

LAKE SHORE BANCORP, INC.  
Form 10-Q  
November 12, 2014

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, 2014

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

Commission File No.: 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)

31 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

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

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	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:

There were 5,938,951 shares of the registrant’s common stock, \$0.01 par value per share, outstanding at November 1, 2014.

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## PART I

## Item 1. Financial Statements

## Lake Shore Bancorp, Inc. and Subsidiary

## Consolidated Statements of Financial Condition

	September 30, 2014 (Unaudited)	December 31, 2013 (Unaudited)
	(Dollars in thousands, except share data)	
Assets		
Cash and due from banks	\$ 8,162	\$ 7,748
Interest earning deposits	27,381	2,321
Federal funds sold	6,349	7,133
Cash and Cash Equivalents	41,892	17,202
Securities available for sale	140,951	157,964
Federal Home Loan Bank stock, at cost	1,375	1,560
Loans receivable, net of allowance for loan losses 2014 \$1,803; 2013 \$1,813	275,156	277,345
Premises and equipment, net	9,529	9,642
Accrued interest receivable	1,864	1,787
Bank owned life insurance	14,597	14,407
Other assets	1,223	2,260
<b>Total Assets</b>	<b>\$ 486,587</b>	<b>\$ 482,167</b>
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Interest bearing	\$ 349,800	\$ 353,915
Non-interest bearing	39,705	34,320
Total Deposits	389,505	388,235
Short-term borrowings	-	11,650
Long-term debt	18,950	7,850
Advances from borrowers for taxes and insurance	2,039	3,454
Other liabilities	6,366	5,707
<b>Total Liabilities</b>	<b>\$ 416,860</b>	<b>\$ 416,896</b>

Commitments and Contingencies	-	-
Stockholders' Equity		
Common stock, \$0.01 par value per share, 25,000,000 shares authorized; 6,622,849 shares issued and 5,938,951 shares outstanding at September 30, 2014 and 6,619,203 shares issued and 5,915,835 shares outstanding at December 31, 2013	\$ 66	\$ 66
Additional paid-in capital	28,104	28,039
Treasury stock, at cost (683,898 shares at September 30, 2014 and 703,368 shares at December 31, 2013)	(6,420)	(6,588)
Unearned shares held by ESOP	(1,812)	(1,876)
Unearned shares held by compensation plans	(669)	(499)
Retained earnings	47,544	45,624
Accumulated other comprehensive income	2,914	505
Total Stockholders' Equity	69,727	65,271
Total Liabilities and Stockholders' Equity	\$ 486,587	\$ 482,167

See notes to consolidated financial statements.

## Lake Shore Bancorp, Inc. and Subsidiary

## Consolidated Statements of Income

	Three Months		Nine Months Ended	
	Ended September	2013	September 30,	2013
	30,		September 30,	
	2014	2013	2014	2013
	(Unaudited)			
	(Dollars in thousands, except per share data)			
<b>Interest Income</b>				
Loans, including fees	\$ 3,307	\$ 3,426	\$ 9,977	\$ 10,361
Investment securities, taxable	552	696	1,884	2,071
Investment securities, tax-exempt	530	499	1,589	1,463
Other	6	5	10	13
<b>Total Interest Income</b>	<b>4,395</b>	<b>4,626</b>	<b>13,460</b>	<b>13,908</b>
<b>Interest Expense</b>				
Deposits	724	797	2,229	2,413
Short-term borrowings	-	12	20	38
Long-term debt	102	50	182	165
Other	25	27	76	79
<b>Total Interest Expense</b>	<b>851</b>	<b>886</b>	<b>2,507</b>	<b>2,695</b>
<b>Net Interest Income</b>	<b>3,544</b>	<b>3,740</b>	<b>10,953</b>	<b>11,213</b>
Provision for Loan Losses	70	60	70	105
<b>Net Interest Income after Provision for Loan Losses</b>	<b>3,474</b>	<b>3,680</b>	<b>10,883</b>	<b>11,108</b>
<b>Non-Interest Income</b>				
Service charges and fees	396	421	1,202	1,234
Earnings on bank owned life insurance	65	66	190	215
Recovery on previously impaired investment securities	35	-	136	-
Gain on sale of securities available for sale	-	206	59	206
Gain on sale of loans	5	-	5	-
Total other-than-temporary impairment ("OTTI") losses	-	(613)	-	(613)
Portion of OTTI losses recognized in other comprehensive income	-	433	-	433
(before taxes)	-	433	-	433
<b>Net OTTI losses recognized in earnings</b>	<b>-</b>	<b>(180)</b>	<b>-</b>	<b>(180)</b>
Other	30	28	89	96
<b>Total Non-Interest Income</b>	<b>531</b>	<b>541</b>	<b>1,681</b>	<b>1,571</b>
<b>Non-Interest Expenses</b>				
Salaries and employee benefits	1,682	1,524	4,936	4,664
Occupancy and equipment	531	520	1,648	1,509
Professional services	298	333	956	1,079
Data processing	202	163	579	480
Advertising	85	93	353	357
FDIC Insurance	70	64	211	194
Postage and supplies	61	55	194	192
Other	279	261	838	900
<b>Total Non-Interest Expenses</b>	<b>3,208</b>	<b>3,013</b>	<b>9,715</b>	<b>9,375</b>

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Income before Income Taxes	797	1,208	2,849	3,304
Income Tax Expense	109	222	487	612
Net Income	\$ 688	\$ 986	\$ 2,362	\$ 2,692
Basic and Diluted earnings per common share	\$ 0.12	\$ 0.17	\$ 0.41	\$ 0.47
Dividends declared per share	\$ 0.07	\$ 0.07	\$ 0.21	\$ 0.21

See notes to consolidated financial statements.

## Lake Shore Bancorp, Inc. and Subsidiary

## Consolidated Statements of Comprehensive Income/(Loss)

	Three Months Ended September 30, 2014      2013 (Unaudited) (Dollars in thousands)	
Net Income	\$ 688	\$ 986
Other Comprehensive Income (Loss), net of tax (expense) benefit		
Unrealized holding gains (losses) on securities available for sale, net of tax (expense) benefit 2014 \$(40); 2013 \$141	62	(223)
Reclassification adjustments related to:		
Recovery on previously impaired investment securities, net of tax expense(1) 2014 \$14	(21)	-
Net gain on sale of securities included in net income, net of tax expense(2) 2013 \$80	-	(126)
Impairment charge for losses included in net income, net of tax benefit(3) 2013 \$70	-	110
Total Other Comprehensive Income (Loss)	41	(239)
Total Comprehensive Income	\$ 729	\$ 747

(1) Gross amount included in recovery on previously impaired investment securities on consolidated statements of income 2014 \$35

(2) Gross amount included in gain on sale of securities available for sale on consolidated statements of income 2013 \$206

(3) Included in net OTTI losses recognized in earnings on consolidated statements of income 2013 \$(180)

	Nine Months Ended September 30, 2014      2013 (Unaudited) (Dollars in thousands)	
Net Income	\$ 2,362	\$ 2,692
Other Comprehensive Income (Loss), net of tax (expense) benefit	2,528	(3,900)

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Unrealized holding gains (losses) on securities available for sale, net of tax (expense) benefit  
2014 \$(1,597); 2013 \$2,461

Reclassification adjustments related to:

Recovery on previously impaired investment securities included in net income, net of tax expense(1) 2014 \$53	(83)	-
Net gain on sale of securities included in net income, net of tax expense(2) 2014 \$23; 2013 \$80	(36)	(126)
Impairment charge for losses included in net income, net of tax benefit(3) 2013 \$70	-	110
Total Other Comprehensive Income (Loss)	2,409	(3,916)
Total Comprehensive Income (Loss)	\$ 4,771	\$ (1,224)

(1) Gross amount included in recovery on previously impaired investment securities on consolidated statements of income 2014 \$136

(2) Gross amount included in gain on sale of securities available for sale on consolidated statements of income 2014 \$59; 2013 \$206

(3) Included in net OTTI losses recognized in earnings on consolidated statements of income 2013 \$(180)

See notes to consolidated financial statements.

## Lake Shore Bancorp, Inc. and Subsidiary

## Consolidated Statements of Changes in Stockholders' Equity

Nine Months Ended September 30, 2014 and 2013 (Unaudited)

	Common Stock	Additional Paid-In Capital	Treasury Stock	Unearned Shares Held by ESOP	Unearned Shares Held by Compensation Plans	Retained Earnings	Accumulated Other Comprehensive Income	Total
(In thousands, except share and per share data)								
Balance - January 1, 2013	\$ 66	\$ 27,973	\$ (6,469)	\$ (1,961)	\$ (553)	\$ 42,468	\$ 5,461	\$ 66,985
Net income	-	-	-	-	-	2,692	-	2,692
Other comprehensive loss, net of tax benefit of \$2,471	-	-	-	-	-	-	(3,916)	(3,916)
Stock options exercised (506 shares)	-	4	-	-	-	-	-	4
ESOP shares earned (5,951 shares)	-	3	-	64	-	-	-	67
Stock based compensation	-	7	-	-	-	-	-	7
Compensation plan shares earned (3,017 shares)	-	(11)	-	-	41	-	-	30
Purchase of treasury stock, at cost (5,000 shares)	-	-	(58)	-	-	-	-	(58)
Cash dividends declared (\$0.21 per share)	-	-	-	-	-	(441)	-	(441)
Balance - September 30, 2013	\$ 66	\$ 27,976	\$ (6,527)	\$ (1,897)	\$ (512)	\$ 44,719	\$ 1,545	\$ 65,370
Balance - January 1, 2014	\$ 66	\$ 28,039	\$ (6,588)	\$ (1,876)	\$ (499)	\$ 45,624	\$ 505	\$ 65,271
Net income	-	-	-	-	-	2,362	-	2,362
Other comprehensive income, net of tax expense of \$1,521	-	-	-	-	-	-	2,409	2,409
Stock options exercised (3,646 shares)	-	54	-	-	-	-	-	54
ESOP shares earned (5,951 shares)	-	9	-	64	-	-	-	73
	-	(3)	-	-	-	-	-	(3)

Stock based compensation Compensation plan shares granted (24,570 shares)	-	-	230	-	(230)	-	-	-
Compensation plan shares earned (5,322 shares)	-	5	-	-	60	-	-	65
Purchase of treasury stock, at cost (5,100 shares)	-	-	(62)	-	-	-	-	(62)
Cash dividends declared (\$0.21 per share)	-	-	-	-	-	(442)	-	(442)
Balance - September 30, 2014	\$ 66	\$ 28,104	\$ (6,420)	\$ (1,812)	\$ (669)	\$ 47,544	\$ 2,914	\$ 69,727

See notes to consolidated  
financial statements.

## Lake Shore Bancorp, Inc. and Subsidiary

## Consolidated Statements of Cash Flows

	Nine Months Ended September 30,	
	2014	2013
	(Unaudited)	
	(Dollars in thousands)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 2,362	\$ 2,692
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of investment securities	223	405
Amortization of deferred loan costs	341	386
Provision for loan losses	70	105
Impairment of investment securities	-	180
Recovery on previously impaired investment securities	(136)	-
Net gain on sale of investment securities	(59)	(206)
Originations of loans held for sale	(386)	(891)
Proceeds from sales of loans held for sale	391	891
Gain on sale of loans	(5)	-
Depreciation and amortization	559	516
Increase in bank owned life insurance, net	(190)	(215)
ESOP shares committed to be released	73	67
Stock based compensation expense	62	37
Increase in accrued interest receivable	(77)	(150)
Decrease in other assets	268	319
Increase in other liabilities	52	245
Net Cash Provided by Operating Activities	3,548	4,381
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Activity in available for sale securities:		
Sales	10,337	3,863
Maturities, prepayments and calls	10,577	22,060
Purchases	-	(34,651)
Purchases of Federal Home Loan Bank Stock	(351)	-
Redemptions of Federal Home Loan Bank Stock	536	231
Loan origination and principal collections, net	1,634	(1,625)
Additions to premises and equipment	(446)	(636)
Net Cash Provided by (Used in) Investing Activities	22,287	(10,758)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase in deposits	1,270	12,609
Net decrease in advances from borrowers for taxes and insurance	(1,415)	(1,281)
Net (decrease) increase in short term borrowings	(11,650)	500
Proceeds from issuance of long-term debt	15,200	1,750
Repayment of long-term debt	(4,100)	(7,000)
Proceeds from stock options exercised	54	4
Purchase of treasury stock	(62)	(58)
Cash dividends paid	(442)	(441)
Net Cash (Used in) Provided by Financing Activities	(1,145)	6,083
Net Increase (Decrease) in Cash and Cash Equivalents	24,690	(294)
<b>CASH AND CASH EQUIVALENTS - BEGINNING</b>	<b>17,202</b>	<b>19,765</b>

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CASH AND CASH EQUIVALENTS - ENDING	\$ 41,892	\$ 19,471
SUPPLEMENTARY CASH FLOWS INFORMATION		
Interest paid	\$ 2,492	\$ 2,715
Income taxes paid	\$ 648	\$ 868
SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Foreclosed real estate acquired in settlement of loans	\$ 171	\$ 299
Securities sold and not settled	\$ -	\$ 520

See notes to consolidated financial statements.

Lake Shore Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

Note 1 – Nature of Operations and Basis of Presentation

Lake Shore Bancorp, Inc. (the “Company,” “us,” “our,” or “we”) was formed on April 3, 2006 to serve as the stock holding company for Lake Shore Savings Bank (“the Bank”) as part of the Bank’s conversion and reorganization from a New York-chartered mutual savings and loan association to the federal mutual holding company form of organization.

The interim consolidated financial statements include the accounts of the Company and the Bank, its wholly owned subsidiary. All intercompany accounts and transactions of the consolidated subsidiary have been eliminated in consolidation.

The interim financial statements included herein as of September 30, 2014 and for the three and nine months ended September 30, 2014 and 2013 have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, and therefore, do not include all information or footnotes necessary for a complete presentation of the consolidated statements of financial condition, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America (“GAAP”). The consolidated statement of financial condition at December 31, 2013 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete consolidated financial statements. The consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of such information and to make the financial statements not misleading. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013. The consolidated results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of the results for any subsequent period or the entire year ending December 31, 2014.

To prepare these consolidated financial statements in conformity with GAAP, management of the Company made a number of estimates and assumptions relating to the reporting of assets and liabilities and the reporting of revenue and expenses. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, securities valuation estimates, evaluation of impairment of securities and income taxes.

The Company has evaluated events and transactions occurring subsequent to the statement of financial condition as of September 30, 2014 for items that should potentially be recognized or disclosed in these consolidated financial statements. The evaluation was conducted through the date these consolidated financial statements were issued.

Note 2 – New Accounting Standards

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”) which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying the revenue model to contracts within its scope, an entity will identify the contract(s) with a customer (step 1), identify the performance obligations in the contract (step 2), determine the transaction price (step 3), allocate the transaction price to the performance obligations in the contract (step 4), and recognize revenue when (or as) the entity satisfies a performance obligation (step 5). ASU 2014-09 applies to all contracts with customers except those that are within the scope of other topics in the FASB ASC. ASU 2014-09 requires entities to disclose both quantitative and qualitative information that enables users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and

cash flows arising from contracts with customers. ASU 2014-09 is effective for annual reporting periods, including interim reporting periods within those periods, beginning after December 15, 2016. Early application is not permitted. The Company has not yet determined the impact the adoption of ASU 2014-09 will have on its financial condition and results of operations.

In June 2014 the FASB issued ASU 2014-12, “Compensation – Stock Compensation (“Topic 718”): “Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period” (“ASU 2014-12”). ASU 2014-12 applies to all reporting entities that grant their employees share-based payments in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. The update requires that a performance target be treated as a performance condition. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. ASU 2014-12 is effective for the reporting periods beginning after December 15, 2015. Management does not expect the adoption of this update to have a material impact on the Company’s consolidated financial statements or results of operations.

In August 2014, the FASB issued ASU 2014-14, “Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans Upon Foreclosure” (“ASU 2014-14”). ASU 2014-14 applies to all creditors that hold government-guaranteed mortgage loans. The update requires that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if three conditions are met. The first condition would be that the loan has a government guarantee that is not separable from the loan before foreclosure. The second condition is that at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim. The third and final condition is that at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. ASU 2014-14 is effective for the reporting periods beginning after December 15, 2014. Management does not expect the adoption of this update to have a material impact on the Company’s consolidated financial statements or results of operations.

Note 3 – Investment Securities

The amortized cost and fair value of securities are as follows:

	September 30, 2014			
	Gross	Gross		Fair
	Amortized	Unrealized	Unrealized	Value
	Cost	Gains	Losses	
	(Dollars in thousands)			
<b>SECURITIES AVAILABLE FOR SALE:</b>				
U.S. Treasury bonds	\$ 12,827	\$ 1,301	\$ -	\$ 14,128
Municipal bonds				