Investor/Media Contacts

Thomas W. Schneider – President, CEO
James A. Dowd – Executive Vice President, COO, CFO
Telephone: (315) 343-0057

Pathfinder Bancorp, Inc. Announces 2017 Net Income of $3.0 Million

Excluding One-Time Charges, Pathfinder Had 2017 Net Income of $3.3 Million, An Increase of 2.4% Over 2016

Total revenue for 2017 was $25.5 million, an increase of $2.0 million, or 8.6%, compared to $23.5 million for 2016

Oswego, N.Y. — February 2, 2018 — Pathfinder Bancorp, Inc. ("Company") (NASDAQ: PBHC), the holding company for Pathfinder Bank ("Bank"), announced fourth quarter 2017 net income available to common shareholders of $379,000, compared to $959,000 for the fourth quarter of 2016. Fourth quarter 2017 basic earnings per share were $0.09 compared to $0.24 per basic share for the fourth quarter of 2016. Fourth quarter 2017 diluted earnings per share were $0.09 compared to $0.23 per diluted share for fourth quarter of 2016. Fourth quarter 2017 revenue (net interest income after the provision for loan loss and total noninterest income) of $6.6 million increased $569,000, or 9.4%, compared to $6.1 million for the fourth quarter of 2016. Net income available to common shareholders was $3.0 million for 2017 compared to $3.3 million for the previous year. Earnings per basic share were $0.74 for 2017 compared to $0.79 per basic share for 2016. Earnings per diluted share were $0.72 for 2017 compared to $0.78 per diluted share for 2016. Total revenue for 2017 was $25.5 million, an increase of $2.0 million, or 8.6%, compared to $23.5 million for 2016.

<u>2017 Fourth Quarter and Full Year Performance Highlights</u>

- Total interest-earning assets at December 31, 2017 were $834.3 million, an increase of $126.9 million, or 17.9%, over $707.5 million at the end of 2016
- Total loans of $580.8 million at December 31, 2017 increased by $88.7 million, or 18.0%, from $492.2 million at December 31, 2016
- Total deposits of $723.6 million at December 31, 2017 were up $112.6 million, or 18.4%, compared to $611.0 million at December 31, 2016
- Total revenue for 2017 was $25.5 million, an increase of $2.0 million, or 8.6%, compared to total revenue of $23.5 million for 2016
- Asset quality metrics remained stable with net loan charge-offs to average loans of 0.16% in 2017, compared to 0.09% in 2016, and nonperforming loans to total loans of 0.84% at December 31, 2017, a 14 basis point improvement compared to 0.98% at December 31, 2016

- Fourth quarter 2017 net interest income improved to $6.0 million, an increase of $885,000, or 17.2%, from $5.2 million for the prior year fourth quarter

The Company's financial results for the fourth quarter of 2017 reflected a one-time charge to earnings for the effects of the Tax Cuts and Jobs Act of 2017 (the "Tax Act") that was enacted on December 22, 2017. The Tax Act reduced the Company's Federal income tax rate from 34% to 21% effective January 1, 2018. Generally Accepted Accounting Principles ("GAAP") require that the impact of the provisions of the Tax Act be accounted for in the period of enactment. Accordingly, the incremental income tax expense recorded by the Company in the fourth quarter of 2017 related to the Tax Act was $347,000. The additional income tax expense was largely attributable to the reduction in carrying value of net deferred tax assets reflecting lower future tax benefits resulting from the lower corporate tax rate. Had the one-time charge related to the Tax Act not been incurred, diluted earnings per common share for the quarter and year-ended December 31, 2017 would have been $0.17 and $0.80, respectively.

"The Company's operating results provide a clear message of short-term challenges and continued organizational buildout for long-term value creation." said Thomas W. Schneider, President and Chief Executive Officer. "The fourth quarter charge to adjust downward the value of tax deferred assets resulting from the tax law change on corporate tax rates is a micro-example of this message. While fourth quarter and annual earnings were adversely impacted by this change, future net income is likely to be enhanced by the lower forward effective tax rate. Of more significance, however, is pricing in the form of interest rates. The increase in short-term rates relative to long-term rates resulted in a compression of the spread between the 2-year Treasury bond and 10-year Treasury bond to its current level of approximately 66 basis points. The 10-year historical average of the "2/10" spread is approximately 177 basis points. The 2/10 spread is a good indicator of the difference between the average pricing of the cost for our deposit and borrowed funding, and average pricing for the yield on our loan and fixed income securities. Our balance sheet is moderately liability sensitive and therefore the liability cost price is more sensitive to rate changes than the asset yield price. Our modeling, however, has consistently indicated that the first 18 months of rising rates are challenging to net interest margin, with future ongoing improvement as asset yields rise. The flatter the yield curve, the less generous the improvement, but we are comfortable and confident in the condition of our balance sheet. It is balance sheet composition quality and growth that is the source of great pride in the efforts of our team and validation of our business model."

"The balance sheet diversification in both interest earning-assets and interest-bearing liabilities, are fostered and supplemented by a market that, based upon our growth, seeks the value of a business model built upon our commitment of using local knowledge and decision capacity, as well as full community engagement to be trusted, local, community bankers. The 18% growth in our loan portfolio, funded by a 18% growth in deposits, is consistent with our trends over the prior three years and is not built upon aggressive prospecting for business, but rather our meeting the demands of our market for a trusted banking partner. This growth must be carefully risk managed in a disciplined manner, and our service model and platform delivery systems require continued investment in people, technology and physical infrastructure." Schneider continued, "We must ever enhance our risk management capabilities and customer-centric service model to meet the demands of a market that increasingly places its trust in us. This continuous enhancement process will also enable us to meet the higher expectations of our constituents and regulators that we expect will be placed on the bank as its assets approach $1.0 billion. We are confident and proud of our team's ability to meet the challenges of our balance sheet growth during this cycle, and build the value of our franchise for the benefit of shareholders, customers, communities and employees."

Income Statement

Fourth quarter 2017 net interest income increased $885,000, or 17.2%, to $6.0 million compared to $5.2 million for the fourth quarter of 2016, due to a $1.7 million, or 26.5%, increase in interest income. This improvement resulted principally from an increase of $97.5 million, or 20.2%, in average loans, along with a $52.7 million increase in average taxable investment securities combined with a 88 basis point improvement in the securities portfolio yield, compared to the prior year quarter. The increase in interest income was partially offset by higher interest expense which increased $777,000 to $1.9 million, reflecting increased average balances and higher interest rates paid on time deposits, money market accounts and borrowings.

Net interest income for 2017 increased $2.8 million, or 14.0%, to $23.1 million compared to $20.3 million for the previous year. Interest and dividend income for 2017 was $29.4 million, an increase of $5.3 million, or 22.1%, compared to $24.1 million for 2016. The increase was primarily a result of average loan growth of $91.1 million, or 20.0%, compared to the prior year period. Interest expense of $6.3 million for 2017 increased by $2.5 million, or 65.4%, from $3.8 million in the prior year period. The increase in interest expense was primarily because of a $23.0 million increase in the average balance of, and a 106 basis point increase in the rate paid on borrowings, along with a $24.2 million increase in the average balance of time deposits and a $63.9 million increase in MMDA deposits, coupled with 29 and 18 basis point increases in the interest rates paid on those deposits, respectively.

The net interest margin for the three months and twelve months ended December 31, 2017, was 2.88% and 2.97%, respectively, compared to 2.97% and 3.14% for the respective periods of 2016. The lower net interest margin for fourth quarter 2017 was primarily a result of a 30 basis point increase in funding cost that was related to an increase in the average balance of, and interest rate paid on, borrowings and time deposits. The decline in the net interest margin for 2017 was primarily a result of a 24 basis point increase in funding costs, principally resulting from a $23.0 million increase in average borrowings coupled with a 106 basis point increase in the interest rate paid, along with a $24.2 million increase in average time deposits coupled with a 29 basis point increase in the rate paid.

The fourth quarter 2017 provision for loan losses was $537,000, compared to $271,000 for the prior year quarter. The increased provision for the three month period primarily reflects the addition of a $300,000 specific reserve established for a single $1.7 million commercial real estate loan that may be affected in future periods by a loss in its current operating revenues. Absent this additional provisioning for this commercial real estate loan, the provision for loan losses in the fourth quarter of 2017 was essentially unchanged from the same quarter in 2016, which is indicative of stable asset quality metrics for the respective reporting periods. The provision for loan losses recorded in 2017 was $1.8 million compared with a provision of $953,000 for 2016. Absent the additional provisioning for the $1.7 million commercial real estate loan described above, the provision for loan losses in 2017 was $516,000 greater than in 2016 and is reflective of the continued significant growth in the Bank's commercial and other lending portfolios.

Fourth quarter 2017 noninterest income was $1.1 million compared to $1.2 million for the same period in 2016. The decrease in current year noninterest income was due primarily to a $203,000 decrease in net gains on sales and redemptions of investment securities, partially offset by a $116,000 increase in net gains on sales of loans and foreclosed real estate and a $30,000 increase in income from other charges, commissions and fees. Noninterest income was $4.2 million for both 2017 and 2016.

Total noninterest expense for the fourth quarter of 2017 was $5.9 million, an increase of $1.1 million or 21.9%, in comparison to $4.8 million for the prior year period. The higher noninterest expense was principally a result of a $542,000 increase in salary and employee benefit expenditures, along with a $162,000 increase in FDIC assessments compared to the prior year quarter. Through its subsidiary, Pathfinder Risk Management Company, Inc., the Bank owns a 51% interest in the FitzGibbons Agency, LLC (the "Agency"). Salary and benefits expense increased in the fourth quarter of 2017, as compared to the same quarter of 2016, primarily due to a $302,000 one-time incentive compensation payment made to the senior management team of the Agency in the fourth quarter of 2017. Absent this payment, salary and benefits expense increased in the fourth quarter of 2017, as compared to the same quarter of 2016, by $240,000 which was primarily due to the Company's increased staffing levels within its loan origination, customer service and risk management departments.

Noninterest expense for 2017 was $21.2 million compared with $19.1 million for the prior year. The higher noninterest expense was due largely to a $1.1 million increase in salary and benefit expenses, which would have been $843,000 absent the effects of the one-time incentive compensation payment described above. The increase in salary and benefit expenses, absent the effects of the one-time incentive described above, is primarily due to the Company's increased staffing levels within its loan origination, customer service and risk management departments that is commensurate with the Company's growth in assets. Noninterest expenses for 2017, as compared to the previous year, were also affected by an increase in building occupancy costs of $260,000. The increase in building occupancy expenses was primarily due to increases in depreciation and property taxes resulting from the Company's increased investments in facilities and physical infrastructure over the preceding eighteen months.

The Agency's net operating expenses increased by $199,000 in 2017 to $942,000. The increase in operating expenses was primarily due to the $302,000 incentive compensation payment made to the Agency's senior management team in 2017, as described above. The increase in operating expenses was partially offset by an $8,000 increase in revenues to $803,000. As a result of these year-over-year net variances, the Agency's net loss in 2017 was $139,000 as compared to net income of $52,000 in 2016. On a consolidated basis, the Company reported a net after tax loss related to the Agency in 2017 of $68,000 after subtracting minority interest, as compared to a consolidated after tax net income related to the Agency of $26,000 in 2016 after subtracting minority interest.

Balance Sheet at December 31, 2017

Total assets at year-end were $881.3 million, an increase of $132.2 million, or 17.7%, from $749.0 million at December 31, 2016. This increase was primarily driven by higher loan and investment securities balances. Loan growth was achieved primarily through the Bank's increased penetration of the Syracuse and surrounding Onondaga County markets reflective of the Company's success in executing its strategic initiatives related to increased brand awareness and operating presence in those markets. Total loans of $580.8 million grew by $88.7 million, or 18.0% from December 31, 2016. The securities portfolio was $237.3 million at year-end 2017 reflecting the acquisition of relatively short-term, investment-grade collateral matching the strong inflow of municipal deposits which typically occurs in the first and fourth quarters of each calendar year.

Total deposits at December 31, 2017 were $723.6 million, an increase of $112.6 million, or 18.4%, from $611.0 million at December 31, 2016. Noninterest-bearing deposits at 2017 year-end were $89.8 million, an increase of $14.5 million, or 19.3% to $75.3 million at December 31, 2016.

Shareholders' equity was $61.7 million on December 31, 2017, compared with $57.9 million on December 31, 2016, reflecting a $3.8 million increase in equity.

Asset Quality

The Bank's asset quality metrics for the quarter and year-end were consistent with recent reporting periods and continue to compare favorably to broad industry and peer group averages. The net loan charge-offs to average loans ratio of 0.16% for fourth quarter 2017, was up seven basis points from 0.09% from the fourth quarter of 2016, and down five basis points from 0.21% for the linked third quarter of 2017. Nonperforming loans to total loans were 0.84% at December 31, 2017, down 14 basis points compared to 0.98% at December 31, 2016. The allowance for loan losses to non-performing loans at December 31, 2017 was 145.61%, compared with 129.85% at December 31, 2016. The Bank's solid asset quality metrics continue to reflect its economically stable service area, along with the Bank's robust loan servicing and collection capabilities, and consistent underwriting procedures.

Cash Dividend Declared

The Company announced, on December 22, 2017, that its Board of Directors had declared a cash dividend of $0.0575 per common share, payable on February 2, 2018, to shareholders of record as of January 12, 2018. This represents an increase of 4.5% from the third quarter 2017 dividend of $0.055, and an increase of 9.5% from the second quarter 2017 dividend of $0.0525. The implied dividend yield is 1.48%, based on the closing price of the Company's common stock of $15.55 on February 1, 2018. The quarterly cash dividend of $0.0575 equates to a dividend payout ratio of 63.9%, based on unaudited reported GAAP earnings for the quarter ended December 31, 2017.

About Pathfinder Bancorp, Inc.

Pathfinder Bank is a New York State chartered commercial bank headquartered in Oswego, whose deposits are insured by the Federal Deposit Insurance Corporation. The Bank is a wholly owned subsidiary of Pathfinder Bancorp, Inc, (NASDAQ SmallCap Market; symbol: PBHC). The Bank has nine full service offices located in its market areas consisting of Oswego and Onondaga County. Through its subsidiary, Pathfinder Risk Management Company, Inc., the Bank owns a 51% interest in the FitzGibbons Agency, LLC. At December 31, 2017, there were 4,280,227 shares of common stock issued and outstanding. The Company's common stock trades on the NASDAQ market under the symbol "PBHC." At December 31, 2017, the Company and subsidiaries had total consolidated assets of $881.3 million, total deposits of $723.6 million and shareholders' equity of $61.7 million.

Forward-Looking Statement

This release may contain certain forward-looking statements, which are based on management's current expectations regarding economic, legislative, and regulatory issues that may impact the Company's earnings in future periods. Factors that could cause future results to vary materially from current management expectations include, but are not limited to, general economic conditions, changes in interest rates, deposit flows, loan demand, real estate values, and competition; changes in accounting principles, policies, or guidelines; changes in legislation or regulation; and economic, competitive, governmental, regulatory, and technological factors affecting the Company's operations, pricing, products, and services.