notes to Consolidated Financial Statements.

(b) Exhibits

3.1 Certificate of Incorporation of Pathfinder Bancorp, Inc. (Incorporated herein by reference to the Company's Current Report on Form 8-K dated June 25, 2001)

3.2 Bylaws of Pathfinder Bancorp, Inc. (Incorporated herein by reference to the Company's Current Report on Form 8-K dated June 25, 2001)

4 Form of Stock Certificate of Pathfinder Bancorp, Inc. (Incorporated herein by reference to the Company's Current Report on Form 8-K dated June 25, 2001)

10.1 Form of Pathfinder Bank 1997 Stock Option Plan (Incorporated herein by reference to the Company's S-8 file no. 333-53027)

10.2 Form of Pathfinder Bank 1997 Recognition and Retention Plan (Incorporated by reference to the Company's S-8 file no. 333-53027)

10.3 Employment Agreement between the Bank and Thomas W. Schneider, President and Chief Executive Officer (Incorporated by reference to the Company's S-4 file no. 333-36051)

13 Annual Report to Stockholders

14 Code of Ethics for Directors, Officers and Employees

21 Subsidiaries of Company

23.1 Consent of Beard Miller Company LLP

23.2 Consent of Pricewaterhouse Coopers LLP

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 and Chief Financial Officer

99.1 Report of PricewaterhouseCoopers LLP

(c) Reports on Form 8-K

The Company has two Current Reports on Form 8-K during the fourth quarter of the fiscal year ended December 31, 2003 dated November 5, 2003 and November 3, 2003 reporting press releases relating to the fourth quarter earnings release and the Board's approval of a change in auditors, respectively. The 8-K filed on November 3, 2003 was a duplicate filing of the 8-K filed on August 19, 2003.

SIGNATURES

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PATHFINDER BANCORP, INC.

Date: March 30, 2004

By: /s/ Thomas W. Schneider
Thomas W. Schneider
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By: /s/ Janette Resnick
Janette Resnick, Chairman of the Board
Date: March 30, 2004

By: /s/ Thomas W. Schneider
Thomas W. Schneider, President and Chief Executive Officer
Date: March 30, 2004

By: /s/ Chris R. Burritt
Chris R. Burritt, Director
Date: March 30, 2004

By: /s/ James A. Dowd
James A. Dowd, Vice President and . . Chief Financial Officer
Date: March 30, 2004

By: /s/ Raymond W. Jung
Raymond W. Jung, Director
Date: March 30, 2004

By: /s/ Bruce B. Manwaring
Bruce E. Manwaring., ... Director
Date: March 30, 2004

By: /s/ George P. Joyce
. George P. Joyce, Director
Date: March 30, 2004

By: /s/ L. William Nelson, Jr.
L. William Nelson, Jr., ... Director
Date:.March 30, 2004

By: /s/ Corte J. Spencer
Corte J. Spencer, Director
Date: March 30, 2004

By: /s/ Steven W. Thomas
Steven W. Thomas, ... Director
Date:.March 30, 2004

By: /s/ Chris C. Gagas
Chris C. Gagas, Director
Date: March 30, 2004

EXHIBIT 13 ANNUAL REPORT TO STOCKHOLDERS

2003 ANNUAL REPORT

[PHOTOS] IF IT'S IMPORTANT TO YOU,
IT'S IMPORTANT TO US.

[LOGO] PathFinder
BANCORP, INC.

[PHOTOS] [LOGO] PathFinder
BANCORP, INC.

FINANCIAL HIGHLIGHTS

Pathfinder Bancorp, Inc. ("the Company") is the parent company of Pathfinder Bank and Pathfinder Statutory Trust I. Pathfinder Bank has three operating subsidiaries - Pathfinder Commercial Bank, Pathfinder REIT Inc., and Whispering Oaks Development Corporation.

The following table sets forth certain financial highlights of the Company for the years ended December 31:

	2003	2002	2001	2000	199
YEAR END (IN THOUSANDS)					
Total assets	$277,940	$279,056	$244,514	$232,355	$216,
Loans receivable, net.	187,002	179,001	162,588	148,362	130,
Deposits	206,894	204,522	169,589	161,459	152,
Equity	21,785	23,230	22,185	20,962	20,
FOR THE YEAR (IN THOUSANDS)					
Net interest income.	$ 9,337	$ 8,789	$ 7,853	$ 7,393	$ 7,
Net income	1,652	1,156	1,602	356	
PER SHARE					
Net income (basic)	$ 0.68	$ 0.45	$ 0.62	$ 0.14	$ 0
Book value	8.96	8.90	8.64	8.06	7
Cash dividends declared.	0.40	0.30	0.26	0.24	0
RATIOS					
Return on average assets	0.59%	0.45%	0.68%	0.16%	0
Return on average equity	7.61%	5.01%	7.34%	1.79%	4
Average equity to average assets	7.77%	8.94%	9.22%	8.91%	10
Dividend payout ratio (a).	39.41%	36.85%	28.37%	173.62%	67
Net interest rate spread	3.53%	3.47%	3.35%	3.34%	3
Allowance for loan losses to loans receivable.	0.91%	0.82%	1.03%	0.86%	0
Noninterest expense to total assets.	3.27%	2.85%	2.81%	3.31%	3
Efficiency ratio (b)	76.13%	73.18%	70.61%	90.64%	80

(a) The dividend payout ratio is calculated using dividends declared and not waived by the Company's mutual holding company parent, Pathfinder

Bancorp, M.H.C., divided by net income.

(b) The efficiency ratio is calculated as noninterest expense divided by net interest income plus noninterest income.

MARKET FOR COMMON STOCK

Pathfinder Bancorp, Inc.'s common stock currently trades on the NASDAQ SmallCap Market under the symbol "PBHC". There were 359 shareholders of record as of February 20, 2004. The following table sets forth the high and low closing bid prices and dividends paid per share of common stock for the periods indicated:

QUARTER ENDED:	HIGH	LOW	DIVIDEND PAID
December 31, 2003.	$ 18.459	$16.250	$0.100
September 30, 2003	17.000	14.000	0.100
June 30, 2003. . .	15.250	13.685	0.100
March 31, 2003 . .	14.890	13.200	0.100
December 31, 2002.	15.000	11.910	0.080
September 30, 2002	12.850	10.380	0.080
June 30, 2002. . .	14.990	12.750	0.070
March 31, 2002 . .	13.500	12.050	0.070

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[PHOTOS]

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LETTER TOSHAREHOLDERS

Janette Resnick, Chairman, Thomas W. Schneider, President and CFO

LETTER TO SHAREHOLDERS

On behalf of the Board of Directors and the employees of Pathfinder Bancorp, Inc., we are pleased to present our Annual Report to our shareholders. We invite you to attend our annual meeting on April 28, 2004 at 10:00 a.m. at the Econo Lodge Riverfront Hotel in Oswego.

2003 REVIEW The Company's activities during 2003 were primarily focused on: 1) enhancing the breadth and capabilities of our delivery systems, 2) providing core banking products and services to our customers, and 3) ensuring enhanced governance processes to meet regulatory and shareholder expectations.

Pathfinder Bank is the leading depository institution in our market with a 41% deposit market share in the city of Oswego and a 23% deposit market share in Oswego County. We are strategically focused on retaining and expanding that leadership position by differentiating ourselves through higher quality service delivery. To accomplish this we are directing our development efforts toward what we believe are the core drivers of service delivery and market position: 1) location development, 2) systems enhancements, 3) product diversity and 4) employee training and education.

Toward that end in 2003, we have done the following:

Relocated our Fulton branch to provide better access, parking, drive-thru capabilities, and a superior customer experience through design, state-of-the-art equipment and training.

Redesigned the lobby in our Lacona branch to provide private offices and an ATM.

Reconfigured and expanded the parking and drive-thru in our Mexico branch.

Acquired prime property in Central Square to locate our 7th branch.

Installed a new Windows based teller/platform system for enhanced customer service.

Introduced our new deposit services to the municipalities in the county through our commercial bank subsidiary.

Continued our focus on employee development through Pathfinder University and other training and education forums.

We strongly believe that our focus in these areas will allow the Company to gain market share through superior customer service.

Residential mortgage lending dominated our core banking activities in 2003 as originations exceeded $50 million. Total loans grew $8.2 million with $23.4 million sold into the secondary market. The Company's mortgage servicing portfolio for loans sold is $47.6 million at December 31, 2003. Deposit growth for the year was nominal following a 21% increase in the prior year. A stagnant local economy has precluded the flow of new funds into the market. It is anticipated that in 2004, deposit growth through branch expansion and municipal markets will be more robust, while commercial lending production through Pathfinder Business Services will accelerate as residential mortgage lending activity slows.

Pathfinder Investment Services had a record year of growth in 2003 with revenues increasing 22% over the prior year. Our investment services division now serves over 700 individuals, families, and businesses in our market.

The Board of Directors was highly active and engaged in understanding their evolving responsibilities resultant from adoption of the Sarbanes-Oxley Act of 2002. The Governance/Nominating Committee adopted a comprehensive set of governance guidelines in 2003. The Audit Committee added meetings specifically targeted for educational purposes. The Board also successfully transitioned the Chairman's position as Chris C. Gagas stepped down after 17 years as Chairman and was replaced by unanimous decision with Janette Resnick as Chairman. Chris remains on the Board of Directors and the Directors and Company deeply appreciate his unparalleled leadership. The Board of Directors is comprised of 9 independent directors and one inside director who are committed to ensuring that the Company represents the best interests of its shareholders, customers, and community.

SHAREHOLDER VALUE Earnings of $1.7 million in 2003 resulted in a return on average equity of 7.61% and earnings per share of $.68. Both performance measures were more than a 50% improvement over the prior year, while EPS achieved the highest level in the Company's history as a public company.

The Company continued to use share repurchases and increased dividends as a means to provide return and value to shareholders. The Company repurchased approximately 18% of the shares of common stock held by public shareholders during the year and increased the dividend to $.40 per share, a 33% increase over the prior year.

The Company's common stock performance reflected both this positive trend in earnings and dividends, as well as the rising values of the bank and thrift stock sectors. During 2003, the common stock provided a total return of 28%.

LOOKING AHEAD In 2004, our strategic focus remains dedicated to the principles we have outlined above. Our management team is educated, experienced and well positioned to execute the Company's business plans and lead our bank through the turbulent times ahead. In an industry that is constantly changing through consolidation, competition, and regulation, we believe a consistently improving bank dedicated to the people, businesses, and organizations in the communities we serve, will garner the benefits of customer loyalty and the resultant market share. We look forward to the challenges and opportunities that lay ahead, the successful implementation of our business plan, and our continued service to the market.

/s/: Janette Resnick	/s/: Thomas W. Schneider
Janette Resnick	Thomas W. Schneider
Chairman	President and CEO

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MANAGEMENT DISCUSSION AND ANALYSIS

INTRODUCTION

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 Corp. represent wholly owned subsidiaries of Pathfinder Bank. At December 31, 2003, Pathfinder Bancorp, M.H.C, the Company's mutual holding company parent, whose activities are not included in the MD&A, held 65.1% of the Company's common stock and the public held 34.9%.

When used in this Annual Report the words or phrases "will likely result", "are expected to", "will continue", "is anticipated", "estimate", "project" or similar expression are intended to identify "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 results 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.

The Company's business strategy is to operate as a well-capitalized, profitable and independent community bank dedicated to providing value-added products and services to our customers. Generally, the Company has sought to implement this strategy by emphasizing retail deposits as its primary source of funds and maintaining a substantial part of its assets in locally-originated residential first mortgage loans, loans to business enterprises operating in its markets, and in investment securities. Specifically, the Company's business strategy incorporates the following elements: (i) operating as an independent community-oriented financial institution; (ii) maintaining capital in excess of regulatory requirements; (iii) emphasizing investment in one-to-four family residential mortgage loans, loans to small businesses and investment securities; and (iv) maintaining a strong retail deposit base.

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 and other loans, investment securities and other assets, and its cost of funds consisting of interest paid on deposits and other borrowings. The Company's net income also is affected by its provision for loan losses, as well as by the amount of noninterest income, including income from fees, service charges and servicing rights, net gains and losses on sales of securities, loans and foreclosed real estate, and noninterest expense such as employee compensation and benefits, occupancy and equipment costs, data processing costs 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.

On October 25, 2002, Pathfinder Bank completed the purchase of assets and the assumption of non-municipal deposits of the Lacona, New York branch of Cayuga Bank (the "Branch Acquisition"). In addition, Pathfinder Bank formed a limited purpose commercial bank subsidiary, Pathfinder Commercial Bank. Pathfinder Commercial Bank was established to serve the depository needs of public entities in its market area and it assumed the municipal deposit liabilities of the Lacona, New York branch. The transaction included approximately $26.4 million in deposits, $2.3 million in loans and $430,000 in vault cash and facilities and equipment. The acquisition reflects a premium on deposit liabilities assumed of approximately $2.4 million.

On January 13, 2003, the Company completed the purchase of 160,114 shares of common stock at a price of $2.3 million, or $14.60 per share, from Jewelcor Management Inc. ("JMI"), which is owned by Mr. Seymour Holtzman ("the Repurchase"). The Repurchase represented approximately 6.1% of the Company's outstanding common stock as of December 31, 2002.

As part of the repurchase agreement, Mr. Holtzman and JMI, as well as those persons and entities who signed the Schedule 13D with Mr. Holtzman with respect to the Company's common stock, agreed in writing, that neither they nor their affiliates will purchase shares of the Company's common stock for a period of five years. JMI also agreed to stipulate to the discontinuance with prejudice of the lawsuit entitled "Jewelcor Management, Inc. v. Pathfinder Bancorp, Inc.", and withdrew a shareholder proposal previously submitted by JMI.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States 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 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. 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 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 December 31, 2003, 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 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.

RESULTS OF OPERATIONS

Net income for 2003 was $1.7 million, an increase of $495,000, or 43%, compared to net income of $1.2 million for 2002. Basic earnings per share increased to $0.68 per share for the year ended December 31, 2003 from $0.45 per share for the year ended December 31, 2002. Return on average equity increased 52% to 7.61% in 2003 from 5.01% in 2002.

In the current low interest rate environment, the Company was able to maintain a strong net interest margin through growth in average earning assets of 7%, resulting in an increase in net interest income, on a tax-equivalent basis, of

$530,000, or 6%. Provision for loans losses decreased 57% due to a prior year charge-off of two significant credit relationships. The Company also experienced a 21% increase in other income, net of securities gains and losses, primarily attributable to increased deposit levels, service charges associated with checking accounts and mortgage servicing fees. Earnings were hampered by an increase in other expenses of 14% primarily attributable to the operation of a new branch and an increase in employee pension and healthcare costs.

SELECTED PERFORMANCE MEASURES

	Years Ended December 31,		
	2003	2002	2001
Return on average assets	0.59%	0.45%	0.68%
Return on average equity	7.61%	5.01%	7.34%
Net interest margin (1).	3.68%	3.73%	3.67%
Noninterest income to total assets .	0.94%	0.75%	0.76%
Noninterest expense to total assets.	3.27%	2.85%	2.81%

(1) net interest margin is calculated on a tax-equivalent basis

NET INTEREST INCOME

Net interest income is the Company's primary source of operating income for payment of operating expenses and providing for possible loan losses. It is the amount by which interest earned on interest-earning deposits, loans and

investment securities, exceeds the interest paid on deposits and other interest-bearing liabilities. Changes in net interest income and net interest margin ratio result from the interaction between the volume and composition of earning assets, interest-bearing liabilities, related yields and associated funding costs.

Net interest income, on a tax-equivalent basis, increased $530,000, or 6%, to $9.4 million for the year ended December 31, 2003, as compared to the year ended December 31, 2002. The Company's net interest margin for 2003 decreased slightly to 3.68% from 3.73% in 2002. The increase in net interest income is attributable to increased volumes in earning asset and deposit balances and the maintenance of stable spreads. The average balance of interest-earning assets grew $17.5 million, or 7%, during 2003 and the average balance of interest-bearing deposits increased by $24.1 million, or 14%. The increase in the average balance of interest-bearing deposits is attributable to the Branch Acquisition. The Company invested the proceeds from the Branch Acquisition into

the loan and investment portfolio. The decrease in the average yield on interest-earning assets by 67 basis points more than offset the increase in average balance as loans were refinanced or modified and new investment securities were acquired at lower yields. As a result, interest income, on a tax-equivalent basis, decreased $544,000 during 2003. Interest expense on deposits decreased $906,000, or 19%, resulting from a decrease in the cost of deposits to 1.96% in 2003 from 2.78% in 2002. In addition to the decrease in the cost of deposits, interest expense on borrowings also decreased by $168,000, or 7%, from the prior year.

In comparison, net interest income increased $943,000, or 12%, on a tax-equivalent basis, from 2001 to 2002. The increase in net interest income was comprised of a decrease in net interest expenses of $1.5 million, or 17%, partially offset by a decrease in interest income of $519,000, or 3%.

The following table sets forth information concerning average interest-earning assets and interest-bearing liabilities and the yields and rates thereon. Interest income and resultant yield information in the table is on a fully tax-equivalent basis using marginal federal income tax rates of 34%. Averages are computed on the daily average balance for each month in the period divided by the number of days in the period. Yields and amounts earned include loan fees. Non-accrual loans have been included in interest-earning assets for purposes of these calculations.

	For the Years Ended December 31,				
	2003			2002	
(Dollars in thousands)	Average Balance	Interest	Average Yield / Cost	Average Balance	Interest
INTEREST-EARNING ASSETS					
Real estate loans residential	$129,687	$ 8,346	6.44%	$117,688	$ 8,194
Real estate loans commercial.	31,122	2,480	7.97%	31,790	2,641
Commercial loans.	14,181	798	5.62%	14,774	984
Consumer loans.	15,787	1,225	7.76%	12,795	1,117
Taxable investment securities	54,115	2,193	4.05%	46,247	2,437
Tax-exempt investment securities.	7,869	305	3.87%	6,036	434
Interest-earning deposits	3,252	33	0.99%	9,163	117
Total interest-earning assets	$256,013	$ 15,380	6.01%	$238,493	$ 15,924
Noninterest-earning assets:					
Other assets.	24,859			20,987	
Allowance for loan losses	(1,591)			(1,877)	
Net unrealized gains on available for sale securities.	52			368	
Total Assets	$279,333			$257,971	
Interest-bearing liabilities:					
NOW accounts.	$ 17,663	$ 140	0.79%	$ 15,850	$ 167
Money management accounts	21,788	248	1.14%	11,571	242
Savings and club accounts	66,481	511	0.77%	62,494	948
Time deposits	85,751	2,852	3.33%	77,701	3,299
Mandatorily redeemable preferred securites.	5,000	236	4.66%	2,635	138
Borrowings	43,490	1,962	4.51%	48,626	2,228
Total Interest-bearing liabilities.	$240,173	$ 5,949	2.48%	$218,877	$ 7,023
Noninterest-bearing liabilities:					
Demand deposits	16,345			13,154	
Other liabilities	1,098			2,873	
Total liabilities	257,616			234,904	
Shareholders' equity.	21,717			23,067	
Total liabilities & shareholders' equity. .	$279,333			$ 257,971	
Net interest income	$ 9,431			$ 8,901	
Net interest rate spread.			3.53%		

Net interest margin			3.68%
Ratio of average interest-earning assets to average interest-bearing liabilities . .			106.60%

	For the Year Ended December 31,		
	2001		
(Dollars in Thousands)	Average Balance	Interest	Average Yield/ Cost
INTEREST-EARNING ASSETS			
Real estate loans residential.	$101,363	$ 7,678	7.58%
Real estate loans commercial	27,847	2,487	8.93%
Commercial loans	13,843	1,170	8.45%
Consumer loans	12,600	1,220	9.69%
Taxable investment securities.	53,581	3,382	6.31%
Tax-exempt investment securities	6,192	441	7.12%
Interest-earning deposits.	1,418	65	4.58%
Total interest-earning assets.	$216,844	$ 16,443	7.58%
Noninterest-earning assets:			
Other assets	20,796		
Allowance for loan losses.	(1,431)		
Net unrealized gains on available for sale securities	605		
Total Assets.	$236,814		
Interest-bearing liabilities:			
NOW accounts	$ 16,064	$ 228	1.42%
Money management accounts.	1,080	41	3.80%
Savings and club accounts.	60,936	1,435	2.35%
Time deposits.	77,681	4,396	5.66%
Mandatorily redeemable preferred securites	-	-	-
Borrowings.	44,458	2,385	5.36%
Total Interest-bearing liabilities	$200,219	$ 8,485	4.24%
Noninterest-bearing liabilities:			
Demand deposits.	11,175		
Other liabilities.	3,592		
Total liabilities.	214,986		
Shareholders' equity	21,828		
Total liabilities & shareholders' equity .	$236,814		
Net interest income.		$ 7,958	
Net interest rate spread			3.35%
Net interest margin.			3.67%
Ratio of average interest-earning assets to average interest-bearing liabilities. .			108.30%

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INTEREST INCOME
Average loans increased $13.7 million in 2003, with yields declining 57 basis points to 6.74%. The Company's residential mortgage loan portfolio increased $12.0 million, or 10%, when comparing the year 2003 to 2002. The average yield on the residential mortgage loan portfolio decreased 52 basis points to 6.44% in 2003 from 6.96% in 2002. New loans were originated at lower rates than in the prior period and a large volume of existing mortgages had their rates modified downward or were refinanced at lower rates. An increase in the average balance of consumer loans of $3.0 million, or 23%, resulted from an increase in home equity loans. The average yield declined 97 basis points, to 7.76% from 8.73% in 2002. Average commercial loans remained relatively constant and experienced a decline in the average tax-equivalent yield of 104 basis points, to 5.62% from 6.66%, in 2002. The decrease in the yield on commercial loans was affected, in part, by the offering of short-term notes to municipalities beginning in 2003. The average balance of loans to municipal entities was $2.3 million, having a tax-equivalent yield of 3.00%.

Average loans in 2002 increased $21.4 million compared to 2001, while average loan yields declined 76 basis points. Interest income on loans increased $381,000, or 3% in 2002 compared to 2001. For the comparable periods, average residential mortgage loans increased $16.3 million, or 16%, average consumer loans increased $195,000, or 2%, and average commercial mortgage loans increased $3.9 million, or 14%.

Average investment securities (taxable and tax-exempt) in 2003 increased by $9.7 million, with a decrease in tax-equivalent interest income from investments of $373,000, or 13%, compared to 2002. The average tax-equivalent yield of the portfolio declined 146 basis points, to 4.03% from 5.49%. The increase in the average balance of investment securities resulted from the investment of the net proceeds received in the Branch Acquisition into the investment and loan portfolios. The net proceeds as well as proceeds from maturities and principal

payments received on existing investment securities were reinvested into the portfolio at lower interest rates.

Average investment securities (taxable and tax-exempt) decreased $7.5 million, or 13%, in 2002 compared to 2001, with tax-equivalent interest income down $952,000, or 25%, for the comparative period. The average tax-equivalent yield on the portfolio had declined 91 basis points in 2002, when compared to 2001. Proceeds from maturities and principal repayments of investment securities funded the loan growth in 2002.

INTEREST EXPENSE
Interest expense decreased $1.1 million, or 15%, in 2003, when compared to 2002. Average interest-bearing liabilities increased $21.3 million, or 10%, in 2003. This increase was more than offset by a reduction in the average cost of interest-bearing liabilities of 73 basis points, to 2.48% in 2003 from 3.21% at 2002.

Interest expense decreased $1.5 million, or 17%, in 2002 compared to 2001. The average cost of interest bearing liabilities declined 103 basis points during the 12 months ended December 31, 2002.

RATE/VOLUME ANALYSIS
Net interest income can also be analyzed in terms of the impact of changing interest rates on interest-earning assets and interest-bearing liabilities and changing the volume or amount of these assets and liabilities. The following

table represents the extent to which changes in interest rates and changes i