



THEIR
STORY,
is OUR
STORY.



LAKE SHORE BANCORP

2007 Annual Report

CORPORATE PROFILE

Lake Shore Bancorp Inc. is the parent company of Lake Shore Savings Bank, originally chartered as a savings and loan association in New York State in 1891. Lake Shore Savings is a community-oriented bank dedicated to serving the financial needs of consumers and businesses in Western New York. In April 2006, the Bank converted to a federal mutual holding company. As part of that process, Lake Shore Bancorp conducted an initial public offering and became a public company. Consolidated assets as of December 31, 2007, were \$357.8 million.

In 2007, Lake Shore Savings celebrated more than 115 years of service to the community since opening its first branch in Dunkirk, New York. The Bank opened its second branch office nearby in the Village of Fredonia in 1987. Since then, it has expanded to eight full-service branches and 13 ATMs throughout Chautauqua and Erie counties. The Bank also maintains its corporate headquarters in Dunkirk.

Lake Shore Savings serves customers' financial needs at every stage of life—from the first savings account, to student loans, to home mortgages, to retirement accounts. The Bank specializes in high-quality, personal customer service. Its primary business is in residential and small commercial loans, with an emphasis on residential real estate mortgages.

Lake Shore Savings supports its markets through a Community Reinvestment Fund. This program makes money available to area clubs, sports teams, civic groups, schools, charitable organizations and other non-profit groups. After all, we're dedicated to "putting people first" throughout the communities we serve.

SHAREHOLDER INFORMATION

Annual Meeting

The Annual Meeting of Shareholders will be held at 8:30 a.m. on May 21, 2008, in The Bayside Ballroom of the Clarion Hotel located at 30 Lake Shore Drive East in Dunkirk, NY.

Stock Listing

The NASDAQ Global Market under the symbol LSBK.

Special Counsel

Paul, Hastings, Janofsky & Walker, LLP
875 15th Street, NW
Washington, DC 20005

Independent Auditors

Beard Miller Company, LLP
P.O. Box 101086
Pittsburgh, PA 15237

Transfer Agent and Registrar

Registrar and Transfer Company
10 Commerce Drive
Cranford, NJ 07016
800-368-5948



CORPORATE HEADQUARTERS

125 East Fourth Street
Dunkirk, NY 14048
Phone: 716-366-4070
Fax: 716-366-3010

BRANCH LOCATIONS

ERIE COUNTY

3111 Union Road
Orchard Park, New York 14127
Phone: 716-674-2066
Fax: 716-674-4347

5751 Transit Road
East Amherst, New York 14051
Phone: 716-688-6114
Fax: 716-688-5941

59 Main Street
Hamburg, New York 14075
Phone: 716-646-9480
Fax: 716-646-9481

CHAUTAUQUA COUNTY

128 East Fourth Street
Dunkirk, New York 14048
Phone: 716-366-4070
Fax: 716-366-2965

30 East Main Street
Fredonia, New York 14063
Phone: 716-673-9555
Fax: 716-679-0696

106 East Main Street
Westfield, New York 14787
Phone: 716-326-4414
Fax: 716-326-4422

1 Green Avenue, WE
Lakewood, New York 14701
Phone: 716-483-3400
Fax: 716-483-3468

115 East Fourth Street
(Corner of Fourth & Spring Streets)
Jamestown, New York 14701
Phone: 716-664-1103
Fax: 716-664-1183

In its first full year as a public company, Lake Shore Bancorp performed well for shareholders by doing what it does best: helping families, businesses and institutions build promising futures.

Our success is especially noteworthy given the challenging environment faced by all financial services companies in 2007. Sticking to the sound lending fundamentals that have become our hallmark paid off, as we increased our loan portfolio and maintained expenses. That means we helped more families secure affordable home mortgages, and more local entrepreneurs and organizations find productive financial solutions.

All of this is possible because we stay close to our communities. There simply is no substitute for local knowledge, involvement and commitment. Our customers' stories become part of the Lake Shore story. So we work hard to ensure happy outcomes.

THEIR STORY, is OUR STORY.



Hear from some of our customers on pages 4 and 5.

To Our Shareholders

I am pleased to report that 2007 was another successful year for Lake Shore Savings despite continued pressure on earnings as a result of high interest rates being paid on deposit accounts. Total assets as of December 31, 2007, were \$357.8 million, up \$3.6 million from the prior year. Net income for the years ending December 31, 2007 and 2006, was \$1.8 million. Our net income remained the same as the prior year, despite a challenging interest rate environment, mainly due to increased loan originations and management's cost-cutting strategies.



We take great pride in the fact that we have no subprime loans or other high-risk mortgage products in our loan portfolios. As you probably know, subprime lending practices have created unrest and losses throughout the banking industry. Fortunately, we have continued to focus on maintaining high-quality assets in our lending portfolio during 2007.

Several factors contributed to the quality of our loans:

- We live and work in the communities where our branches are located, giving us firsthand knowledge of our markets.
- We are well-informed about collateral values and borrower risks, allowing us to maintain and adhere to solid underwriting standards.
- Our originators and underwriters are focused on providing loans that our borrowers can afford.

As a result, Lake Shore Savings is not facing the same foreclosure issues as many other banks. We will continue to offer customers the best products available and concentrate on sound underwriting practices to ensure a high quality loan portfolio.

The discipline of our loan underwriters has significantly contributed to our strong financial condition. Nonperforming loans as a percent of net loans was 0.75% as of December 31, 2007, compared to 0.64% as of December 31, 2006. The ratio of net charge-offs to average loans outstanding as of December 31, 2007, was 0.06% compared to 0.07% on December 31, 2006. Our allowance for loan losses as a percent of total net loans was 0.56% on December 31, 2007, compared to 0.61% on December 31, 2006.

Our strategy to improve interest income included the purchase of an interest rate floor product in 2006. This product provides payments if the prime rate drops below 8%. The floor covers \$10.0 million of our variable rate home equity loan portfolio. This means that even as rates drop, we will continue to have a steady interest income stream from this investment.

Our lending portfolio increased significantly in 2007, exceeding our expectations. Actual loan originations were \$10.0 million more than we had projected. Our loan portfolio as of December 31, 2007, was \$218.7 million compared to \$205.7 million at December 31, 2006, an increase of 6.3%. The majority of the

increase was in residential mortgages, and to a lesser extent in commercial real estate.

During 2007, we introduced an “enhanced” home equity line of credit product. This unique home equity product enables borrowers to split the repayment of loan proceeds between fixed and adjustable rates. The customer borrows on a master line of credit and can then take portions of that line and “term” them out at a fixed rate for a set time period. As the customer pays down the term loan, the funds become available again for use on the line of credit. It’s a flexible option that has been well received by customers.

We also introduced commercial overdraft line of credit and Small Business Administration (SBA) loan products during 2007.

In 2007 we completed stock buybacks of 184,705 shares at an average cost of \$11.80. The stock buyback represented 6.2% of the shares issued as of January 1, 2007, excluding those owned by our mutual holding company. The repurchased stock was put into treasury shares.

The decision to repurchase shares was made based on the stock price during 2007 and the current business environment in the banking industry. We also paid dividends of \$0.03 per share during the first three quarters of 2007, and increased the dividend payment to \$0.04 per share for the fourth quarter. Both of these initiatives should provide continued value to our shareholders.

We remain committed to growing our business in existing locations and will look for opportunities to expand our branch network, especially in Erie County. Our focus on customer service and our expertise in residential mortgages position us well to expand our market area.

Complementing our core lending strengths, we continue to see growth in electronic banking, especially Internet banking, online bill pay and e-statements. The number of customers using these services has steadily increased over the past few years.

We are constantly working on service improvements and new products. We will introduce a “remote deposit capture” service for business customers

in 2008. This enables customers to scan checks and electronically transmit them to the bank for deposit, eliminating the need to visit a branch. We also plan to offer debit cards to business customers in 2008, allowing them to make purchases without having to write paper checks.

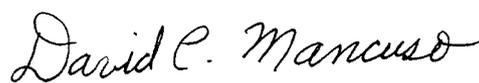
Our lending portfolio increased significantly in 2007, exceeding our expectations. Actual loan originations were \$10.0 million more than we had projected.

I would like to thank our employees and the Board of Directors for all their hard work and dedication in 2007. Without them, our success would not be possible. In particular, I would like to thank Reginald S. Corsi, our Executive Vice President and Chief Operations Officer, for his 14 years of service to the Bank. Mr. Corsi retired from this position in March 2008. He helped improve Lake Shore in many ways, including leveraging his commercial background to establish a solid commercial lending program.

I would also like to thank Mr. Thomas E. Reed, who will retire as a member of the board in May 2008, for his 20 years of dedication and service. Mr. Reed has always provided valuable insight and advice, drawing on his years of leadership experience at a public company.

Finally, on behalf of the Board of Directors and the Bank’s employees, I would like to thank you, the shareholders, for having confidence in Lake Shore Bancorp as we continue our journey. Know that we will work tirelessly to be the best community bank in Western New York.

Sincerely,



David C. Mancuso
President and Chief Executive Officer

WE MEASURE **OUR SUCCESS** BY
THAT OF **OUR CLIENTS...**
and they tell some pretty good stories!



Homeowners Christine and Keith Ryan (left) break bread with branch manager Charlie Brooks.

“There’s peace of mind when you’re talking to people you know. Unless you’ve met someone face-to-face, you never know what you’re getting into, especially on the Internet.”

– Christine Ryan, Hamburg, NY

Turns out their (second) dream home was right next door. Keith and Christine Ryan had been eyeing the spacious center-hall brick Colonial in Hamburg, NY, for quite some time. It seemed like the perfect place to raise their two-year-old daughter Mackenzie. And moving would be easy! So when it finally came on the market, they started combing web sites for the best rate on a mortgage.

“We looked at over 20 options online and from other local banks,” said Keith, “and Lake Shore came back with the best package every time.” But what really sealed the deal was Lake Shore’s responsiveness, he added. “Our branch manager, Charlie Brooks, always got back to us right away with answers to any questions.”

Keith is director of marketing and operations for a test preparation company, while Christine is director of academic advancement at nearby Canisius College in Buffalo. The Ryans purchased their new home in August 2007.

“The bank was flexible and made everything easy,” said Christine. “The closing was a breeze!”



Feeling right at home in Fredonia are John and Karen Kijinski (left) thanks to a little help from mortgage originator Patty Bertges.

“With one foot in Idaho, and one foot in New York, finding and financing a new home was especially challenging.”

– John Kijinski, Fredonia, NY

When John Kijinski became dean of the College of Arts and Sciences at SUNY Fredonia, he didn’t know much about the town and its environs. After all, he had been in Pocatello, Idaho, for over 20 years. And now he was busy selling his house and wrapping up other affairs out west.

So John and his wife Karen were happy to find a trusted advisor in mortgage originator Patty Bertges. “She was such a treat to work with...very personable and professional,” John said. “Patty served as kind of an ambassador for the community.”

Much of the loan process had to be completed by telephone, but Patty and other staff at the bank were able to move things along in the couple’s absence. Sometimes the bank staff stayed at work after hours to accommodate the Kijinski’s. “Rates weren’t the most important thing,” John added. “The service meant a lot more to us than fractions of a point.”

John and Karen purchased their two-story Colonial in September 2007. Now they have checking, savings and debit cards with Lake Shore as well. “I was aware that Lake Shore paid for the construction of a clock tower on the Fredonia campus,” John said. “I like that it’s a local bank, and one that’s really committed to the community.”

“Other financial institutions balked at an arrangement where we would build and pay for a campus building, then turn it over to the state.”

– Charles Notaro, Faculty Student Association, SUNY Fredonia

One might mistake it for a high-end shopping mall. A two-story atrium at the entrance welcomes visitors to a sparkling new Starbucks, a bookstore sporting a whole lot of merchandising savvy and a nicely appointed convenience store. Climb the open staircase to find a spacious café (cafeteria is definitely the wrong word) where a variety of food stations offer made-to-order meals and snacks. Yes, it’s a college campus. But mystery meat and gritty institutional decor are worlds away.



It took a lot of vision to convert an old building at SUNY Fredonia into what is now University Commons, according to Chuck Notaro, Executive Director of the Faculty Student Association. It also took a lot of money — and a financial partner who was willing to do some homework.

“We were aware of Lake Shore Savings Bank’s commitment to the community,” said Notaro. “Dave Mancuso (President) and Reg Corsi (former Executive Vice President) both took a personal interest in the project. They also took the time to understand how it could work with different private and state entities participating.”

In the end, Lake Shore structured a deal to help finance the \$23 million, 45,000-square-foot addition to and renovation of what was once Cranston Hall. “Now we’re talking to them about financing the construction of a new food court at another campus location,” Notaro added.



Sharing a Starbucks at SUNY Fredonia’s new University Commons are (left to right) Matthew Snyder, Controller of the Faculty Student Association (FSA), former Lake Shore Executive Vice President and Chief Operations Officer Reginald Corsi, and Charles Notaro, Executive Director of the FSA.

Selected Financial Data

Our selected consolidated financial and other data is set forth below, which is derived in part from, and should be read in conjunction with, our audited consolidated financial statements and notes thereto, beginning on page F-1 of our Annual Report on Form 10-K, copies of which may be obtained by contacting us at (716) 366-4070.

As of December 31,					
(Dollars in thousands)	2007	2006	2005	2004	2003
SELECTED FINANCIAL CONDITION DATA:					
Total assets	\$357,801	\$354,237	\$333,724	\$329,841	\$303,511
Loans, net	218,711	205,677	206,160	199,525	187,138
Securities available for sale	105,922	108,016	94,082	99,170	83,027
Securities held to maturity	—	—	2,275	2,359	371
Federal Home Loan Bank stock	3,081	2,481	2,716	2,709	2,167
Total cash and cash equivalents	10,091	18,682	12,053	11,577	16,753
Total deposits	240,828	249,637	250,890	243,554	230,495
Short-term borrowings	18,505	10,605	11,205	11,725	11,800
Long-term debt	37,940	32,750	37,480	42,260	31,535
Total equity	53,465	53,747	27,995	26,915	24,947
Allowance for loan losses	1,226	1,257	1,240	1,288	1,293
Non-performing loans	1,644	1,309	1,362	792	1,052
Non-performing assets	1,705	1,492	1,448	932	1,506

For the Year Ended December 31,					
(Dollars in thousands)	2007	2006	2005	2004	2003
SELECTED OPERATING DATA:					
Interest income	\$18,622	\$17,774	\$15,956	\$14,744	\$12,780
Interest expense	9,133	8,045	6,426	5,332	4,694
Net interest income	9,489	9,729	9,530	9,412	8,086
Provision for loan losses	105	158	20	267	345
Net interest income after provision for loan losses	9,384	9,571	9,510	9,145	7,741
Total non-interest income	2,002	1,805	1,847	1,875	1,728
Total non-interest expense	9,118	8,646	8,350	7,939	7,218
Income before income taxes	2,268	2,730	3,007	3,081	2,251
Income taxes	451	911	953	902	744
Net income	\$ 1,817	\$ 1,819	\$ 2,054	\$ 2,179	\$ 1,507
Basic earnings per common share ⁽¹⁾	\$ 0.29	\$ 0.24	\$ —	\$ —	\$ —
Diluted earnings per common share ⁽¹⁾	\$ 0.29	\$ 0.24	\$ —	\$ —	\$ —
Dividends declared per share	\$ 0.13	\$ 0.03	\$ —	\$ —	\$ —

⁽¹⁾ The Company completed an initial public offering of its common stock on April 3, 2006.

Selected Financial Ratios and Other Data

	At or for the Year Ended December 31,				
	2007	2006	2005	2004	2003
PERFORMANCE RATIOS:					
Return on average assets	0.52%	0.52%	0.62%	0.68%	0.58%
Return on average equity	3.39%	4.05%	7.47%	8.45%	6.24%
Interest rate spread ⁽¹⁾	2.42%	2.60%	2.93%	3.03%	3.18%
Net interest margin ⁽²⁾	2.92%	3.00%	3.09%	3.15%	3.32%
Efficiency ratio ⁽³⁾	79.35%	74.96%	73.39%	70.34%	73.55%
Non interest expense to average total assets	2.60%	2.49%	2.53%	2.48%	2.76%
Average interest-earning assets to average interest-bearing liabilities	117.94%	116.16%	107.51%	106.35%	107.49%
CAPITAL RATIOS:					
Total risk-based capital to risk weighted assets	23.72%	23.88%	17.06%	16.34%	16.37%
Tier 1 risk-based capital to risk weighted assets	22.90%	22.81%	16.00%	15.18%	15.19%
Tangible capital to tangible assets	12.28%	11.68%	8.47%	7.99%	7.97%
Tier 1 leverage (core) capital to adjustable tangible assets	12.28%	11.68%	8.47%	7.99%	7.97%
Equity to total assets	14.94%	15.17%	8.39%	8.16%	8.22%
ASSET QUALITY RATIOS:					
Non-performing loans as a percent of total net loans	0.75%	0.64%	0.66%	0.40%	0.56%
Non-performing assets as a percent of total assets	0.48%	0.42%	0.43%	0.28%	0.50%
Allowance for loan losses as a percent of total net loans	0.56%	0.61%	0.60%	0.65%	0.69%
Allowance for loan losses as a percent of non-performing loans	74.57%	96.03%	91.04%	162.63%	122.91%
OTHER DATA:					
Number of full service offices	8	8	8	7	7

⁽¹⁾ Represents the difference between the weighted-average yield on interest-earning assets and the weighted-average cost of interest-bearing liabilities for the period.

⁽²⁾ The net interest margin represents the net interest income as a percent of average interest-earning assets for the period.

⁽³⁾ The efficiency ratio represents non-interest expense divided by the sum of net interest income and non-interest income.

Cautionary Statement

The statements contained herein that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. The words “plan,” “anticipate,” “believe,” “estimate,” “expect,” “intend,” and other similar expressions are intended to identify forward-looking statements. Such statements reflect the current views of management with respect to future events and are subject to certain risks, uncertainties and assumptions. It is important to note that our actual results could differ materially from those described herein. Factors that could cause results to differ materially include among others, the following: general economic and business conditions; changes in the interest-rate environment; existing government regulations and changes in, or the failure to comply with, government regulations; liability and other claims; significant increases in competitive pressure in the banking and financial services industry; deposit attrition or customer loss; changes in operating strategy or development plans; and the ability to attract and retain qualified personnel. We assume no obligation to update any such forward-looking statements.

BOARD OF DIRECTORS



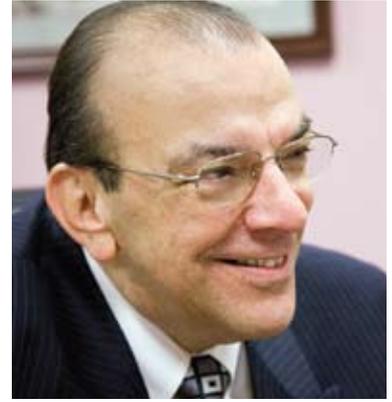
Sharon E. Brautigam
Partner, Brautigam & Brautigam, LLP,
a law firm



Michael E. Brunecz
Chairman of the Board
President, Office Concepts, Inc.



James P. Foley, DDS
Semi-retired dentist in practice with
Jennifer L. Foley, DDS



David C. Mancuso
President and CEO



Thomas E. Reed
Chairman of the Board,
ECR International, Inc.



Daniel P. Reininga
Vice Chairman of the Board
President, G.H. Graf Realty
Corporation, Inc.



Gary W. Winger
Principal, Compass Consulting, Inc.
Former Dean of Administration and
Development, Chief Financial Officer,
and Development Officer,
Jamestown Community College



Nancy L. Yocum, CPA
Partner, Brumfield & Associates,
an accounting and tax preparation firm

EXECUTIVE OFFICERS



From left: David C. Mancuso, President and CEO; Katherine A. Kaus, Senior Vice President and Mortgage Lending Officer; Reginald S. Corsi, Executive Vice President and Chief Operations Officer (Retired); and Rachel A. Foley, Chief Financial Officer.

BRANCH MANAGERS



Front row, left to right: John Huber, Vice President and Manager of E. Amherst Office; Amy Dobek, Manager of Dunkirk Office. *Back row, left to right:* Lou DiPalma, Vice President and Manager of Fredonia Office; Sally Pyne, Assistant Vice President and Manager of Orchard Park Office; Nancy March, Assistant Vice President and Manager of W. Ellicott Office; Charles Brooks, Assistant Vice President and Manager of Hamburg Office; Beverley Mulkin, Corporate Secretary and Treasurer, and Manager of Westfield Office; and Hiroko Walters, Manager of Jamestown Office.



L A K E S H O R E B A N C O R P

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