

Lake Shore Bancorp, Inc.
Form 10-Q
November 15, 2010

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2010

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

Commission file number: 000-51821

LAKE SHORE BANCORP, INC.
(Exact name of registrant as specified in its charter)

United States
(State or other jurisdiction of incorporation or
organization)

20-4729288
(I.R.S. Employer Identification Number)

125 East Fourth Street, Dunkirk, New York
(Address of principal executive offices)

14048
(Zip code)

(716) 366-4070
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting

Edgar Filing: Lake Shore Bancorp, Inc. - Form 10-Q

company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>
Do not check if smaller reporting company			

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practical date:

Common stock (\$0.01 par value) 5,996,782 shares outstanding as of November 1, 2010.

TABLE OF CONTENTS

ITEM		PAGE
<u>PART I</u>		
<u>1</u>	<u>FINANCIAL STATEMENTS</u>	2
	- <u>Consolidated Statements of Financial Condition as of September 30, 2010 and December 31, 2009 (Unaudited)</u>	2
	- <u>Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2010 and 2009 (Unaudited)</u>	3
	- <u>Consolidated Statements of Changes in Stockholders' Equity for the Nine Months Ended September 30, 2010 and 2009 (Unaudited)</u>	4
	- <u>Consolidated Statements of Cash Flows for the Nine Months ended September 30, 2010 and 2009 (Unaudited)</u>	5
	- <u>Notes to Unaudited Consolidated Financial Statements</u>	6
<u>2</u>	<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	23
<u>3</u>	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	40
<u>4</u>	<u>CONTROLS AND PROCEDURES</u>	40
<u>PART II</u>		
<u>1A</u>	<u>RISK FACTORS</u>	41
<u>2</u>	<u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	42
<u>6</u>	<u>EXHIBITS</u>	43
	<u>SIGNATURES</u>	44

PART I

Item 1. Financial Statements

LAKE SHORE BANCORP, INC. and SUBSIDIARY
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	September 30, 2010	December 31, 2009
	(Unaudited)	
	(Dollars in thousands, except per share information)	
Assets		
Cash and due from banks	\$7,239	\$7,057
Interest earning deposits	14,996	7,754
Federal funds sold	22,051	7,253
Cash and Cash Equivalents	44,286	22,064
Securities available for sale	147,311	118,381
Federal Home Loan Bank stock, at cost	2,628	2,535
Loans receivable, net of allowance for loan losses 2010 \$824; 2009 \$1,564	256,837	259,174
Premises and equipment, net	8,811	7,950
Accrued interest receivable	1,821	1,721
Bank owned life insurance	11,046	10,842
Other assets	3,380	2,989
Total Assets	\$476,120	\$425,656
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Interest bearing	\$337,160	\$297,242
Non-interest bearing	26,678	21,172
Total Deposits	363,838	318,414
Short-term borrowings	2,350	6,850
Long-term debt	41,850	36,150
Advances from borrowers for taxes and insurance	1,643	3,070
Other liabilities	8,552	5,726
Total Liabilities	418,233	370,210
Commitments and Contingencies	-	-
Stockholders' Equity	66	66

Edgar Filing: Lake Shore Bancorp, Inc. - Form 10-Q

Common stock, \$0.01 par value per share, 25,000,000 shares authorized;
 6,612,500 shares issued and 5,996,782 shares outstanding at September 30, 2010 and
 6,612,500 shares issued and 6,157,162 shares outstanding at December 31, 2009

Additional paid-in capital	27,899	27,838
Treasury stock, at cost (615,718 shares at September 30, 2010 and 455,338 shares at December 31, 2009)	(5,764)	(4,467)
Unearned shares held by ESOP	(2,153)	(2,217)
Unearned shares held by RRP	(815)	(987)
Retained earnings	35,920	34,224
Accumulated other comprehensive income	2,734	989
Total Stockholders' Equity	57,887	55,446
Total Liabilities and Stockholders' Equity	\$476,120	\$425,656

See notes to consolidated financial statements.

LAKE SHORE BANCORP, INC. and SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME

Three Months Ended		Nine Months Ended	
September 30,		September 30,	
2010	2009	2010	2009

(Unaudited)

(Dollars in Thousands, except per share data)

Interest Income				
Loans, including fees	\$3,415	\$3,523	\$10,470	\$10,488
Investment securities, taxable	1,173	1,183	3,464	34,811
Retained earnings	47,720	47,722		
Accumulated other comprehensive loss	(3,656)	(2,923)		
Total shareholders' equity	79,840	79,610		
Total liabilities and shareholders' equity	\$ 733,391	\$ 761,077		

See notes to consolidated financial statements

United Security Bancshares and Subsidiaries
Consolidated Statements of Income and Comprehensive Income (unaudited)

(In thousands except shares and EPS)	Quarters Ended March 31,	
	2009	2008
Interest Income:		
Loans, including fees	\$ 8,067	\$ 11,352
Investment securities – AFS – taxable	1,190	1,318
Investment securities – AFS – nontaxable	15	24
Federal funds sold	0	16
Interest on deposits in other banks	40	34
Total interest income	9,312	12,744
Interest Expense:		
Interest on deposits	1,705	4,201
Interest on other borrowings	459	558
Total interest expense	2,164	4,759
Net Interest Income Before Provision for Credit Losses	7,148	7,985
Provision for Credit Losses	1,351	265
Net Interest Income	5,797	7,720
Noninterest Income:		
Customer service fees	989	1,197
Gain on redemption of securities	0	24
Loss on sale of other real estate owned	(77)	0
Loss on swap ineffectiveness	0	9
(Loss) gain on fair value of financial liability	(59)	540
Shared appreciation income	9	110
Other	279	453
Total noninterest income	1,141	2,333
Noninterest Expense:		
Salaries and employee benefits	2,223	2,842
Occupancy expense	942	964
Data processing	42	80
Professional fees	400	309
Director fees	66	64
Amortization of intangibles	228	278
Correspondent bank service charges	107	130
Impairment loss on core deposit intangible	57	624
Impairment loss on investment securities (total other-than temporary loss of \$3.9 million, net of \$3.7 million recognized in other comprehensive income, pre-tax)	163	0
Impairment loss on OREO	166	0
Loss on California tax credit partnership	107	108
OREO expense	305	32
Other	863	685
Total noninterest expense	5,669	6,116
Income Before Taxes on Income	1,269	3,937
Provision for Taxes on Income	348	1,437
Net Income	\$ 921	\$ 2,500
Other comprehensive loss, net of tax:		
	(733)	(227)

Edgar Filing: Lake Shore Bancorp, Inc. - Form 10-Q

Unrealized loss on available for sale securities, interest rate swap, and past service costs of employee benefit plans - net income tax benefit of \$(489) and \$(131)			
Comprehensive Income	\$	188	\$ 2,273
Net income per common share			
Basic	\$	0.08	\$ 0.20
Diluted	\$	0.08	\$ 0.20
Shares on which net income per common shares were based			
Basic		12,129,723	12,204,870
Diluted		12,129,723	12,214,490

See notes to consolidated financial statements

4

United Security Bancshares and Subsidiaries
Consolidated Statements of Changes in Shareholders' Equity
Periods Ended March 31, 2009

(In thousands except shares)	Common stock Number of Shares	Common stock Amount	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance January 1, 2008	11,855,192	32,587	49,997	(153)	82,431
Director/Employee stock options exercised	8,000	70			70
Net changes in unrealized loss on available for sale securities (net of income tax benefit of \$147)				(250)	(250)
Net changes in unrealized loss on interest rate swaps (net of income tax of \$1)				2	2
Net changes in unrecognized past service cost on employee benefit plans (net of income tax of \$14)				21	21
Dividends on common stock (\$0.13 per share)			(1,539)		(1,539)
Repurchase and cancellation of common shares	(29,626)	(452)			(452)
Stock-based compensation expense		32			32
Net Income			2,500		2,500
Balance March 31, 2008 (Unaudited)	11,833,566	32,237	50,958	(380)	82,815
Net changes in unrealized loss on available for sale securities (net of income tax benefit of \$1,763)				(2,615)	(2,615)
Net changes in unrecognized past service cost on employee benefit plans (net of income tax of \$48)				72	72
Dividends on common stock (\$0.13 per share)			(1,542)		(1,542)
1% common stock dividend	236,181	3,264	(3,264)		0
Repurchase and cancellation of common shares	(59,375)	(767)			(767)
Stock-based compensation expense		77			77
Net Income			1,570		1,570
Balance December 31, 2008	12,010,372	34,811	47,722	(2,923)	79,610
Net changes in unrealized loss on available for sale securities (net of income tax benefit of \$489)				(733)	(733)
Dividends on common stock (cash-in-lieu)			(4)		(4)
1% common stock dividend	119,622	919	(919)		0
Repurchase and cancellation of common shares	(488)	(4)			(4)

Edgar Filing: Lake Shore Bancorp, Inc. - Form 10-Q

Other			37					37
Stock-based compensation expense			13					13
Net Income						921		921
Balance March 31, 2009 (Unaudited)	12,129,506	\$	35,776	\$	47,720	\$	(3,656)	\$ 79,840

See notes to consolidated financial statements

5

Edgar Filing: Lake Shore Bancorp, Inc. - Form 10-Q

United Security Bancshares and Subsidiaries
Consolidated Statements of Cash Flows (unaudited)

(In thousands)	Three Months Ended March 31,	
	2009	2008
Cash Flows From Operating Activities:		
Net income	\$ 921	\$ 2,500
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for credit losses	1,351	265
Depreciation and amortization	640	703
Accretion of investment securities	(20)	(37)
Gain on redemption of securities	0	(24)
Decrease (increase) in accrued interest receivable	(363)	425
Decrease in accrued interest payable	(168)	(647)
Decrease in unearned fees	(179)	(228)
Increase in income taxes payable	894	1,435
Stock-based compensation expense	13	33
Decrease in accounts payable and accrued liabilities	(476)	(622)
Loss on sale of other real estate owned	77	0
Impairment loss on other real estate owned	166	0
Impairment loss on core deposit intangible	57	624
Impairment loss on investment securities	163	0
Gain on swap ineffectiveness	0	(9)
Increase in surrender value of life insurance	(136)	(193)
Loss (gain) on fair value option of financial liabilities	59	(540)
Loss on tax credit limited partnership interest	107	108
Net decrease (increase) in other assets	337	(1,210)
Net cash provided by operating activities	3,443	2,583
Cash Flows From Investing Activities:		
Net decrease in interest-bearing deposits with banks	16,464	169
Purchases of available-for-sale securities	0	(24,666)
Maturities and calls of available-for-sale securities	3,784	11,096
Net redemption from limited partnerships	0	(42)
Investment in other bank stock	0	(72)
Proceeds from sale of investment in title company	99	0
Net (increase) decrease in loans	(1,883)	18,948
Proceeds from sales of foreclosed assets	0	43
Net proceeds from settlement of other real estate owned	1,515	0
Capital expenditures for premises and equipment	(59)	(178)
Net cash provided by investing activities	19,920	5,298
Cash Flows From Financing Activities:		
Net increase in demand deposit and savings accounts	1,561	13,950
Net increase (decrease) in certificates of deposit	12,092	(34,072)
Net decrease in federal funds purchased	(17,360)	(7,280)
Net (decrease) increase in FHLB term borrowings	(24,500)	18,000
Proceeds from Director/Employee stock options exercised	0	70
Repurchase and retirement of common stock	33	(452)
Payment of dividends on common stock	(5)	(1,483)

Edgar Filing: Lake Shore Bancorp, Inc. - Form 10-Q

Net cash used in financing activities	(28,179)	(11,267)
Net decrease in cash and cash equivalents	(4,816)	(3,386)
Cash and cash equivalents at beginning of period	19,426	25,300
Cash and cash equivalents at end of period	\$ 14,610	\$ 21,914

See notes to consolidated financial statements

6

United Security Bancshares and Subsidiaries - Notes to Consolidated Financial Statements - (Unaudited)

1. Organization and Summary of Significant Accounting and Reporting Policies

The consolidated financial statements include the accounts of United Security Bancshares, and its wholly owned subsidiary United Security Bank (the "Bank") and two bank subsidiaries, USB Investment Trust (the "REIT") and United Security Emerging Capital Fund, (collectively the "Company" or "USB"). Intercompany accounts and transactions have been eliminated in consolidation.

These unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information on a basis consistent with the accounting policies reflected in the audited financial statements of the Company included in its 2008 Annual Report on Form 10-K. These interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of a normal recurring, nature) considered necessary for a fair presentation have been included. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for any other interim period or for the year as a whole.

Certain reclassifications have been made to the 2008 financial statements to conform to the classifications used in 2009. Effective January 1, 2009, the Company reclassified a contingent asset that represents a claim from an insurance company related to a charged-off lease portfolio, including specific reserves, from loans to other assets. Management believes the asset is better reflected, given its nature, as an asset other than loans. In periods prior to March 31, 2009, the contingent asset had been included in impaired and nonaccrual loan balances. All periods presented have been retroactively adjusted for the reclassification to other assets and therefore amounts have been excluded from loans and reserves for credit losses, including impaired and nonaccrual balances for periods prior to March 31, 2009. The amounts reclassified for reporting purposes for the various periods presented in this 10-Q are shown below.

Reclassification Amount (in 000's)	12/31/2008	3/31/2008	12/31/2007
Lease principal claim included in gross loans	\$ 5,425	\$ 5,425	\$ 5,425
Allowance for credit losses	(3,542)	(3,526)	(3,470)
Net balance transferred to other assets	\$ 1,883	\$ 1,899	\$ 1,955

New Accounting Standards:

In April of 2009, the FASB issued Staff Position No. FAS 107-1, "Interim Disclosures About Fair Value of Financial Instruments." This position extends the disclosure requirements of SFAS No. 107, "Disclosures About Fair Value of Financial Instruments," to interim financial statements of publicly traded companies. Staff Position No. FAS 107-1 is effective for interim periods ending after June 15, 2009 with early adoption permitted for periods ending after March 15, 2009. The Company is evaluating the enhanced disclosure requirements around fair value of financial instruments and does not anticipate a material impact on the Consolidated Financial Statements. The Company will adopt Staff Position No. FAS 107-1 for the period ending June 30, 2009.

In April 2009, the FASB issued Staff Position No. FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments." This FASB staff position amends the other-than-temporary impairment guidance in U.S. generally accepted accounting principles for debt securities. If an entity determines that it has other-than-temporary impairment on its securities, it must recognize the credit loss on the securities in the income statement. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. The staff position expands disclosures about other-than-temporary impairment and requires that the annual disclosures in FASB Statement No. 115 and FSP FAS 115-1 and FAS 124-1 be made for interim reporting periods. This FASB staff position becomes effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Company adopted this

FASB staff position for the interim reporting period ending March 31, 2009. See Note 2 to the consolidated financial statements for the impact on the Company of adopting FSP No. FAS 115-2 and FAS 124-2.

7

In April 2009, the FASB issued Staff Position No. FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly." This FASB staff position provides additional guidance on determining fair value when the volume and level of activity for the asset or liability have significantly decreased when compared with normal market activity for the asset or liability. A significant decrease in the volume or level of activity for the asset or liability is an indication that transactions or quoted prices may not be determinative of fair value because transactions may not be orderly. In that circumstance, further analysis of transactions or quoted prices is needed, and an adjustment to the transactions or quoted prices may be necessary to estimate fair value. This FASB staff position becomes effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Company adopted this FASB staff position for the interim reporting period ending March 31, 2009 and it did not have a material impact on the Company's consolidated financial position or results of operations.

In April 2009, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 111 ("SAB 111"). SAB 111 amends Topic 5.M. in the Staff Accounting Bulletin series entitled "Other Than Temporary Impairment of Certain Investments Debt and Equity Securities." On April 9, 2009, the FASB issued Staff Position No. FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments." SAB 111 maintains the previous views related to equity securities and amends Topic 5.M. to exclude debt securities from its scope. SAB 111 was effective for the Company as of March 31, 2009. There was no material impact to the Company's consolidated financial position or results of operations upon adoption.

2. Investment Securities Available for Sale

Following is a comparison of the amortized cost and approximate fair value of securities available-for-sale, as of March 31, 2009 and December 31, 2008:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Carrying Amount)
March 31, 2009:				
U.S. Government agencies	\$ 41,449	\$ 1,776	\$ (1)	\$ 43,224
Collateralized mortgage obligations	36,773	556	(7,468)	29,861
Obligations of state and political subdivisions	1,252	29	0	1,281
Other investment securities	13,909	0	(654)	13,255
	\$ 93,383	\$ 2,361	\$ (8,123)	\$ 87,621
December 31, 2008:				
U.S. Government agencies	\$ 43,110	\$ 1,280	\$ (204)	\$ 44,186
Collateralized mortgage obligations	39,068	189	(4,991)	34,266
Obligations of state and political subdivisions	1,252	28	0	1,280
Other investment securities	13,880	0	(863)	13,017
	\$ 97,310	\$ 1,497	\$ (6,058)	\$ 92,749

Included in other investment securities at March 31, 2009 are a short-term government securities mutual fund totaling \$7.4 million, a CRA-qualified mortgage fund totaling \$4.9 million, and a money-market mutual fund totaling \$909,000. Included in other investment securities at December 31, 2008, is a short-term government securities mutual fund totaling \$7.2 million, a CRA-qualified mortgage fund totaling \$4.9 million, and an overnight money-market mutual fund totaling \$880,000. The short-term government securities mutual fund invests in debt securities issued or guaranteed by the U.S. Government, its agencies or instrumentalities, with a maximum duration equal to that of a 3-year U.S. Treasury Note.

There were no realized gains on sales of available-for-sale securities during the three months ended March 31, 2009. There were no realized losses on sales or calls of available-for-sale securities during the three months ended March 31, 2009, but there were other-than-temporary impairment losses totaling \$163,000 on two of the Company's collateralized mortgage obligations (see discussion below.) There were realized gains totaling \$24,000 on calls of available-for-sale securities during the three months ended March 31, 2008. There were no realized gains or losses on sales of available-for-sale securities during the three months ended March 31, 2008.

Securities that have been temporarily impaired less than 12 months at March 31, 2009 are comprised of two collateralized mortgage obligations and one U.S. government agency security with a total weighted average life of 0.5 years. As of March 31, 2009, there were three collateralized mortgage obligations and two other investment securities with a total weighted average life of 2.8 years that have been temporarily impaired for twelve months or more.

Edgar Filing: Lake Shore Bancorp, Inc. - Form 10-Q

The following summarizes the total of temporarily impaired and other-than-temporarily impaired investment securities at March 31, 2009 (see discussion below for other than temporarily impaired securities included here):

(In thousands)	Less than 12 Months		12 Months or More		Total	
	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses	Fair Value (Carrying Amount)	Unrealized Losses
Securities available for sale:						
U.S. Government agencies	\$ 143	\$ (1)	\$ 0	\$ 0	\$ 143	\$ (1)
Collateralized mortgage obligations	6,870	(68)	9,350	(7,400)	16,220	(7,468)
Obligations of state and political subdivisions	0	0	0	0	0	0
Other investment securities	0	0	12,346	(654)	12,346	(654)
Total impaired securities	\$ 7,013	\$ (69)	\$ 21,696	\$ (8,054)	\$ 28,709	